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South Asia Economic Focus Spring 2018

Jobless Growth?

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This report is a joint product of the Office of the Chief Economist for the South Asia Region (SARCE) and the Macroeconomics, Trade and Investment Global Practice (MTI). Its preparation was led by Robert Beyer (Economist, SARCE) under the oversight of Martin Rama (Chief Economist, SARCE) in close collaboration with Manuela Francisco (Practice Manager, MTI). Substantive contributions were made by Esha Chhabra, Milagros Chocce, Yan (Sarah) Xu, and Zetianyu Wang (all SARCE). The report greatly benefitted from inputs from Ekaterine T. Vashakmadze, Temel Taskin and other colleagues in the Development Economics Prospects Group (DECPG) under the supervision of Ayhan Kose (Director, DECPG). We are very grateful for comments and suggestions provided by Rinku Murgai, Urmila Chatterjee, Sutirtha Sinha Roy, Benu Bidani, Ghazala Mansuri, and David Newhouse (all Poverty Global Practice), as well as by Stefano Paternostro, David A. Robalino, Alvaro Gonzalez and Laurent Loic Yves Bossavie (all Social Protection Global Practice), as well as by Muhammad Waheed (MTI) and Dhushyanth Raju (SARCE). Colleagues providing information for country briefs include Saurabh Shome, Nandini Krishnan, Christina Wieser, Tobias Akhtar Haque and Tae Hyun Lee, Zahid Hussain, Yoichiro Ishihara, Smriti Seth, Florian Blum, Ralph Van Doorn, Sudyumna Dahal, Damir Cosic, Mona Prasad, Adnan Ashraf Ghumman and Kishan Abeygunawardana (all with MTI). Alejandro Espinosa at Sonideas signed responsible for the layout, design and typesetting. Alexander Ferguson, Senior Manager, South Asia External Communications (SAREC) coordinated the dissemination, together with Yann Doignon and Joe Qian (both with SAREC). Gonzalo Alberto Villamizar De La Rosa created accompanying videos, and Neelam Chowdhry provided valuable administrative support.

South Asia as used in this report includes Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

The cutoff date for this report was April 9, 2018.

South Asia Chief Economist Office
Macroeconomics, Trade and Investment Global Practice

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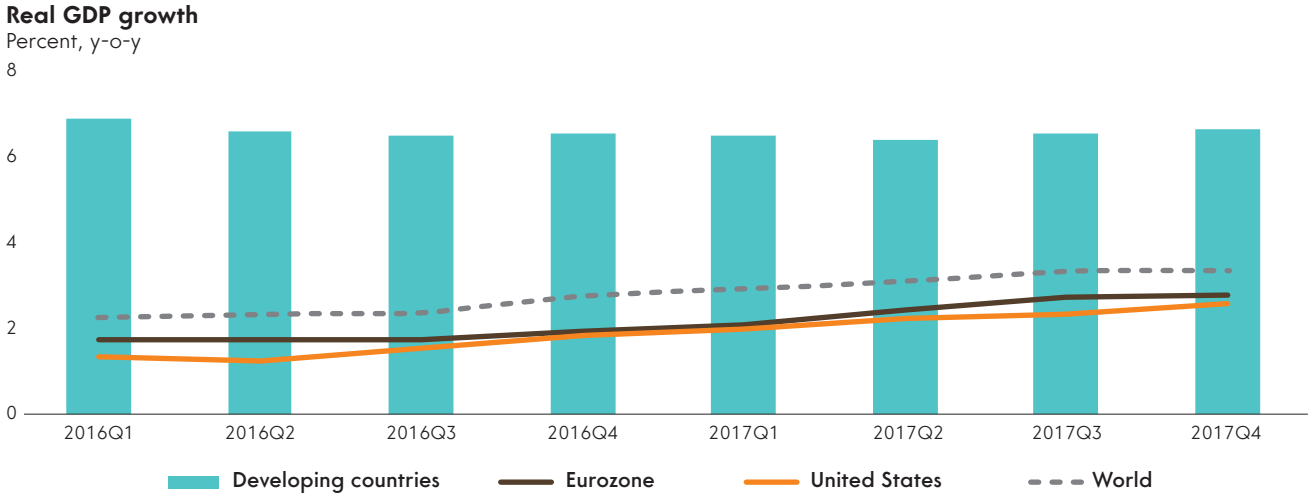
PHOTO: World Bank

Recent economic developments

South Asia is again the fastest growing region in the world, albeit not by a wide margin. The rebound was led by India, whose growth rate picked up in the second half of 2017 after five consecutive quarters of deceleration. Inflation has increased in South Asia, in line with more vibrant economic activity and higher oil prices, but it is aligned with other regions. Besides, the inflation rates of most countries in the region remain near or below inflation targets. Despite an acceleration of economic growth in destination markets, export performance remains disappointing throughout the region, while imports are growing rapidly. The trade deficits of the three biggest countries in South Asia have widened. While remittances are recovering, current account deficits have continued to widen, but among larger countries the deficits are mostly within safe boundaries. The Indian and especially the Pakistani rupee depreciated recently, which may support an improved external balance. As usual, fiscal deficits in South Asia remain large by international standards, and government debt is high in many countries in the region.

FIGURE 1: Growth is picking up in advanced economies.



Source: World Bank and staff calculations.

Number one in growth again

Global growth is gaining momentum. The world economy continued its recovery and global growth increased to 3.3 percent in the last two quarters of 2017. Growth in the United States accelerated to 2.3 percent in the third quarter of last year and further to 2.6 percent in the fourth quarter. In the Eurozone, growth accelerated to 2.7 percent and 2.8 percent respectively. Developing countries grew slightly more slowly last year than in 2016, but their growth picked up to 6.6 percent in the last quarter of 2017.

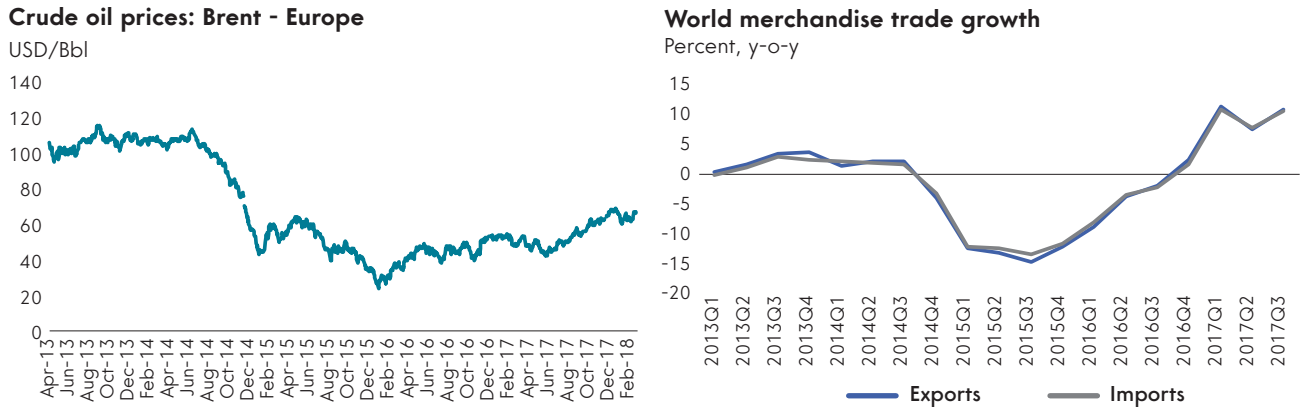
Along with more vibrant economic activity, oil prices and merchandise trade are on an upward trend. While much below their peak, oil prices continued to slowly increase, reaching around 65 USD per barrel recently. This uptick puts pressure on the balance of payments of oil-importing countries, but the price level is still favorable compared to the earlier part of the decade. After decreasing through 2015 and 2016, global merchandise trade increased strongly again last year. World trade increased by 10 percent in the first three quarters of 2017. Higher growth in advanced economies offers export opportunities for many countries in the region, for which Europe and the US are the main destination markets. More restrictive trade policies in those countries could partly offset this improvement, but whether South Asian exports would be targeted is still unclear.

After a short interlude, South Asia claimed back the leading role in global growth. South Asia was the fastest-growing region throughout 2015, but its economic growth declined for five consecutive quarters – from over 9 percent in the first quarter of 2016 to below 5.5 percent in the second quarter of last year – on the back of India's deceleration. The region's growth accelerated to 6.3 percent in the last quarter of last year, and further to 7.2 percent in the first quarter of 2018. Meanwhile, growth in East Asia and the Pacific – the other leading region – remained at 6.5 percent. Sub-Saharan Africa and Latin America and the Caribbean continued their recovery, with both regions growing by more than 2 percent in the fourth quarter of last year. In the Middle East and North Africa, growth remains volatile and has on average moderated after some quarters of very high growth led by Iran.

Given its weight in the region, India's growth performance strongly influences South Asian trends. Around 80 percent of the region's gross domestic product (GDP) is generated in India. A slow but steady fiscal consolidation, stable interest rates despite declining inflation, and growing stress in the financial sector may have contributed to India's growth deceleration during most of 2016. Later that year, demonetization – the large withdrawal of currency from circulation that took place in November 2016 – and the introduction of the Goods and Services Tax (GST) added to the slowdown. While these policy measures are expected to increase the formalization of payments and the efficiency of transactions, they both created short-term disruptions in economic activity. As the inflation rate rebounded pushing real interest rates down, a recapitalization plan for banks was announced, and the effects of the two temporary shocks vanished, growth bounced back to 7.3 percent. This is the same figure as in the third quarter of 2016, the last quarter before demonetization, but still considerably below the levels of late 2015 and early 2016.

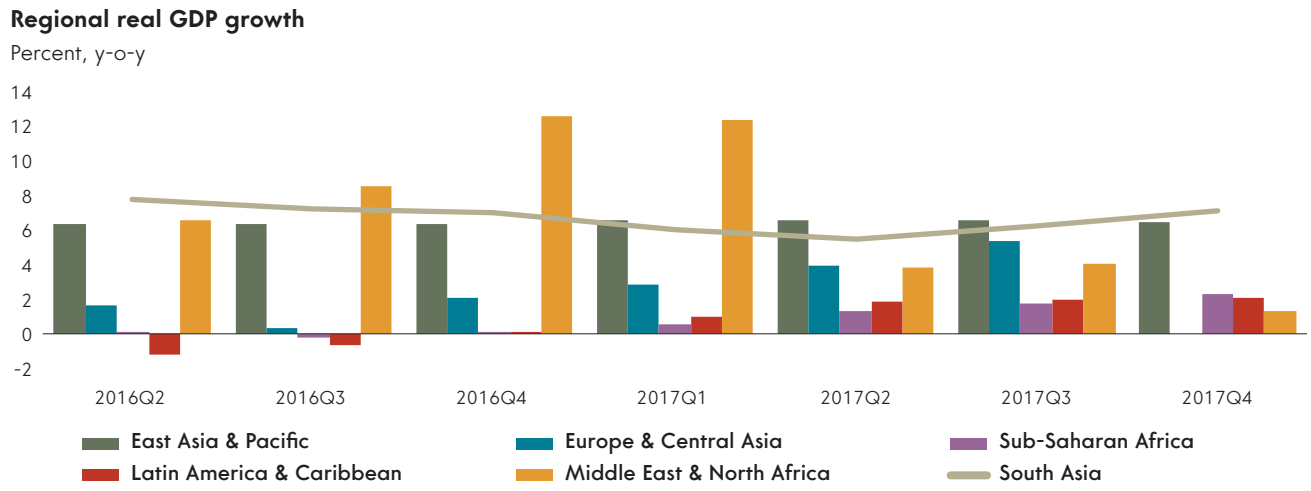
Growth elsewhere in the region is stable or slightly lower. In Nepal, growth is expected to slow down after a strong re-bound in 2017. This is partly due to the heaviest flooding in decades, which adversely affected agriculture. In Bhutan,

FIGURE 2: Oil prices and merchandise trade reflect growing global demand.



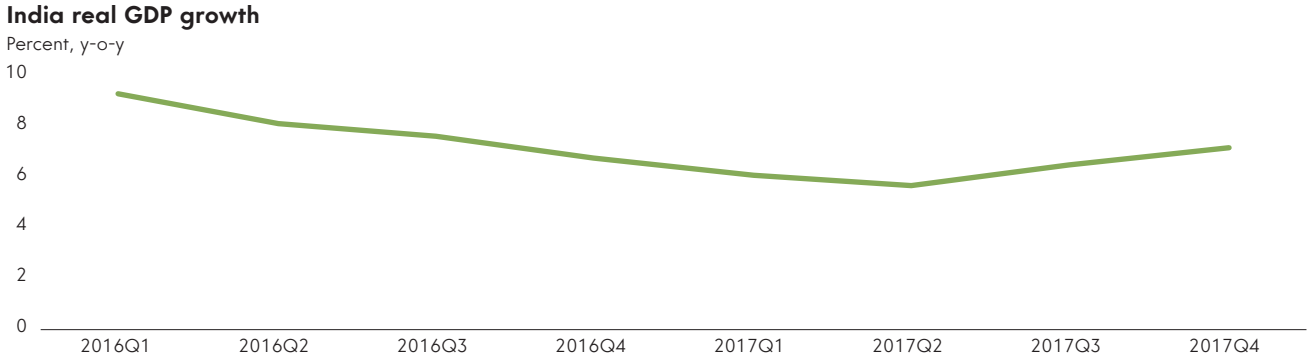
Source: Federal Reserve Bank of St. Louis, Federal Reserve Economic Data; World Merchandise Trade.

FIGURE 3: South Asia is again the fastest growing region in the world.



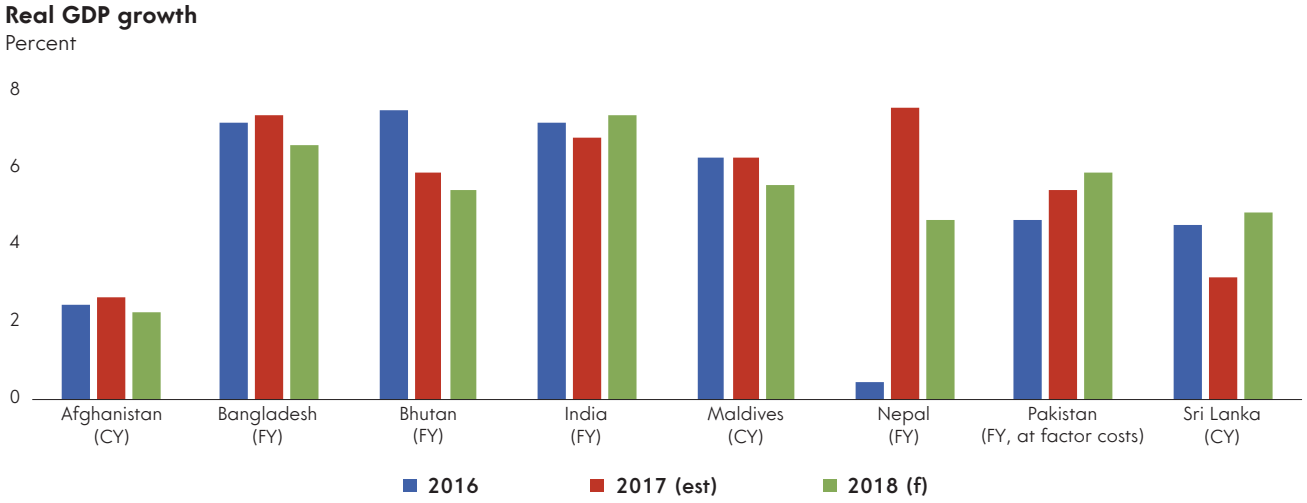
Source: World Bank.

FIGURE 4: South Asia's rebound is led by India emerging from its slowdown.



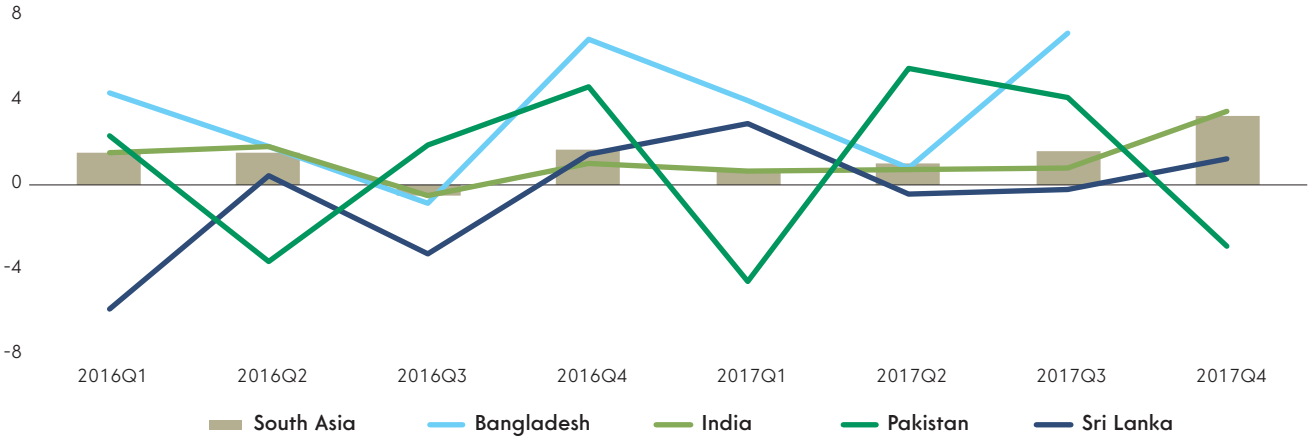
Source: Government of India, Ministry of Statistics and Programme Implementation.

FIGURE 5: Despite favorable conditions, growth in the region has reached a plateau.



Source: World Bank.
Note: Data for Afghanistan, Maldives, and Sri Lanka are in calendar year. Data for all other countries are in fiscal year. Fiscal year in India is named as the starting year of the fiscal cycle. For all other countries, fiscal year is named as the ending year of the cycle. For example, India 2017 runs from April 2017 – March 2018; Pakistan 2017 runs from July 2016 – June 2017. (est) = estimate, (f) = forecast.

FIGURE 6: Industrial production is strong, but remains volatile.



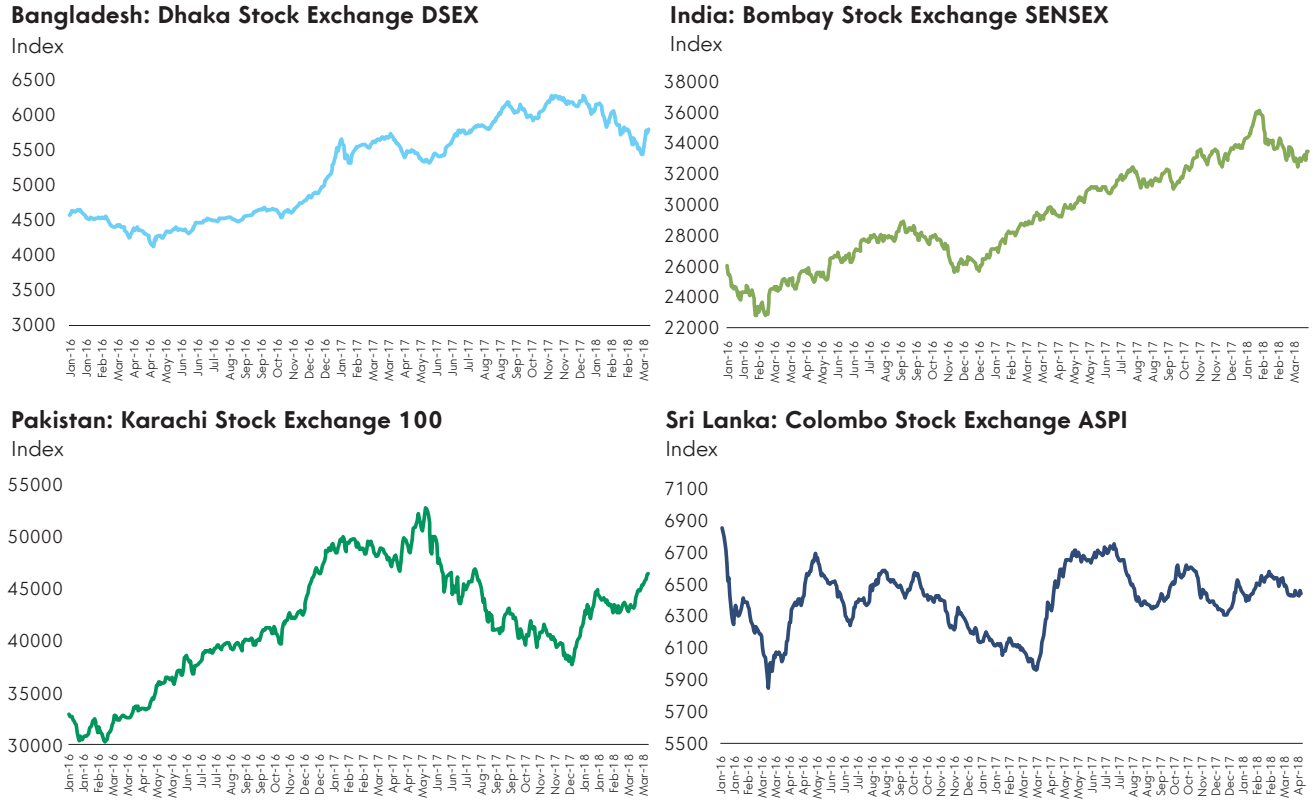
Source: World Bank.

growth remains solid, on the back of on-going hydro-power projects and tourism, but its pace is slowing down. In Pakistan, preliminary estimates based on the first eight months of fiscal year 2018 suggest that GDP growth increased by 0.4 percentage points over the previous year, reaching 5.8 percent. Growth is moderating in 2018 in Afghanistan, Bangladesh, and the Maldives. In Sri Lanka, it is recovering from a low base after a difficult year with inclement weather.

The manufacturing sector, an important contributor to overall growth and a key focus of many governments in the region, shows signs of strength. In the last quarter of 2017, industrial production in South Asia grew by 4 percent, up from 1 and 2 percent in the two previous quarters. In Bangladesh industrial production growth has been substantial for an entire year. In India, it has recently ticked upwards, after many quarters of very low growth. And in Sri Lanka, industrial production growth fluctuates around zero since January 2016, but was positive in the last quarter of 2017. This said, industrial production is a volatile indicator and changes need to be interpreted with caution, particularly for individual countries.

Stock market prices in some of the countries in the region have been strongly influenced by global trends. In India, the stock market has been climbing for a while, even causing some concern about a possible overvaluation. As part of a global correction of stock markets at the beginning of the year, Indian stock prices declined somewhat as well. In Bangladesh, stocks were more expensive than in 2016, but most

FIGURE 7: Stock markets follow global trends in Bangladesh and India, less so in Pakistan and Sri Lanka.



Source: Haver Analytics.

recently the Dhaka Stock Exchange Broad Index decreased from roughly 6300 in January 2018 to around 5600 in March 2018. Since the beginning of 2016, the correlation between the S&P 500 and the BSE SENSEX in India has been above 0.95. The correlation is similarly high with the Dhaka Stock Exchange Broad Index in Bangladesh. Strong co-movements with the US stock market suggests that trends are not heavily influenced by domestic conditions. But strong co-movement also increases contagion risk if global markets go down as monetary policies in advanced economies normalize.

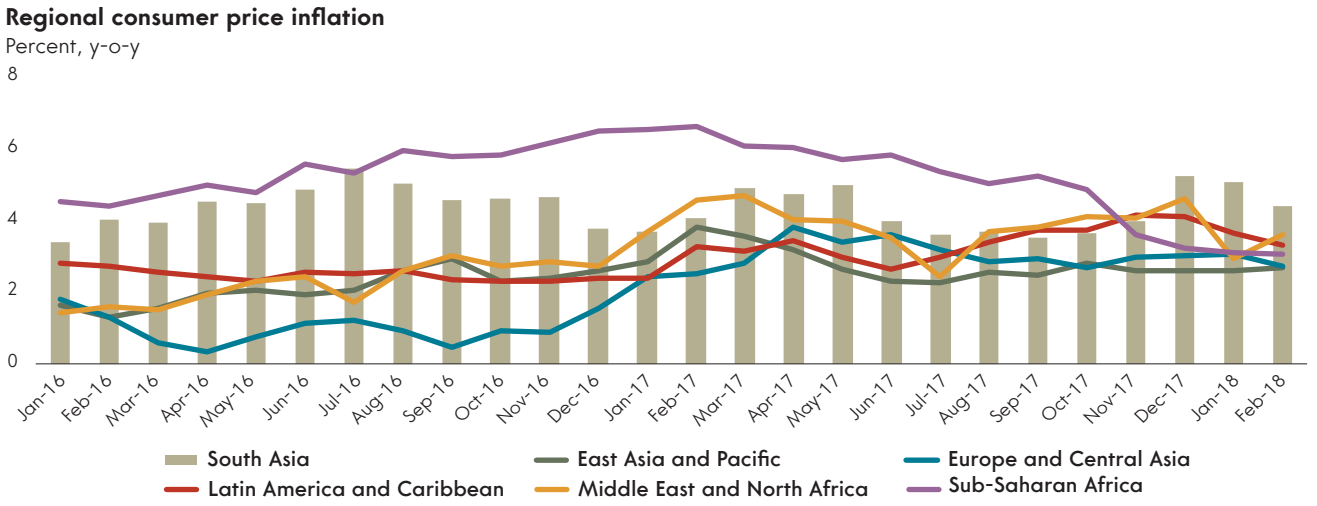
The correlation between global trends and stock market developments in Pakistan and Sri Lanka is weaker. The Sri Lanka Colombo Stock Exchange Index remained rather stable and in Pakistan the Karachi Stock Exchange 100 Index (KSE 100 Index) was on a downward trend until the devaluations of December 2017 and March 2018 pushed stock market prices up again. This downward trend, had started around May 2017, after a period of exuberance that reflected an expected upgrade to the MSCI Emerging Market Index and greater confidence on macroeconomic stability. The declining trend was reverted after the Pakistan rupee depreciated by 5 percent in December, which prompted the KSE 100 Index to jump by around 5000 points.

Inflation is contained

Inflation had been unusually subdued by South Asian standards in recent years, but it is accelerating again. In January 2018, consumer prices in the region grew by 4.8 percent. This is only 0.5 percentage points higher than the average since January 2016, but 1.2 percentage points higher than in July of last year. Due to declining inflation in Sub-Saharan Africa and relatively stable rates in other regions, South Asia has not only the highest GDP growth rate in the world, but also the highest inflation rate. However, its inflation rate is still close to that of other regions. In January 2017 prices in Sub-Saharan Africa were growing by 4.1 percent, in Latin America and the Caribbean by 3.7 percent, and in other developing regions at around 3 percent. By comparison, earlier in the decade the inflation rate of South Asia was about twice as high that of most other developing regions.

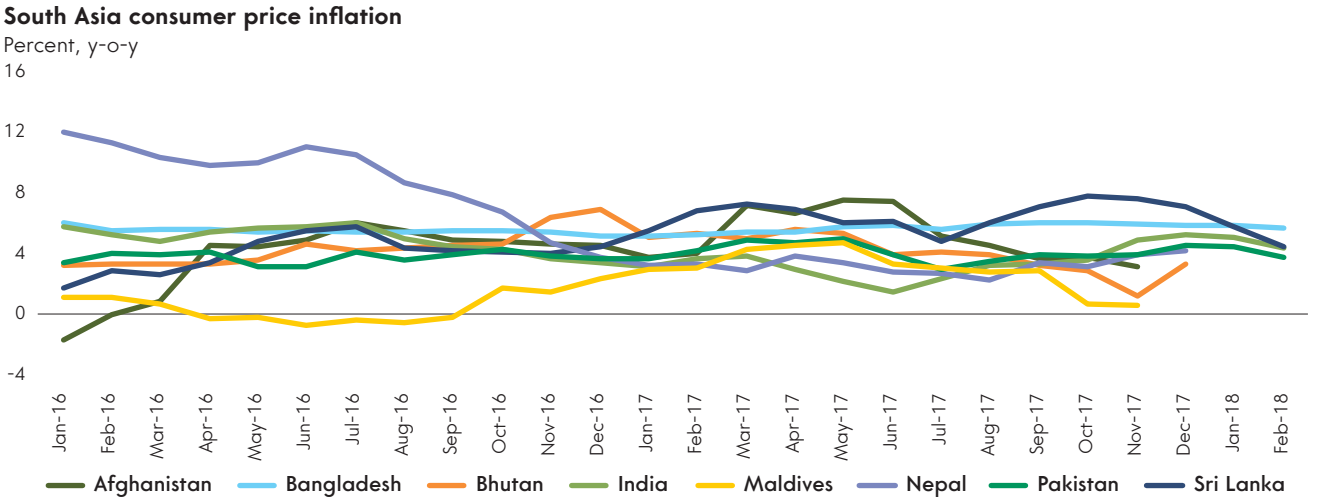
The regional pick-up in inflation is mainly driven by monthly price increases steadily accelerating in India in recent months. In line with rebounding growth, inflation in India increased from 1.5 percent in June 2017 to 3.6 percent in October and to 5.1 percent in January 2018. In February inflation moderated slightly to 4.4 percent. In Pakistan, inflation

FIGURE 8: Inflation has accelerated but remains in line with other regions.



Source: World Bank.

FIGURE 9: The inflation rates of the larger countries fall within a narrow range.



Source: World Bank, Trading Economics, and Sri Lanka Department of Census and Statistics.

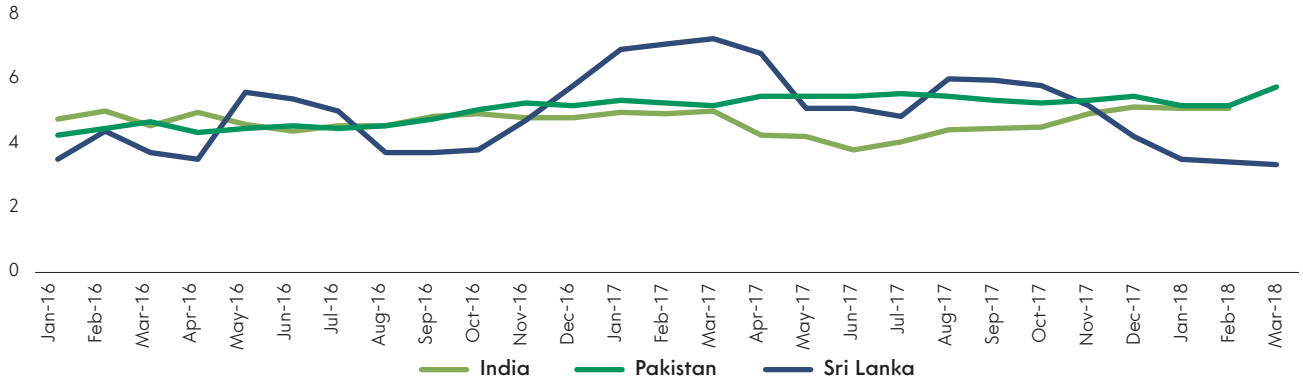
between May and December of last year was somewhat below its average since 2016. It rose again in December, but the mild exchange rate depreciation in December has not led to higher inflation so far. The smaller countries in the region, on the other hand, mainly experienced a deceleration of price increases. In Bhutan, inflation moderated from 7.0 percent at the end of 2016 to only 3.3 percent in December of last year. In Afghanistan, it decreased from 7.5 percent in June of last year (the highest level across South Asia) to 3.1 percent at the end of 2017. In Sri Lanka, inflation was high at 7.1 percent at the end of last year, but moderated to 4.5 percent in February.

Trends in core inflation rates do not point to price increases returning to the high levels observed earlier in the decade. Core inflation excludes price changes for food and energy. Due to the usually large swings in these two components, core inflation tends to be less volatile than overall consumer price inflation, and is therefore more informative about deeper economic trends. In India, core inflation increased much less than overall consumer price inflation from June 2017 to February 2018. In Pakistan, core inflation is very stable; in contrast to overall consumer price inflation, the core inflation rate did not dip in the second half of 2017. On average, core inflation in 2017 was 0.7 percentage points above core inflation in 2016. In Sri Lanka, core inflation dropped sharply in the second half of 2017, reaching only 3.5 percent in February (compared to 4.5 percent overall consumer price inflation).

FIGURE 10: Core inflation rates have not accelerated.

Core consumer price inflation

Percent, y-o-y

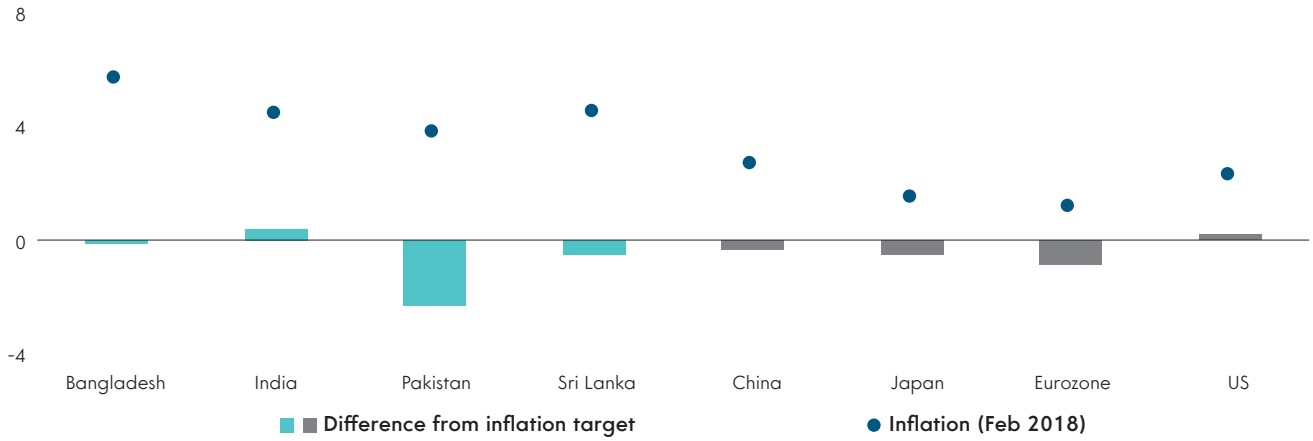


Source: Haver Analytics.

FIGURE 11: In most countries inflation rates are near or below target.

Inflation and distance to policy target

Percent

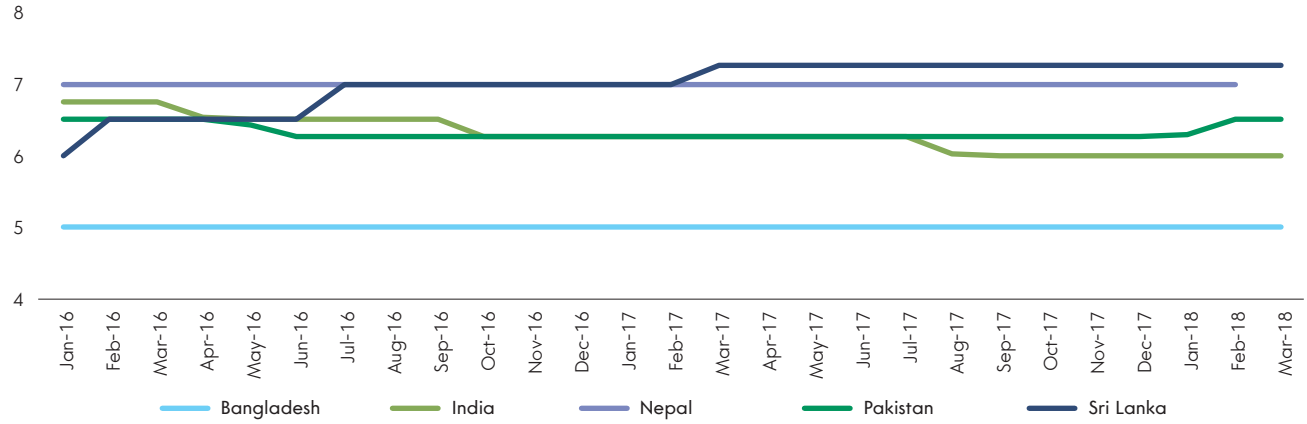


Source: For India, Sri Lanka, Bangladesh, China, Pakistan, inflation target data is from Haver Analytics (National Authorities), and other data are from Trading Economics. US data is from FED. Euro data is from Eurostat. Distance to inflation is based on World Bank staff calculations.
Note: The inflation target for Sri Lanka is not explicitly communicated by the central bank, but implicitly derived (Haver Analytics).

FIGURE 12: Policy rates have remained unchanged, except in Pakistan and Sri Lanka.

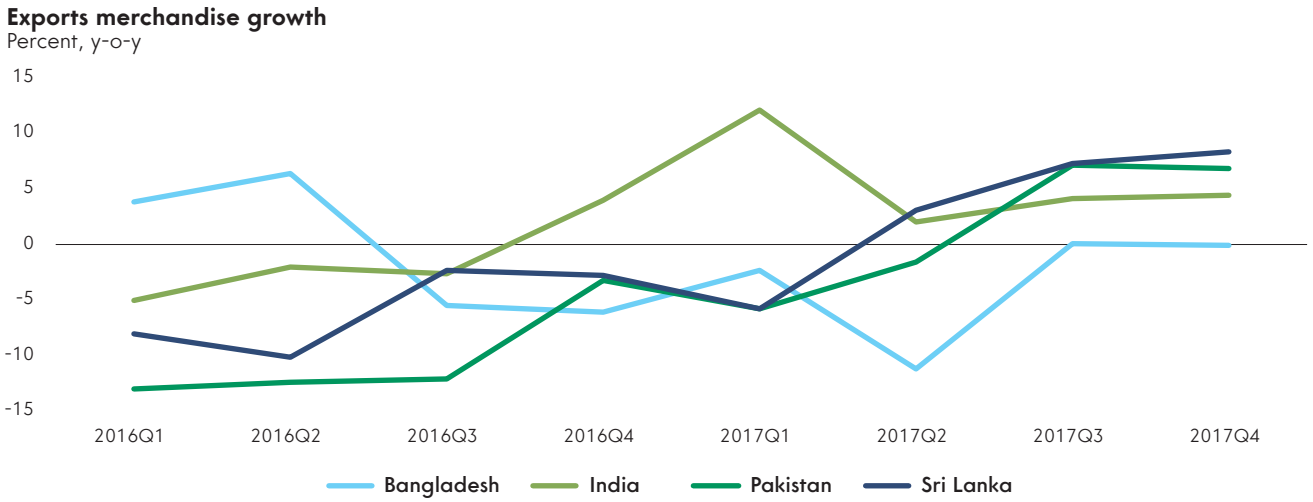
Official interest rate (policy instrument/base rate)

Repo Rate (end of period, percent per annum)



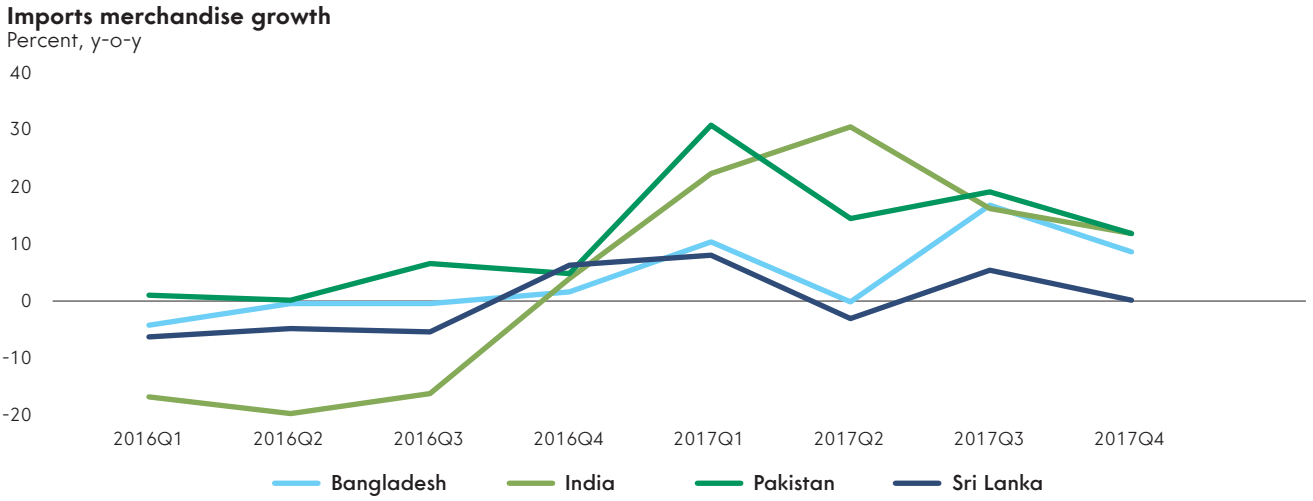
Source: Haver Analytics.
Note: Standing Liquidity Facility (SLF) rate is shown for Nepal.

FIGURE 13: Exports growth was disappointingly modest throughout the region.



Source: World Bank, International Monetary Fund International Financial Statistics (IFS) database and World Bank staff calculations.

FIGURE 14: Imports are growing rapidly across South Asia.

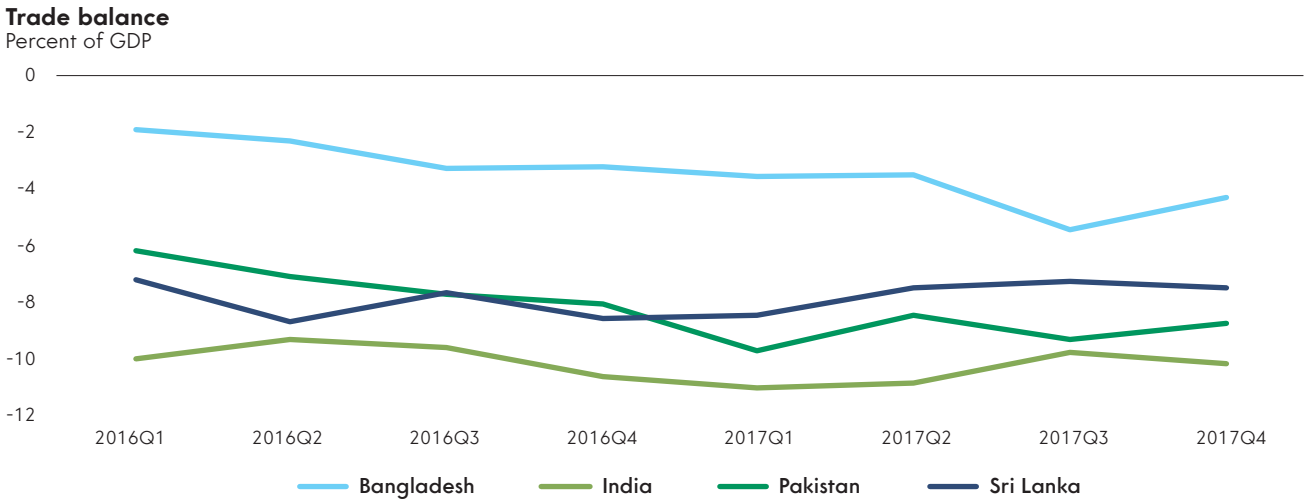


Source: World Bank, International Monetary Fund International Financial Statistics (IFS) database and World Bank staff calculations.

Inflation rates are in line with the explicit or implicit inflation targets of the authorities in most South Asian countries. The comparison of targets and actual rates reveals whether policy makers are confronting unexpected developments on the price front, and allows assessing how successful stabilization policies have been. In Bangladesh, India, and Sri Lanka, the difference between the inflation target and the actual inflation rate is below one percentage point. While inflation was above the target in Sri Lanka six months ago, it now is slightly below. In Pakistan, inflation is 2.2 percentage points below the target of 5 percent.

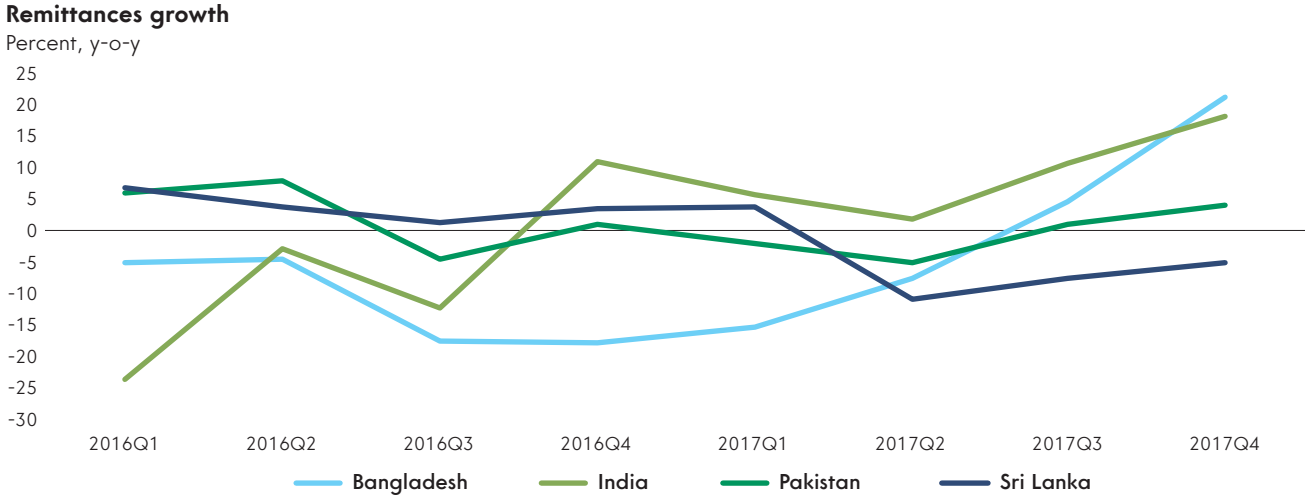
Apart from Pakistan and Sri Lanka, countries in the region have left their policy rates unchanged for the last six months. Consistent with inflation close to target, interest rates have remained mostly stable. Pakistan raised its interest rate slightly at the end of January to pre-empt an overheating of the economy and to react to slowly but steadily increasing core inflation. Sri Lanka, on the other hand, lowered its rate in early April responding to a decline in inflation and to output growth below its perceived potential. All other countries in the region left their monetary policy stance unchanged. However, Bangladesh Bank has lowered the Cash Reserve Requirement from 6.5 percent to 5.5 percent recently.

FIGURE 15: The trade deficits of the three biggest countries are widening.



Source: World Bank, International Monetary Fund International Financial Statistics (IFS) database and World Bank staff calculations.

FIGURE 16: Remittances flows to Bangladesh are increasing again.



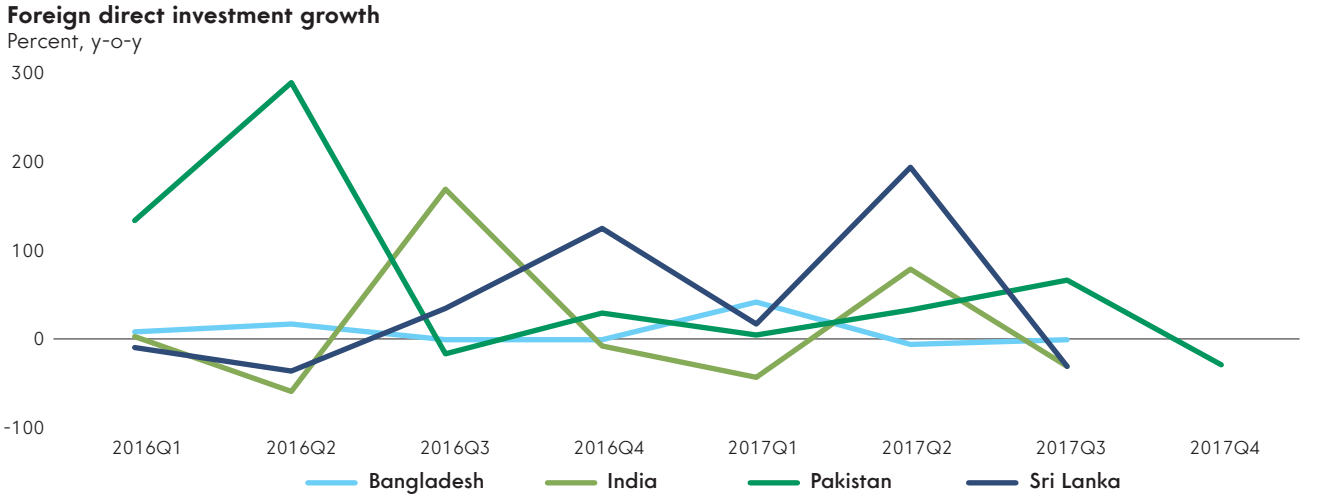
Source: Haver Analytics.

Widening trade and current account deficits

Despite the increasingly firm global recovery, exports remain relatively flat throughout the region, while imports are growing rapidly. Exports have stabilized recently in Bangladesh, after four quarters of decline. And export growth has been positive for five consecutive quarters in India. It has also been positive in Sri Lanka since the second quarter of last year, and in Pakistan since the third quarter. However, export growth in the region is generally lower than overall economic growth, or at best similar. It is also substantially lower than import growth. In both India and Pakistan, imports increased by more than 10 percent in the last quarter of last year. Only in Sri Lanka have exports grown stronger than imports recently.

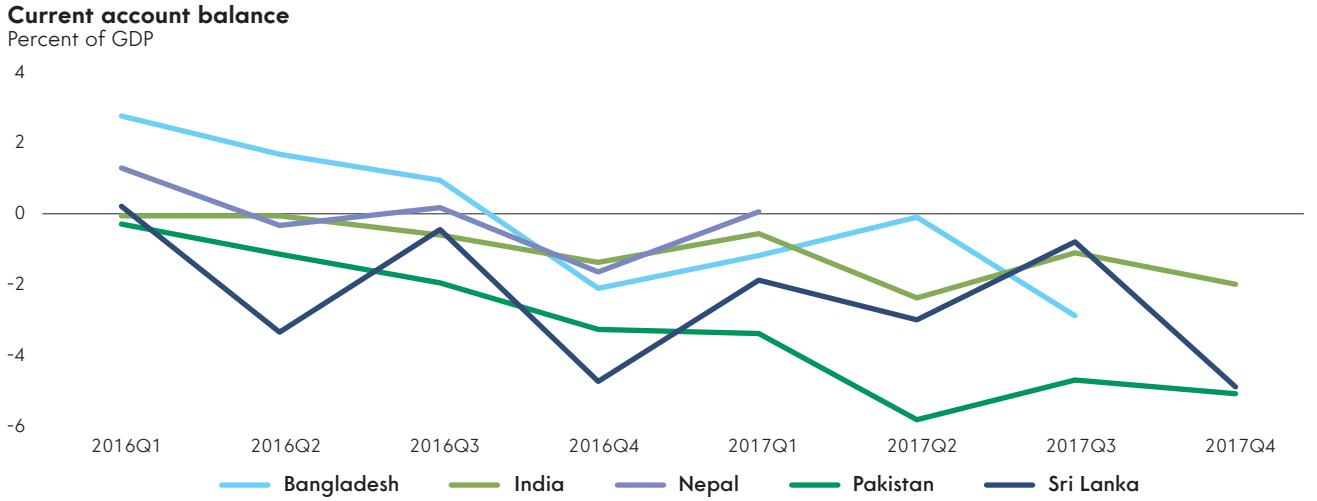
With lackluster export performance and rapidly growing imports, trade deficits are gradually widening. India's monthly trade deficit increased by roughly one third in recent months, from USD 19 billion in September 2016 to USD 25 billion in January 2018. In Pakistan, the monthly trade deficit reached USD 2.3 billion. In Bangladesh, it increased to the point of being the largest ever recorded. Sri Lanka, the trade deficit in percent of GDP narrowed somewhat during the last three quarters compared to the three quarters before. It is important to note that trade deficits are not necessarily a concern: as developing countries need to import capital goods and inputs in order to grow. The key question is how these deficits are financed.

FIGURE 17: Foreign direct investment increased across South Asia.



Source: Trading Economics.

FIGURE 18: Among larger countries, current accounts are mostly within safe boundaries.



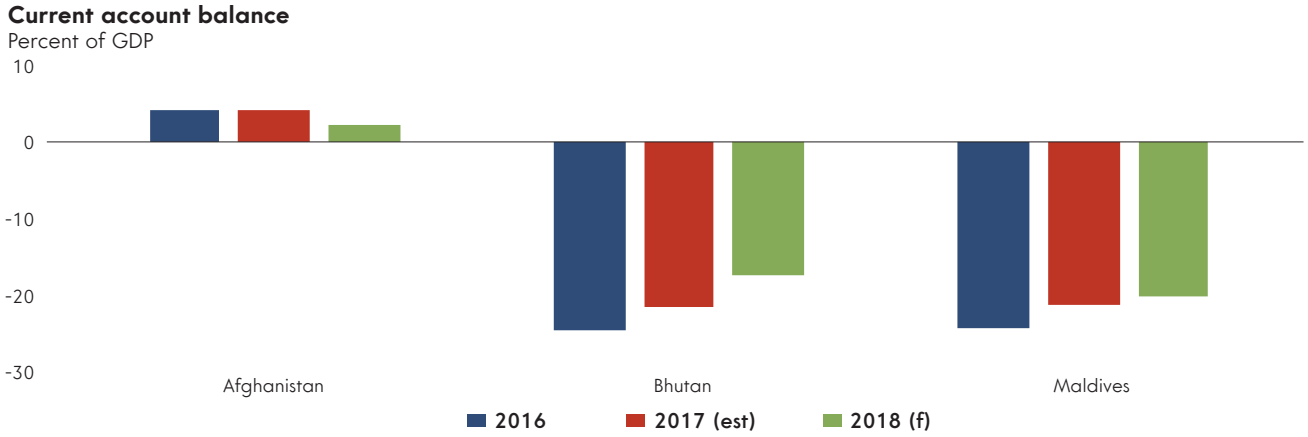
Source: Trading Economics, Haver Analytics, Nepal Central Bureau of Statistics, Central Bank of Sri Lanka, World Bank, and staff calculations.

After being flat or declining for several quarters, remittances are showing some signs of dynamism again. Many South Asian countries have large migrant populations, and remittances have been a key contributor to poverty reduction in the region. Remittances also help finance trade deficits. But declining oil prices had affected the economies of Gulf countries, where many of the region's migrants work. After declining for several quarters, remittances increased by more than 10 percent in India, and they rebounded by over 25 percent in the last quarter of 2017 in Bangladesh. In Pakistan they grew by 3.4 percent year-on-year from July to February. But in Sri Lanka, remittances decreased throughout 2017 and are now USD 78 million lower than at the end of 2016. And across countries, levels are far from the heights reached in past years.

Foreign direct investment (FDI) has been volatile in the short-term, but is on an upward trend across South Asia. Throughout the last two years, FDI growth has been mostly positive throughout the region. In Pakistan, it increased strongly at the beginning of 2016, stabilized for some time, and then increased again by more than 50 percent in the third quarter of 2017, before declining 17 percent in the last quarter. Both India and Sri Lanka saw their FDI increasing very strongly in two of seven quarters. Compared to the beginning of 2016, FDI has increased by over a third in India and Pakistan, and by 45 percent in Bangladesh.

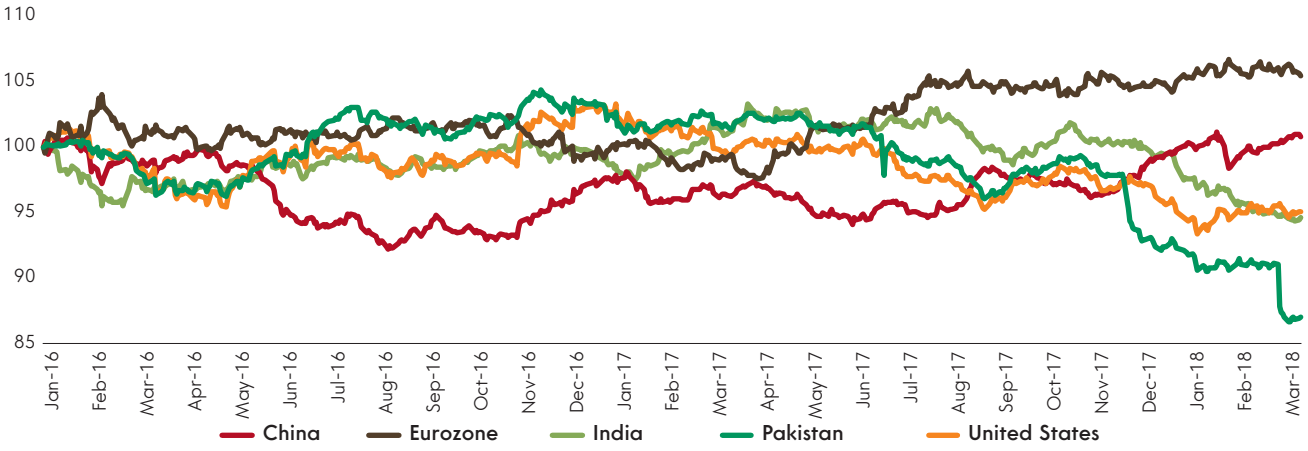
Current account deficits have widened, despite the recovery in remittances, but they remain generally manageable. In Sri Lanka, the deficit bottomed out at the end of 2016 but the balance has remained negative since then. In Bangladesh, the

FIGURE 19: Current account deficits are narrowing slowly in Bhutan and Maldives.



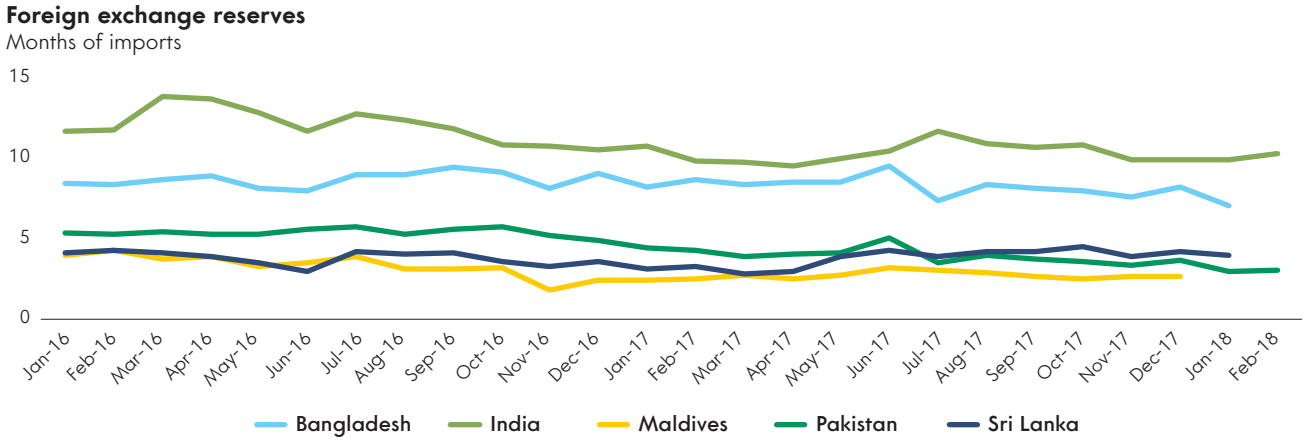
Source: World Bank.
Note: (est) = estimate, (f) = forecast.

FIGURE 20: The Indian and (especially) the Pakistani rupee depreciated recently.



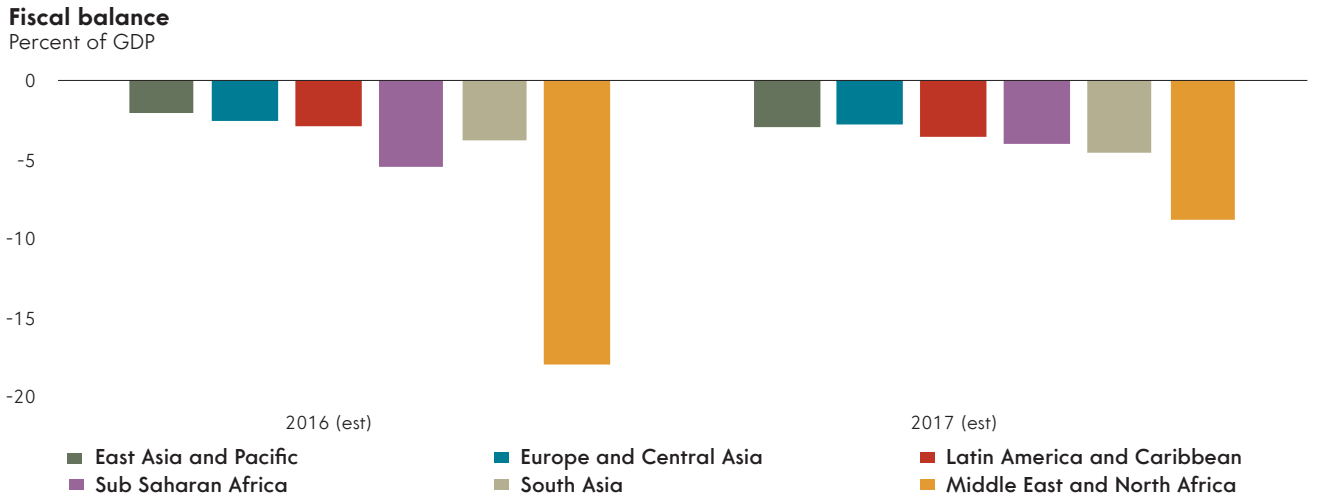
Source: Haver Analytics.

FIGURE 21: International reserves are relatively low in Maldives and Pakistan.



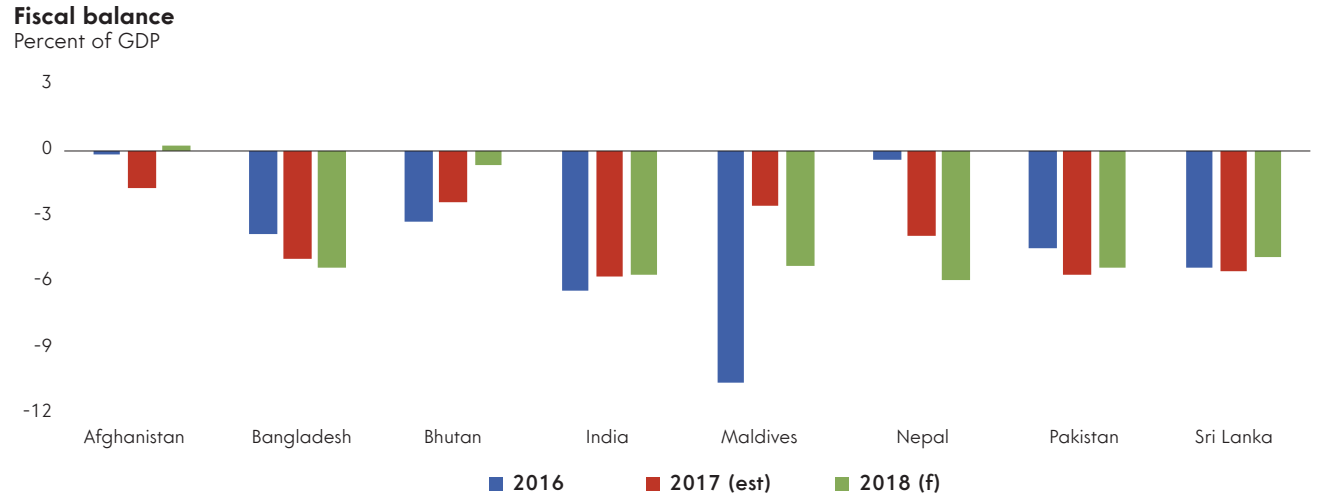
Source: World Bank, Haver Analytics, Maldives Monetary Authority, and World Bank staff calculations.

FIGURE 22: South Asia's fiscal deficit is the second highest in the world.



Source: International Monetary Fund World Economic Outlook Database and World Bank staff calculations.
Note: (est) = estimate.

FIGURE 23: Many countries in South Asia run a large fiscal deficit.



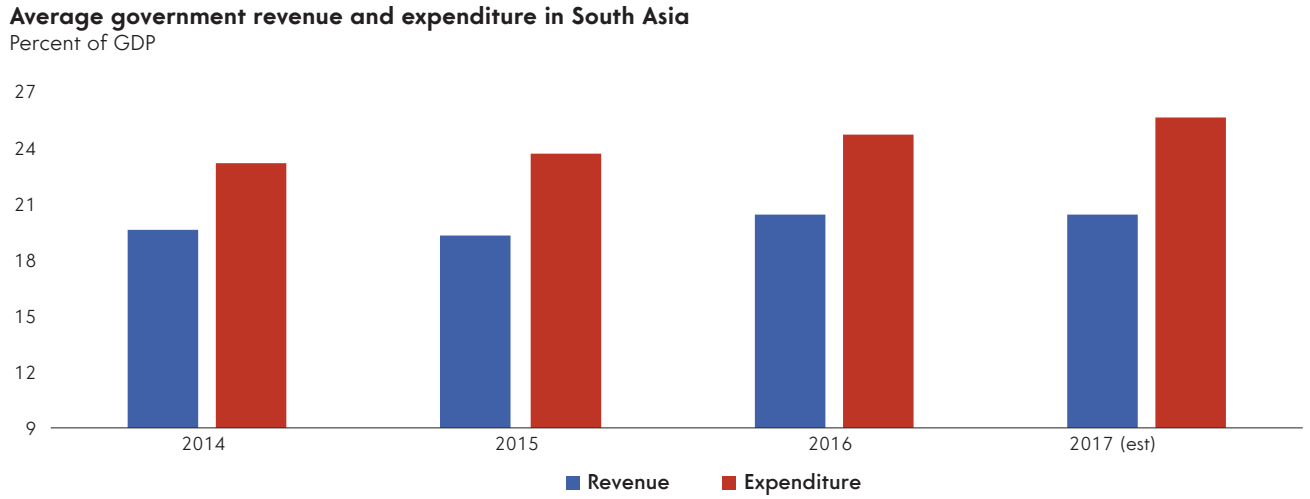
Source: World Bank.
Note: (est) = estimate, (f) = forecast.

current account was in surplus during most of 2016 but it declined from plus 2.7 percent of GDP in the first quarter of 2016 to minus 2.9 percent of GDP at the last quarter of 2017. Similarly, in India the current account was in surplus until the fourth quarter of last year, but then it turned into a deficit amounting now to 2.0 percent of GDP. Pakistan experienced the sharpest deterioration, with the current account balance decreasing steadily from close to zero in the first quarter of 2016 to negative 5 percent of GDP in the last quarter of last year. It remains to be seen whether the modest exchange rate depreciations of December 2017 and March 2018 will be sufficient to revert this trend.

The current account deficits of the two smallest countries in the region, Bhutan and Maldives, have been traditionally large but are now declining. In Bhutan, sizeable imports related to the construction of hydropower projects kept the current account deficit high, reaching 21.7 percent of GDP in 2017. But the deficit was almost entirely financed by loans from India and hence did not affect international reserves. In Maldives, the current account deficit in 2016 was inflated by a one-off payment to settle a dispute; it narrowed to 21.4 percent of GDP in 2017, still driven by large investment-related imports. Only in Afghanistan does the current account balance remain positive, due to large international aid flows.

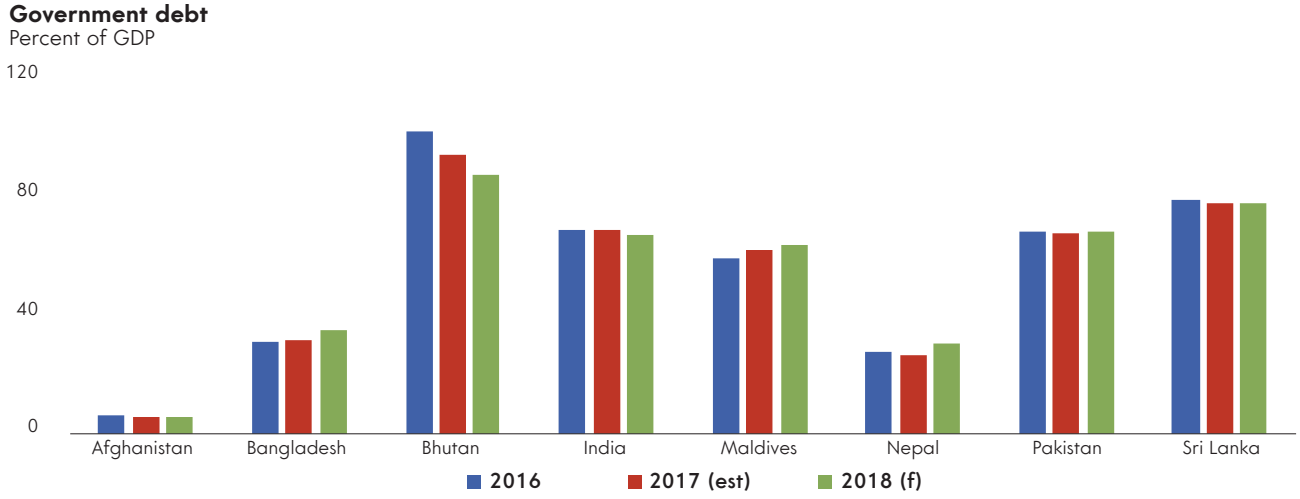
Recent nominal exchange rate depreciations in India and especially in Pakistan should improve competitiveness. In

FIGURE 24: Government revenues are growing more slowly than expenditures.



Source: International Monetary Fund World Economic Outlook and World Bank Staff calculations.
Note: (est) = estimate.

FIGURE 25: Government debt remains high in many South Asian countries.



Source: World Bank.
Note: (est) = estimate, (f) = forecast.

December 2017, the State Bank of Pakistan allowed the currency to depreciate against the USD. The Pakistani rupee fell from around 105 per USD to more than 110.5. A subsequent devaluation in March 2018 took the exchange rate to around 115.6 rupees per USD. In India, the real effective exchange rate declined by 5.2 percent since the beginning of 2018. In both cases, nominal depreciation should support export growth.

With few exceptions, countries in the region have a comfortable level of foreign currency reserves. Both India and Bangladesh have very sizeable international reserves, worth 10 months and 8 months import coverage respectively. Coverage is much lower, but still at a prudent level, in Sri Lanka. On the other hand, in Maldives and Pakistan foreign exchange reserves only cover around three months of imports or less. Pakistan's reserves declined from 5 months of import coverage in January 2016 despite the successful issuance of USD 2.5 billion in international markets in November 2017. The decline was partly due to the larger import bill.

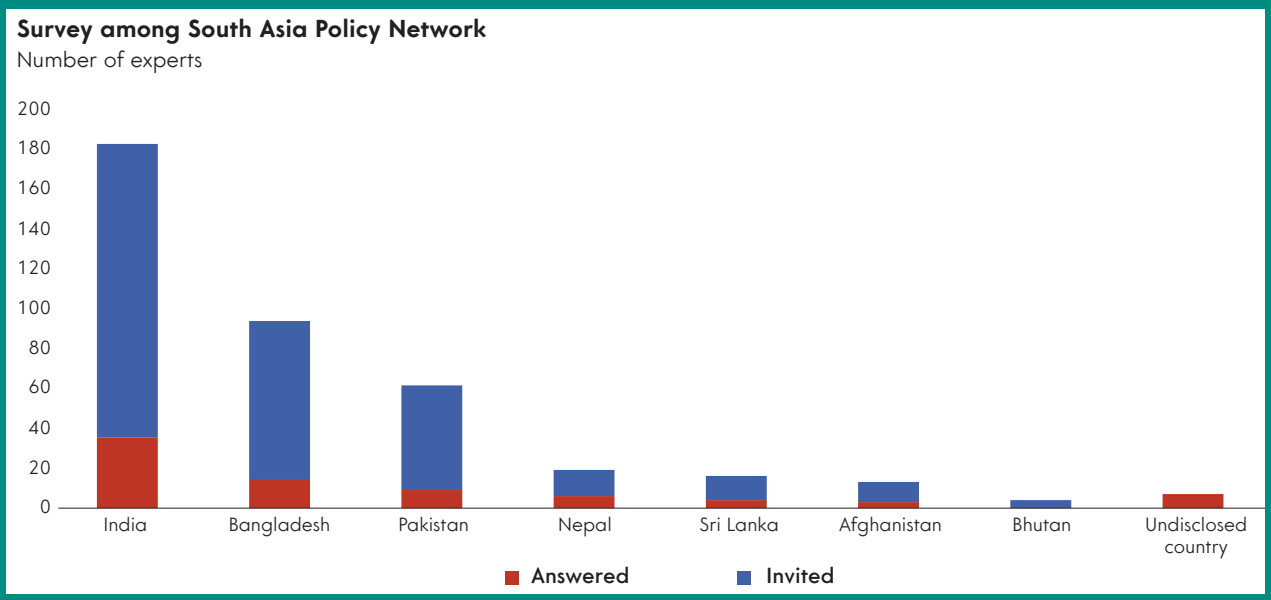
The fiscal position is not improving

Fiscal deficits in South Asia have been traditionally large, especially when taking into account the deficits of sub-national levels of government. And the situation has

Box 1 Views from the South Asia Economic Policy Network

The South Asia Economic Policy Network, launched by the office of the regional Chief Economist at the World Bank in 2017, represents an attempt to engage more strongly with thinkers and doers across South Asia. The objective is to be more pro-active in nurturing the exchange of ideas and to learn more systematically from colleagues and counterparts in the region. The Network currently focuses broadly on macroeconomics, and counts over 300 researchers and practitioners based in the region. The network has a wide regional coverage including researchers from seven countries, selected based on peer recognition and recent conference presentations. Many of them are academics at renowned universities; others are researchers in central banks and think tanks, and some are affiliated with policy-making units.

FIGURE 26: We asked over 300 economists from seven countries about their views.



Source: World Bank South Asia Economic Policy Network.

A short opinion survey was conducted among the group for this edition of South Asia Economic Focus. The objective was to take the pulse of informed and influential experts about economic developments in their countries. By the same token, the survey allowed gathering their views on labor market data and the main obstacles to stronger employment generation.

The response rate exceeded 24 percent, with 78 filled-in questionnaires from 7 countries. Nearly all respondents identified themselves as academics and as macroeconomists. Three quarters of the respondents are involved in policy advising and a

not improved much in recent times. India, Pakistan and Sri Lanka all run general fiscal deficits in excess of 5 percent of GDP. In Pakistan, the fiscal position has deteriorated rapidly. The deficit reached 5.8 percent of GDP in 2017, which is 2 percentage points higher than the initial target and more than 1 percentage point higher than in the previous year. Sri Lanka achieved a primary surplus, but the overall deficit slightly increased due to higher interest expenditure. In India, the pace of consolidation has slowed down. The federal government missed its fiscal target in 2017 and its deficit reached 3.5 percent of GDP. The federal and state deficit combined amount to around 6 percent of GDP. In Afghanistan the fiscal deficit exceeds 5 percent of GDP excluding grants, but is very small if grants are included.

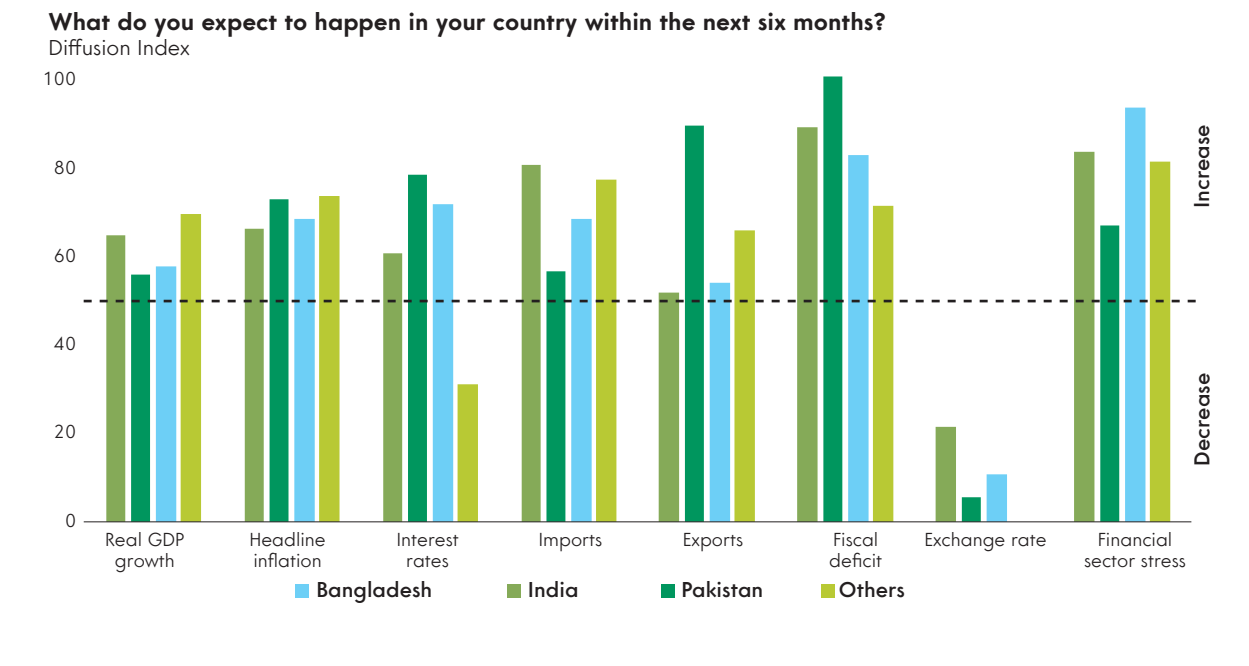
Larger fiscal deficits are mainly driven by larger public expenditures, while government revenue remains relatively stable. Low government revenue has been a distinctive feature of most South Asian countries. Only Bhutan and Maldives are substantially above what can be predicted given their development level. India is roughly in line with comparable countries and can be expected to do better as the impacts of demonetization and GST on the formalization of payments materialize. All other countries are below international

quarter in policy making. Responses regarding the economic situation are summarized here; views on labor market data and the main obstacles to stronger employment generation are reported throughout the chapter on 'Jobless Growth?'.

The expectations of Network members regarding economic developments over the next six months are summarized in a single number, using so-called diffusion indices. For any indicator, a value above 50 indicates that an increase is expected, whereas a value below 50 corresponds to an expected decrease. The farther away the number is from 50, the greater the consensus among Network members that an important change is under way.

Respondents anticipate an acceleration in GDP growth in the entire region. Network members also believe that inflation will pick-up across all countries. In Pakistan, both imports and exports are expected to increase, but the expectation is much stronger for exports. In India, on the other hand, only imports are expected to increase, while exports are seen as stable. In all countries network members foresee and increase in the fiscal deficit. Across South Asia, there are strong views that the exchange rate will depreciate and that financial sector stress will rise.

FIGURE 27: Views on the outlook are generally optimistic.



Source: World Bank South Asia Economic Policy Network.

Note: The index is calculated as follows: Index=(P1*100) + (P2*50) + (P3*0), where P1 is the proportion of responses that report that the variable is too large/overvalued/too high, P2 is the proportion of responses that report that the variable is appropriate, and P3 is the proportion of responses that report that the variable is too low/undervalued/too small.

benchmarks, often by a vast margin. And for region as a whole, government revenue has increased by a very modest 0.8 percent of GDP over the last three years. Meanwhile, public expenditures grew by 2.6 percentage points, to reach 25 percent of GDP last year. With revenues and expenditures increasingly drifting apart, fiscal deficits are worsening.

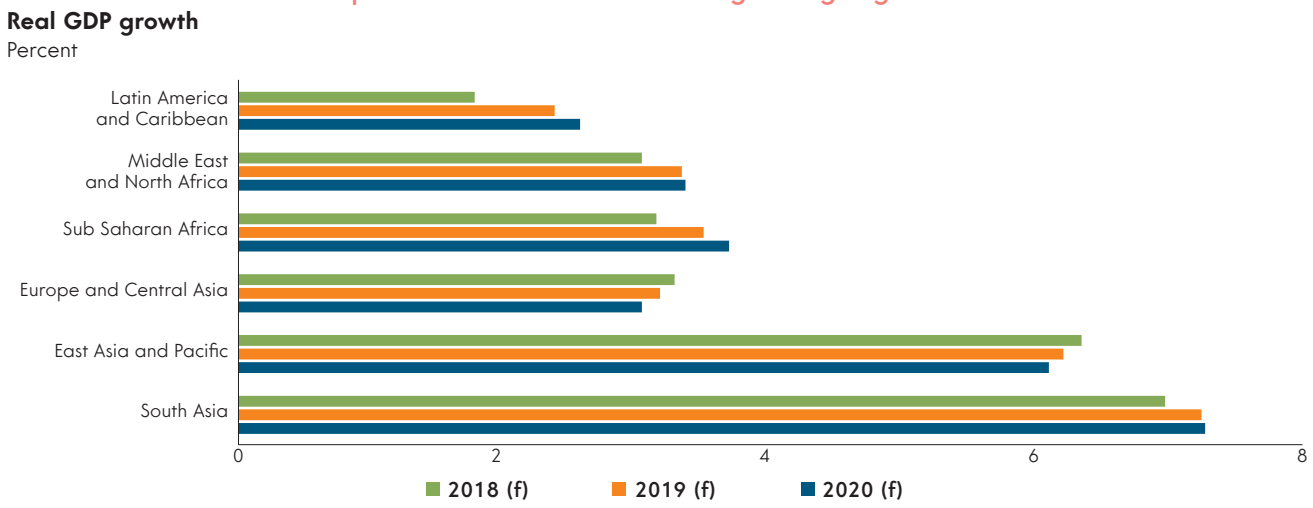
Despite financial repression allowing governments to place government bonds in favorable terms, public debt in South Asia is high by international standards. Only in the Middle East and North Africa is the debt-to-GDP ratio higher, mainly as a consequence of the unbalances created by the fall in oil prices. In South Asia as a whole, public debt has recently surpassed 60 percent of GDP. However, there is considerable variation within the region. Public debt is at around 100 percent of GDP in Bhutan, at around 80 percent in Sri Lanka, and over 60 percent in India, Maldives, and Pakistan. On the other hand, it only reaches around 30 percent in Bangladesh and Nepal, but it has strongly increased in both countries over the last year.

South Asia economic outlook

South Asia is expected to remain the fastest growing region in the world. Growth in South Asia is forecast to pick up to 6.9 percent in 2018, mainly reflecting India emerging from its slowdown. Growth should further strengthen to 7.1 percent on average in 2019-20, reflecting an improvement across most of the region. Although risks to the forecast have become more balanced, with potential for further upside surprises to global growth, they are still tilted to the downside. Despite more favorable international conditions, domestic demand will remain the main driver of economic growth.

PHOTO: Dean Tennekoon/World Bank.

FIGURE 28: South Asia is expected to remain the fastest growing region.



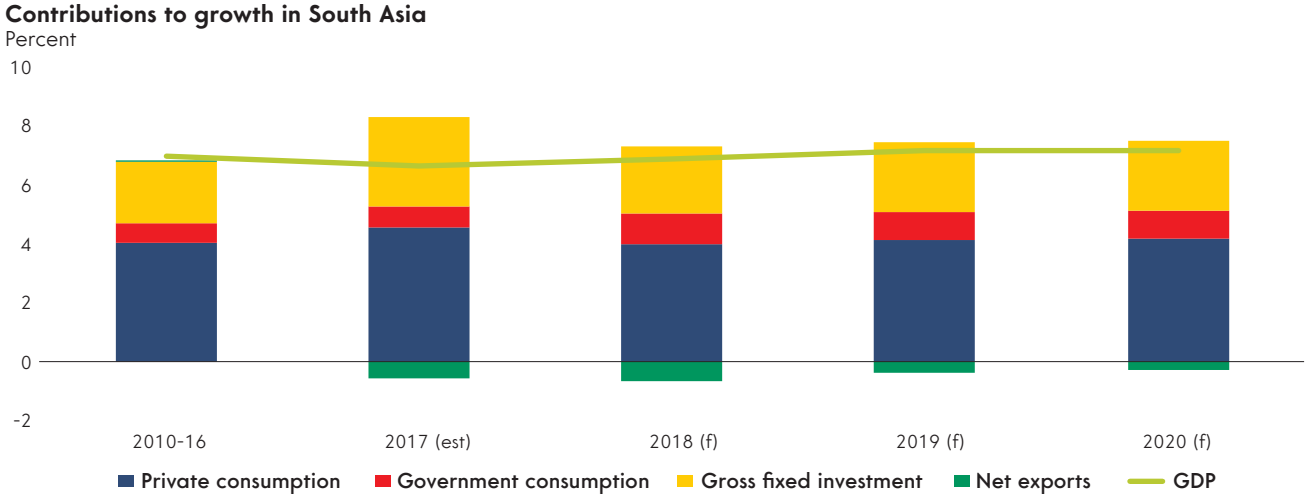
Source: World Bank.
Note: (f) = forecast.

The international environment should remain favorable in 2018. Global growth is projected to peak at 3.2 percent this year, as the cyclical momentum continues. It should then moderate slightly to an average of 3 percent in 2019–20, reflecting a gradual slowdown in advanced economies. Other global trends will become less supportive over the forecast period. Global trade, which accelerated sharply last year due to a cyclical upturn in global manufacturing, is expected to remain strong in 2018, but to moderate thereafter, as global investment growth eases. Protectionist pressures could result in a less favorable environment as well. Global financing conditions, which were benign throughout 2017, are likely to tighten this year, as monetary policy gradually normalizes in major advanced economies. Capital inflows are still expected to be sustained in 2018, but energy prices – and to some extent agricultural prices – should gradually firm up.

South Asia is expected to remain the fastest growing region in the world. Growth in South Asia is forecast to pick up to 6.9 percent in 2018, mainly reflecting India emerging from its slowdown. Growth should further strengthen to 7.1 percent on average in 2019-20, reflecting a broad-based improvement across most of the region. South Asia should maintain its position as the fastest growing region and even extend its lead over East Asia and the Pacific.

While this forecast is broadly unchanged from January 2018, the expected growth rate is slightly lower, mainly

FIGURE 29: Growth will continue to be driven by domestic demand.



Source: World Bank.
Note: (est) = estimate, (f) = forecast.

TABLE 1: Growth is expected to plateau in most countries.

Real GDP growth in South Asia	2015	2016	2017 (est)	2018 (f)	2019 (f)	2020 (f)
Afghanistan (CY)	1.3	2.4	2.6	2.2	2.5	3.3
Bangladesh (FY)	6.6	7.1	7.3	6.5	6.7	7.0
Bhutan (FY)	7.3	7.4	5.8	5.4	6.0	8.7
India (FY)	8.2	7.1	6.7	7.3	7.5	7.5
Maldives (CY)	2.2	6.2	6.2	5.5	4.5	4.9
Nepal (FY)	3.3	0.4	7.5	4.6	4.5	4.2
Pakistan (FY, factor costs)	4.1	4.6	5.4	5.8	5.0	5.4
Sri Lanka (CY)	5.0	4.5	3.1	4.8	4.5	4.5

Source: World Bank.
Note: (est) = estimate, (f) = forecast.

due to a downward revision for Pakistan in 2019. The baseline scenario assumes an ongoing, but gradually moderating recovery in global economy and global trade, higher commodity prices, and gradual tightening of global financing conditions. Although risks to the forecast have become more balanced, with potential for further upside surprises to global growth, they are still tilted to the downside.

Despite more favorable international conditions, domestic demand will remain the main driver of economic growth. Private consumption is expected to firm and offset a moderation in public consumption as fiscal policy gradually tightens. Gross fixed capital formation should remain above 7 percent over the forecast horizon. Private investment is expected to accelerate and offset moderating public investment. Import growth will peak in 2018, and moderate to around 6 percent in 2020, helping reduce the pressure on the current account. Export growth, which underperformed last year, is expected to strengthen to 6 percent in 2019, which is nevertheless lower than projected in January.

Growth rates should remain relatively stable across countries in South Asia. Growth in India is projected to accelerate to 7.3 percent this year, and to 7.5 percent in 2019 and 2020, reflecting stronger private spending and export growth. Sri Lanka's GDP growth may average around 4.5 percent over the medium term, reflecting a recovery from the effects on agriculture of last year's adverse weather disruptions, as well as robust consumption and investment growth. In Bhutan and Maldives, growth will continue to benefit from construction and services, and average 7.4 and 5 percent respectively over the forecast horizon. After the strong 2017 rebound from the effects of the devastating earthquakes, Nepal's GDP growth is forecast to moderate to 4.6 percent this year and to average 4.5 percent over the medium term. In Pakistan, GDP growth is expected to moderate to 5.0 percent in 2019 reflecting tighter policies to unwind vulnerabilities accumulated over the past years. In the medium-term, growth in Pakistan is expected to rebound to 5.2 percent on average in 2019 and 2020, reflecting firming exports, and especially robust investment growth in connection to the China-Pakistan Economic Corridor. This is, however, lower than previously anticipated. In Bangladesh, growth is expected to recover from the effects of natural disasters and reach 6.7 percent in 2019, supported by improving exports and remittances. In Afghanistan, growth will remain subdued owing to weak confidence due to security challenges and political uncertainty. These outlooks assume continued reforms leading to improved confidence, macro stability, and increased export competitiveness.

Risks to the regional forecast are more balanced than in the January 2018 assessment, with potential for further upside surprises thanks to global growth. Downside risks are mainly related to the possibility of domestic policy slippages, such as a weakening of fiscal policies or setbacks in areas of reforms to improve the investment climate or to strengthen the banking sector. However, the region is also vulnerable to exogenous domestic events like increased insecurity and natural disasters. Although South Asia is not a larger exporter of goods, it could also be adversely affected by external shocks, such as escalating trade protectionism. And financial markets in the largest countries in the region could be jittery in the event of an abrupt tightening of global financial conditions.

PHOTO: World Bank

Jobless growth?

The demographic transition is swelling the ranks of the working-age population across most of South Asia. In this context, keeping employment rates constant would require massive job creation. But there is a widespread perception that increases in the working-age population have been offset by declining employment rates, and that women have accounted for most of the decline. To what extent this perception is correct is unclear, because employment data are not always comparable over time. For this report, crucial information about employment in South Asia is extracted in a transparent and replicable way from over 60 surveys and censuses covering the period from 2001 onwards. The analysis of this information reveals that employment does respond to economic growth in the short term, implying that growth is not jobless. It also appears that countries in South Asia have created large numbers of jobs over the years. However, the nature of the jobs created is not fully encouraging, and the analysis shows that rapid growth alone will not be sufficient to bring South Asian employment rates to the levels observed elsewhere in the developing world. In addition to high growth, more and better jobs need to be created for every percentage point of growth. The results in this chapter call for better employment data, and for a focus on the economic policies that can boost job creation.

The job creation challenge

Job creation is one of the main concerns of politicians and policymakers around the world. If anything, the concern is more pronounced in South Asia, where very large numbers of young people are reaching working age every year. Between 2005 and 2015, the number of South Asians aged 15 and above grew by 1.8 million per month, a trend that will only moderate gradually over time. Many of the entrants in this group are staying in school longer than their predecessors, and many may never seek a job. But still, preventing a substantial decline of the employment rate – the share of the working-age population that is at work – is a major challenge.

Assessing what it would take to the keep the employment rate constant provides a useful benchmark for the job creation challenge. Between now and 2025, population will increase in all South Asian countries, although it will do so at different paces. The increase will range between 3 percent in Sri Lanka and 26 percent in Afghanistan. The growth of the working-age population will be faster, across all countries. The number of people aged 15 and above will expand between 8 and 41 percent by 2025, depending on the case. In Bangladesh, the working-age population will increase by 170 thousand every month; the corresponding figures for Pakistan and India are 250 thousand and 1.3 million respectively. To keep employment rates constant, 1.1 million additional jobs would be needed every year in Bangladesh, 1.4 million in Pakistan, and more than 8 million in India.

A key question is whether rapid economic growth alone can generate the massive numbers of additional jobs needed. Concerns that the answer could be negative lie behind discussions on "jobless growth". But before reaching a conclusion it is important to distinguish between short- and medium-term effects of economic growth. In the short term, growth can boost employment rates as greater labor demand pulls people out of unemployment and inactivity. Growth can also lead to better jobs, for example when farm employment is replaced by work in factories and offices. In the long term, on the other hand, growth could reduce employment rates. As countries become richer and living standards improve, families can afford to keep their children longer in school, the ill and the disabled can stay home, and women may withdraw from the labor force. In assessing whether growth is jobless or not, it is therefore important to distinguish between these two effects.

Estimating the short-term relationship between economic growth and employment rates has been the subject of a vast literature in advanced economies. There, the consensus is that rapid economic growth does indeed reduce unemployment rates in the short term, while slowdowns are associated with increases in unemployment. The literature is much scanter in developing countries, partly due to data limitations. Indeed, the unemployment rate is not very informative about the labor market situation in countries where few people can afford to remain idle. Measurement is further complicated by the fact that many occasional jobs fall in a gray area between employment, unemployment and inactivity. With the noisy data available, crude statistical analyses suggest that employment rates are less responsive to economic growth in developing countries than in advanced economies.

Evidence on the long-term relationship between economic growth and employment rates is somewhat more conclusive. When comparing employment rates across countries with different levels of income per capita, a U-shaped curve emerges. Many of the poorest countries in the world have very high employment rates. In these countries, people start working young, and don't have the means to be unemployed or retired. Not only adult men, but also women, the young and the elderly are part of the labor force. As countries become richer, school enrollment increases, old-age pension programs are put in place, and not every adult in a household needs to be at work. But this downward trend reverses at higher levels of income per capita. In richer countries a growing number of youth reach tertiary education, and they are keen to work in the field of their study. Higher wages, safer transportation and workplaces, and more easily available childcare also bring large numbers of women back into the labor force.

Several South Asian countries have employment rates below those of other countries at a similar level of development. Nepal is an exception, as its employment rate is higher than that of many other countries with a similar GDP per capita. In Afghanistan and Bhutan, employment rates are close to what can be expected given their income per capita. In Bangladesh, India, Sri Lanka, and Pakistan, on the other hand, employment rates are much below what is predicted given their income per capita. The gap between the actual employment rate and the estimated U-shaped curve varies between 7 percentage points in Sri Lanka and 13 percentage points in Pakistan.

Low employment rates in South Asia are entirely due to women working less than in other regions. Employment rates among men are above, or at most around, the estimated U-shaped curve. But employment rates among women are consistently below, and the gap between the actual and predicted employment rate is substantial in several countries. In India and Pakistan, the gap is close to 30 percentage points.

A foregone dividend

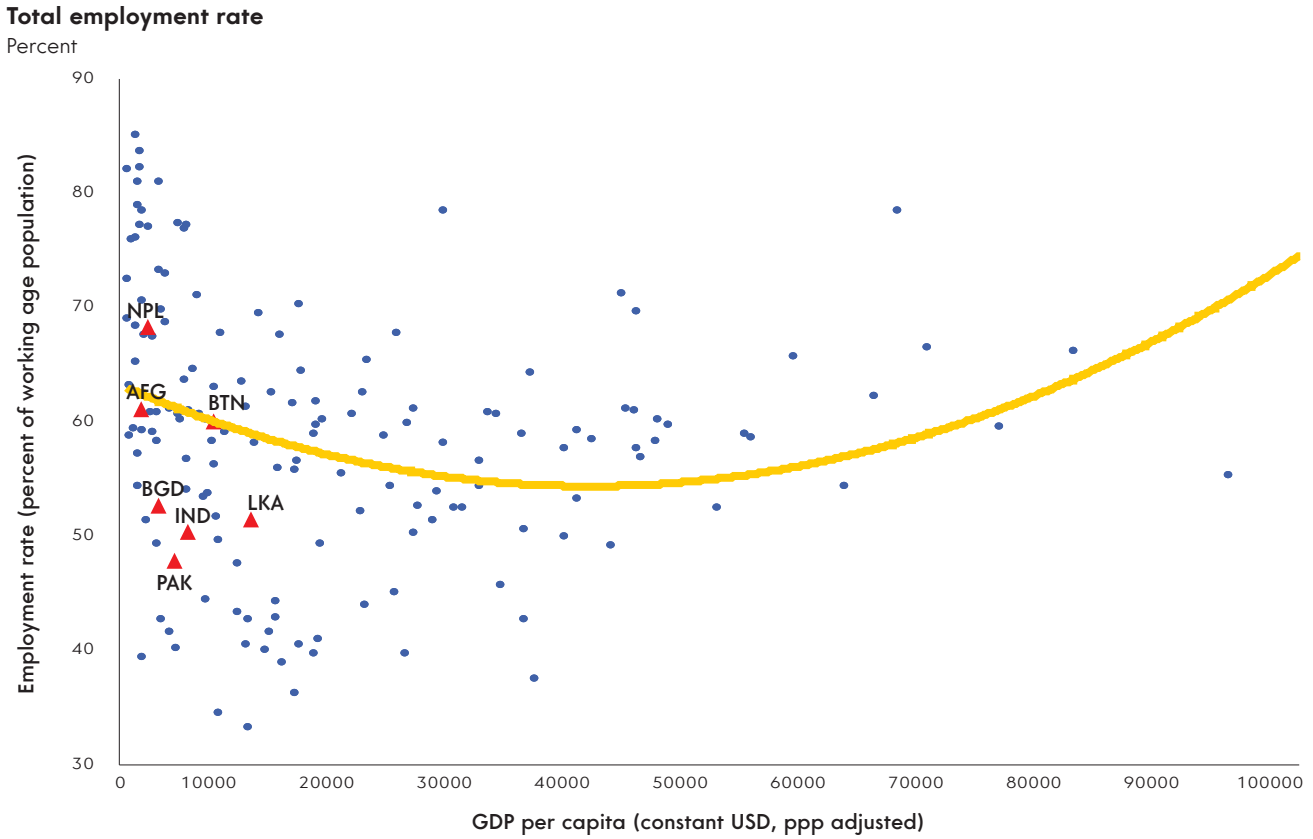
South Asia's rapid demographic transition results in declining dependency ratios, offering an opportunity for faster economic growth. The dependency ratio compares

TABLE 2: Keeping employment rates constant would require massive job creation.

	Monthly increase in population (15+)	Employment rate		Monthly job creation needed to keep employment rate constant		Annual job creation needed to keep employment rate constant	
	2015-2025 (in thousands)	2015 (or most recent)		2015-2025 (in thousands)		2015-2025 (in thousands)	
		Survey estimate	World Developent Indicators	Survey estimate	World Developent Indicators	Survey estimate	World Developent Indicators
Afghanistan	64	48	48		30.5		366.1
Bangladesh	170	53	60	89.6	101.1	1,075.0	1,213.4
Bhutan	1	60	65	0.50	0.54	6.0	6.4
India	1,319	50	52	662.4	684.6	7,948.3	8,214.6
Maldives	1	66	66		0.34		4.1
Nepal	35	68	81	23.9	28.2	286.9	338.3
Pakistan	245	48	51	117.2	124.3	1,407.0	1,492.0
Sri Lanka	10	51	49	5.2	5.0	62.8	60.4

Source: Bangladesh 2015/16 LFS; Bhutan 2012 LSS; India 2011/12 NSS-Thick; Pakistan 2015/16 HIICS; Nepal 2011 LSS; and Sri Lanka 2015 LFS. World Development Indicator data is based on modeled ILO estimates.

FIGURE 30: Employment rates vary with economic growth: A U-shaped curve.



Source: World Development Indicators, Afghanistan 2013/14 ALCS; Bangladesh 2015/16 LFS; Bhutan 2012 LSS; India 2011/12 NSS-Thick; Nepal 2010/11 LSS; Pakistan 2015/16 HIICS; and Sri Lanka 2015 LFS and World Bank staff calculations.

FIGURE 31: Female employment is low in South Asia compared to other developing countries.

Source: World Development Indicators, Afghanistan 2013/14 ALCS; Bangladesh 2015/16 LFS; Bhutan 2012 LSS; India 2011/12 NSS-Thick; Nepal 2010/11 LSS; Pakistan 2015/16 HIICS; and Sri Lanka 2015 LFS and World Bank staff calculations.

the number of dependents, aged zero to 14 and over the age of 64, to the working-age population, aged 15 to 64. In South Asia the dependency ratio has decreased from 63 percent in 2005 to 55 percent in 2015, and it is expected to decrease further to 50 percent by 2025. Except for Sri Lanka, which is the only aging society in South Asia, the trend is present in all counties in the region. This change of the population's age structure creates an opportunity for fast economic growth and rising living-standards. Potentially, there could be more people earning an income for every child and elderly person needing support. Even if the productivity of those at work were to remain unchanged, income per capita would increase, because there would be more working people per capita. But to reap the benefits of this 'demographic dividend', sufficient new jobs need to be created.

Not all countries have transformed their demographic transition into a demographic dividend to the same extent, however. The comparison between South Asia and East Asia is revealing in this respect. In both cases, the U-shaped curve suggests that employment rates were bound to decline with economic growth. But in East Asian countries employment rates declined less than the U-shaped curve would have implied, whereas in South Asian countries they declined more than could be anticipated.

Because of the decline in employment rates, the number of people at work in South Asia has not increased in line with the working-age population. For example, between 2005 and 2015, the share of the working-age group in the total population increased by over 1 percent per year in Bhutan, and by around 0.5 percent in Bangladesh, India, and Pakistan. At the same time, however, the employment rate decreased on average more than 1.5 percent per year in Bhutan and India and by more than 0.5 percent per year in Bangladesh. Since income per capita grew considerably in all these countries from 2005 to 2015, some decline in the employment rates could be anticipated. However, the declines in employment rates are much larger than can be explained by increasing incomes per capita alone.

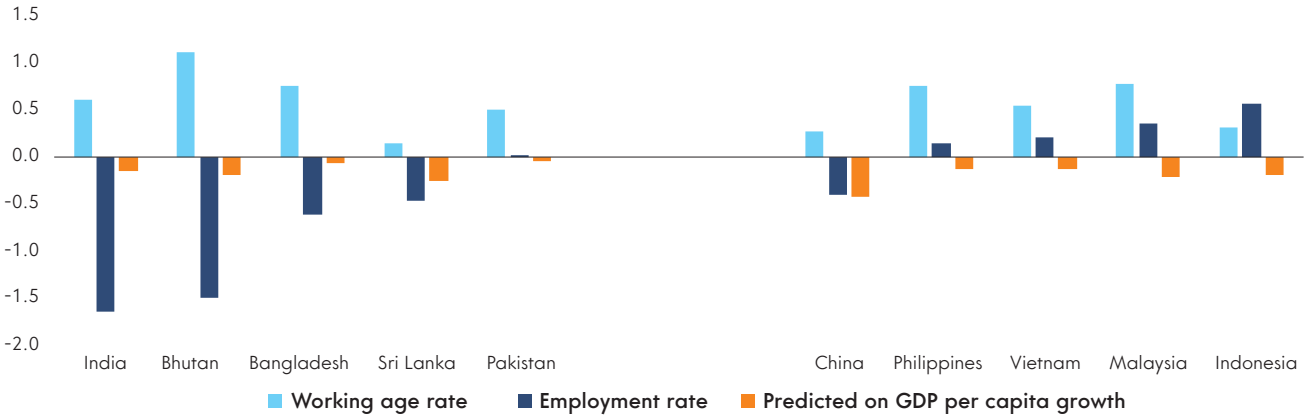
Rapidly declining female employment rates in some South Asian countries are the main explanation for the difference with East Asia. Between 2005 and 2015, male employment rates decreased very little in India, but female employment rates decreased by nearly 5 percent per year. In Bhutan, male employment rates were nearly stable, while female employment rates decreased by over 3 percent per year. But not all countries in the region display the same pattern. In Bangladesh, male employment declined by close to 1 percent per year, whereas female employment remained constant. And in Pakistan, female employment even increased – though from a very low level.

In a context of rapid economic growth, the flip side of declining employment rates is higher average labor productivity. To illustrate the point, if growth was truly jobless it would mean that more goods and services are being produced with the same amount of labor. But this is not necessarily an ideal outcome from an economic point of view. Higher average labor productivity may originate in more capital being used for production, but capital is expensive to accumulate. Countries with limited financial resources and abundant labor may prefer a less capital-intensive development path. They can do so, for instance, by specializing their production in more labor-intensive sectors of activity.

FIGURE 32: Increases in working age population have been offset by declining employment rates

Working age rate, employment rate and predicted employment rate

Annual change in percent, 2005-2015

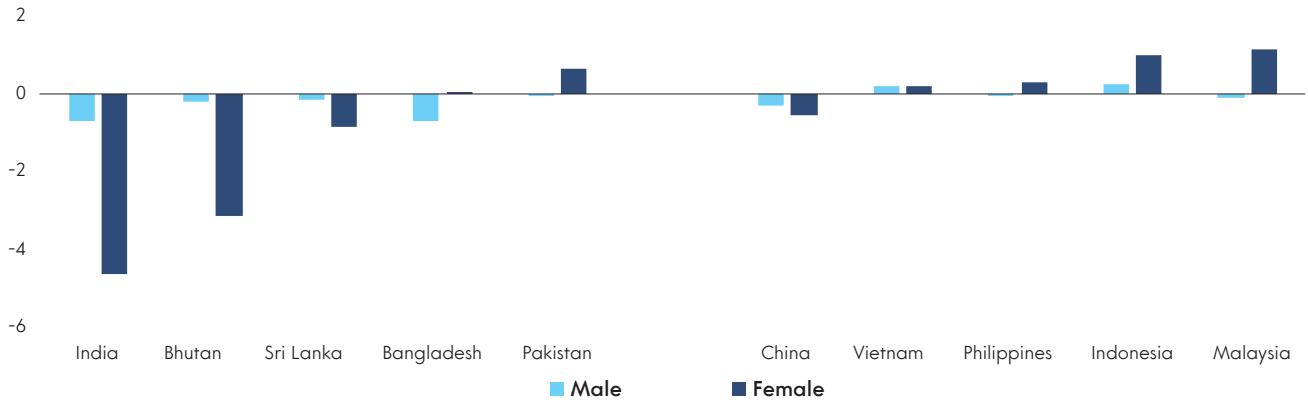


Source: The change of the employment rate for South Asian countries was calculated using the estimates from Bangladesh 2005/06 – 2015/16 LFS; Bhutan 2007-2012 LSS, India 2004/05 – 2011/12 NSS-Thick; Pakistan 2005/06 HIES – 2015/16 HIICS; and Sri Lanka 2006 – 2015 LFS. The change for the other countries is based on modeled ILO estimates. The change in working age rate is based on 2005-2015 UN population statistics.
Note: The working age rate is the share of population above 15 in the total population. The employment rate is the share of employed among the working age population.

FIGURE 33: Women account for most of the decline in employment rates.

Employment rate by gender

Annual change in percent, 2005-2015



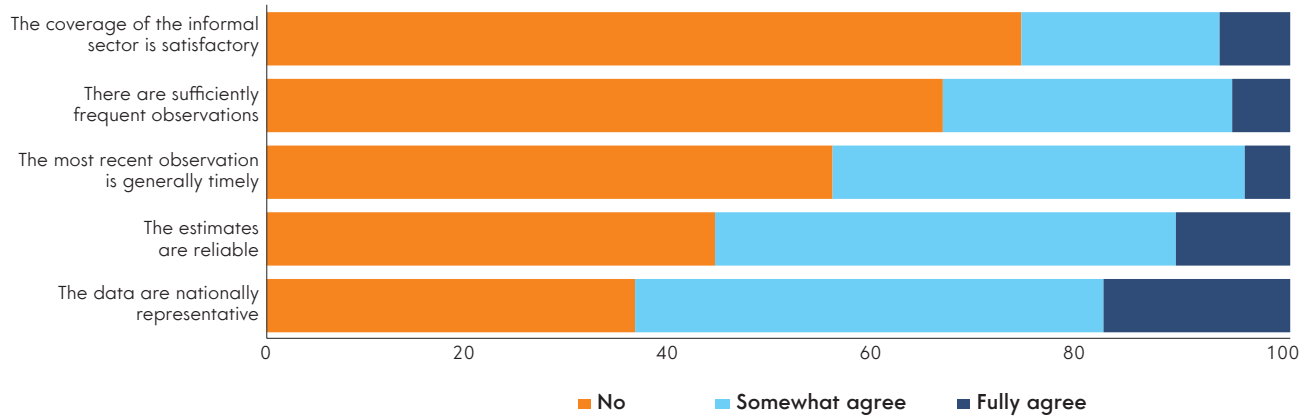
Source: The change of the employment rate for South Asian countries was calculated using the estimates from Bangladesh 2005/06 – 2015/16 LFS; Bhutan 2007-2012 LSS, India 2004/05 – 2011/12 NSS-Thick; Pakistan 2005/06 HIES – 2015/16 HIICS; and Sri Lanka 2006 – 2015 LFS. The change for the other countries is based on modeled ILO estimates. The change in working age rate is based on 2005-2015 UN population statistics.
Note: The working age rate is the share of population above 15 in the total population. The employment rate is the share of employed among the working age population.

Generating comparable employment numbers

Discussions on the relationship between economic growth and job creation in South Asia have been muddled by data gaps and inconsistencies. Employment figures are seldom available with high frequency, and labor indicators differ in subtle but important ways across statistical instruments. Population censuses, economic censuses, household surveys, and labor force surveys may all define employment in different ways. The implications of the gaps between definitions are amplified in economies where self-employment and casual work are the norm. A nine-to-five job, with a written contract and benefits attached to it, is easy to recognize. But relatively few jobs match this description in South Asia. In many cases, it is hence difficult to tell whether people are working, unemployed, or out of the labor force, and the answers vary depending on the statistical instrument considered. The difficulty to measure employment is exacerbated for women, as they tend to engage even more than men in activities falling in the gray area between work, unemployment and inactivity.

FIGURE 34: Economists are aware of the challenges posed by the available employment data.

Do you agree with the following statements regarding the quality of labor market information in your country?
Distribution of responses



Source: World Bank South Asia Economic Policy Network.
Note: Results are from a survey conducted for this report and are based on 78 responses from 7 countries.

Economists in South Asia agree that the quality of the available employment data makes it difficult to credibly assess the labor market situation in their countries. In a survey conducted for this report, views were sought on the challenges faced when measuring employment. Unsatisfactory coverage of the informal sector and infrequent observations were named as the most important limitations of the available data. More than half of the respondents were also concerned about the timeliness of the data, and 40 percent about the reliability of estimates. On the other hand, most respondents agreed that the key employment data was nationally representative.

A rigorous assessment of the relationship between economic growth and job creation requires comparable employment figures across countries and over time. These figures can be constructed out of primary data from existing population censuses, economic censuses, household surveys and labor force surveys. Since 2001, close to 100 such censuses and surveys have been conducted in the region. Sri Lanka and Pakistan have the most frequent and easily accessible household surveys and labor force surveys. Sri Lanka conducts the Household Income and Expenditure Survey (HIES) every three years and has an annual Labor Force Survey (LFS) which is nationally and quarterly representative. Similarly, Pakistan has been carrying out the Pakistan Social and Living Standards Measurement (PSLM) survey and the Household Integrated Economic Survey on alternate years since 2004-05. And with the exception of a few years, the LFS has been conducted on an annual basis during the time period considered for this report. In India, labor market information is collected by the National Sample Survey (NSS) using a separate employment-unemployment module (Schedule 10) every five years. In the intervening years, basic employment information is gathered together with the household consumer expenditure module. The quinquennial surveys have large samples and are referred to as the 'thick rounds', whereas the intervening surveys are known as the 'thin rounds' because of their relatively smaller sample size. Overall, data is less frequent in India, and the most recent data point is the `thick round' NSS conducted in 2011-12. The annual Periodic Labor Force Survey (PLFS), which was started in 2017, aims to fill this gap by providing frequent and timely labor market data that is nationally and regionally representative.

For this report, comparable employment information was constructed in a transparent and replicable way directly from primary data. The data sources used include population censuses, as well as household surveys and labor force surveys. The focus of the exercise were respondents aged 15 and above, but the results would have been similar if the narrower group aged 15 to 64 had been considered, given that the elderly are only a minor share of the population in South Asia. Each respondent was classified as employed, unemployed or inactive based on standard definitions, matched as closely as possible to the questionnaire of each census or survey.

Employed individuals were further classified based on the nature of their activity. Three breakdowns were considered: by type of job (regular, casual, self-employed and unpaid), by sector of activity (agriculture, manufacturing, construction and services) and by institutional sector (private or public).

The procedure used for the construction of this employment database allows to generate information with relatively high frequency. In many of the surveys used for this report it is possible to attribute individual observations to specific quarters. This is because the month when a

TABLE 3: Since 2001, there are close to one hundred surveys and censuses containing credible employment information.

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Afghanistan			NRVA		NRVA		NRVA				NRVA		ALCS			ALCS	
Bangladesh	Census	LFS			HIES LFS	LFS				HIES LFS	Census		LFS		LFS	HIES	
Bhutan	LFS	LFS	BLSS LFS	LFS	Census	LFS	BLSS		LFS	LFS	LFS	BLSS LFS	LFS	LFS	LFS	LFS	BLSS Census
India	Census	NSS (thin) NSS (thin)	NSS (thin)	NSS (thick) NSS (thin)	NSS (thin)		NSS (thin)		NSS (thick)	LBS	NSS (thick) Census LBS	LBS	LBS		LBS		
Nepal	Census		NLSS					LFS		NLSS	Census						
Pakistan	LFS	PIHS LFS		LFS	PSLM HIES HIES LFS	PSLM HIES LFS	PSLM HIES LFS	PSLM HIES LFS	LFS	PSLM HIES LFS	PSLM HIES LFS	PSLM HIES LFS	PSLM HIES LFS	PSLM HIES LFS	PSLM HIICS LFS		Census
Sri Lanka	Census LFS	HIES LFS	LFS	LFS	HIES LFS	HIES LFS	LFS	LFS	HIES LFS	HIES LFS	Census LFS	HIES LFS	LFS	LFS	LFS	HIES LFS	LFS

Note: ALCS: Afghanistan Living Conditions Survey, LBS: Labor Bureau's Employment Unemployment Survey, HIES: Household Income and Expenditure Survey, HIES (for Pakistan): Household Integrated Economic Survey, HIICS: Household Integrated Income and Consumption Survey, LFS: Labor Force Survey, NRVA: National Risk and Vulnerability Assessment, NSS: National Sample Survey, PIHS: Pakistan Integrated Household Survey, PSLM: Pakistan Social and Living Standards Measurement.
The surveys in green have been used for analyses in this report.

TABLE 4: Employment data is compiled from over 60 surveys.

	Employed			Unemployed	Employment type	Sector	Public/ Private	Total No. survey
	week	month	year/usual					
Afghanistan	2	2	-	3	3	3	-	3
Bangladesh	8	-	-	8	5 (3)	8	8	8
Bhutan	3	-	2	3	2 (1)	3	2	3
India	7	-	9	9	7	7	3	9
Nepal	3	-	2	3	1 (2)	3	1	3
Pakistan	10	12	10	19	17 (2)	19	10	19
Sri Lanka	14	-	4	17	12 (4)	17	16	17

Source: World Bank.
x(y): Information for all categories from x surveys and for some categories from y surveys.
-: No information

FIGURE 35: Employment information is extracted in a fully transparent and replicable way.

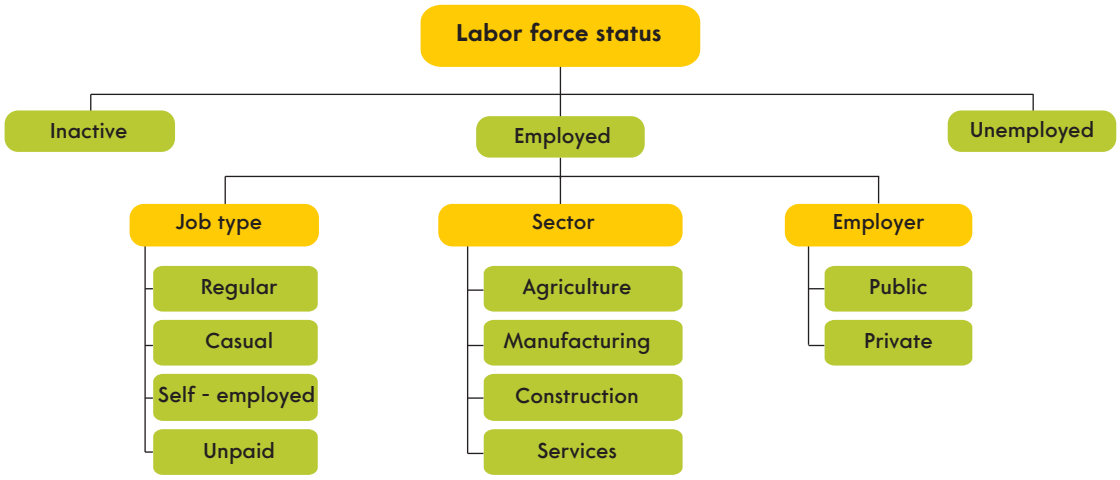
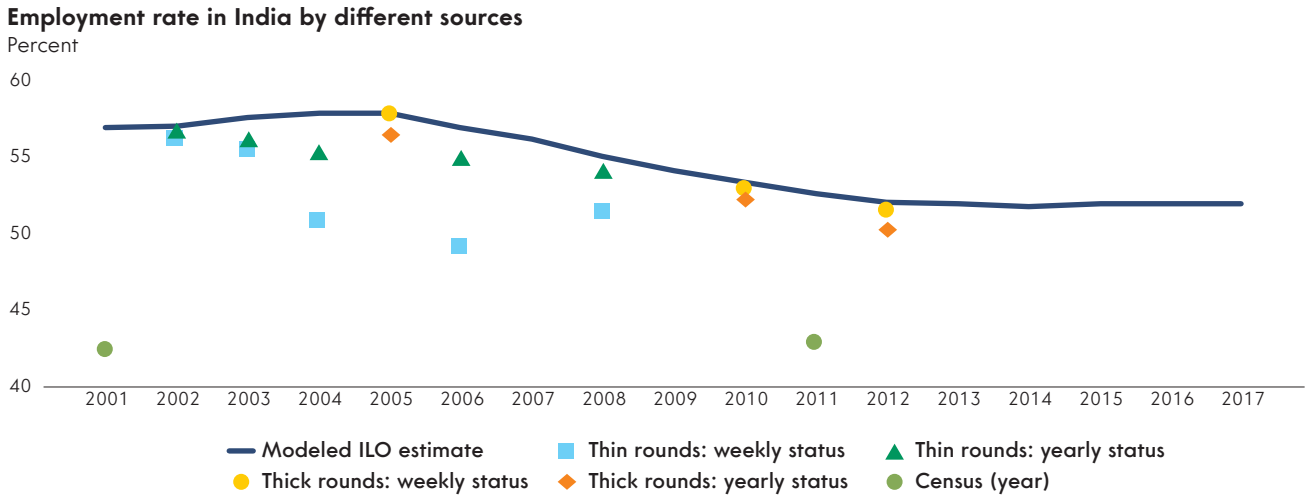


FIGURE 36: How employment is measured matters.



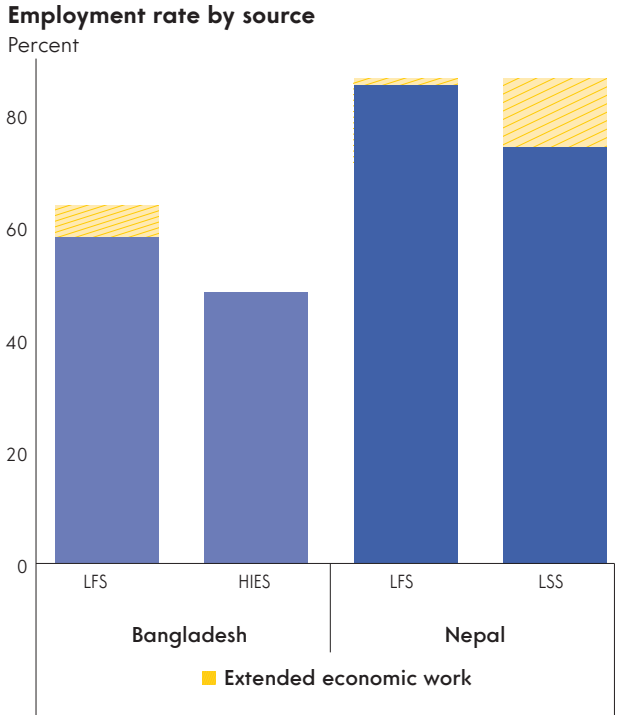
Source: World Bank, NSS, and staff calculations.

respondent was interviewed is recorded in most of the household and labor force surveys. Individual observations can thus be mapped to quarters, allowing to generate quarterly employment data, in addition to annual estimates. However, this approach is only used in the case of surveys in which interviews were spread across space and over time in a relatively even way.

A key difference in the definition of employment across statistical instruments concerns the identification of the main activity of the respondent. For example, in the Bangladesh HIES each respondent lists a number of activities he or she was involved in. Only the activity absorbing the most time is retained here to determine the person's type of job, sector of activity or institutional sector. In the India NSS, a distinction is made between 'usual' status and 'principal' status. Only the former is considered here. And in the Nepal Living Standards Survey (LSS) household activities such as fetching water and collecting firewood and dung, and making mats are counted as work. To ensure comparability with other data sources, such 'extended work' was not considered employment for the purpose of this report.

Another key difference between statistical instruments is the recall period to which the questions refer. For example, the Pakistan LFS uses a recall period of one week when asking respondents whether they are employed, but in the same country the HIES has a recall period of one month. In Sri Lanka, some of the surveys do not specify a recall period at all when inquiring about employment. The India NSS includes a

FIGURE 37: Whether extended economic activity is considered work affects employment rates.



Source: Bangladesh 2015/16 LFS and 2016 HIES; Nepal 2008 LFS and 2011/12 LSS.
Note: Shaded area represents individuals engaging in extended ecnonomic work, including fetching water, collecting firewood and dung, making mats.

weekly status, but it is constructed on the basis of questions about time use successive over-half days. The yearly status, on the other hand, is identified based on a specific question to the respondent.

Because of these differences, comparing employment figures across sources without 'standardizing' them first can be misleading. For example, in India, data from the NSS `thin round' survey of 2005-06 yields an employment rate of 55 percent using the year recall, but of only 49 percent when using the week recall. Similarly, NSS data shows a decline in female labor force participation over time, while population censuses suggest that the female labor force participation rate is stable and instead the female unemployment rate has increased. In this context, relying on published data only is potentially confusing.

The large 'gray' area between work, unemployment and inactivity accounts for much of the difference in employment estimates across sources. For example, in Bangladesh the employment rate for 2016 is 53 percent according to the LFS, but only 44 percent based on the HIES. Removing 'extended work' brings the two rates closer together. In Nepal, the employment rate for 2008 is 78 percent according to the LFS, but 68 percent in the LSS in 2011-12. Part of the gap can again be explained by 'extended work'.

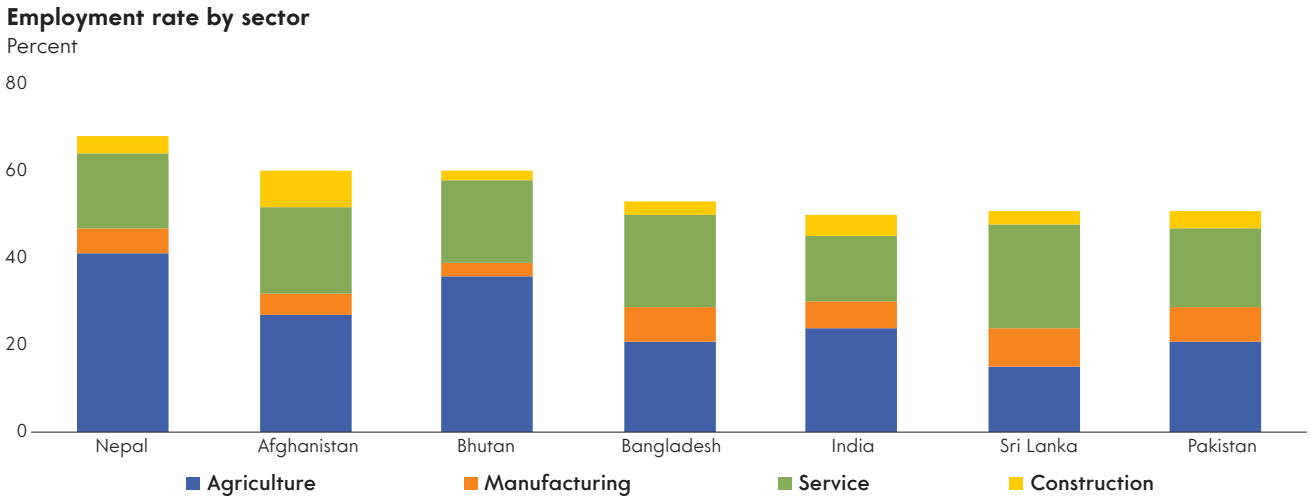
The structure of employment in South Asia

The availability of comparable employment data across South Asia allows to construct meaningful job profiles by country. Starting with the sector of activity, it is clear that agriculture still employs a majority of the working-age population across the region. Agriculture is the main stay for close to 40 percent of the working-age population in both Nepal and Bhutan. In Afghanistan and India, it accounts for around half of all jobs and provides employment to almost a quarter of the working-age population. The second most important source of jobs is the services sector. Sri Lanka is the only country in the region where the services sector employs more people than agriculture. In Bangladesh, 21 percent of those at work are employed in the services sector, making it as important as agriculture. On the other hand, the share of the manufacturing sector is relatively low across all countries in the region ranging from 3 percent of employment in Bhutan to 9 percent in Sri Lanka.

Regular wage employment, regardless of whether it is formal or informal, is uncommon in South Asia. Regular wage employment does not necessarily mean a nine-to-five job, with a written contract and benefits attached. It simply means that there is a stable and predictable employment-employee relationship, and that the worker can expect to still have the job the following month. But even with this stripped-down definition, across South Asia only around one-tenth of the working-age population has a regular wage job. The share is higher in Bhutan, but it only reaches 16 percent. Even casual wage work is relatively uncommon in the region. The corresponding share of the working-age population is highest in India and Sri Lanka, and lowest in Bhutan. As for other workers, it is not always possible to distinguish the self-employed from unpaid family workers, but the combination of these two types of jobs accounts for the majority of employment in the region, with the exception of Sri Lanka. Among the countries for which a breakdown is possible, unpaid family workers account for a quarter of the working-age population in Bhutan, a fifth in Afghanistan, and around one-tenth in India and Pakistan.

A significant share of regular wage employment is accounted for by the public sector. Because of data constraints, the public-versus-private breakdown cannot be computed for all countries. When the information is available, public sector jobs represent less than one-tenth of total employment. The exception is Sri Lanka where the share attains 15 percent; Bangladesh is at the other extreme, with only 3 percent. However more than half of the regular wage jobs in Sri Lanka are in the public sector. The share is also high in India and Pakistan, where public sector jobs constitute around 35 percent of regular wage jobs. Only Bangladesh has a relatively low share of regular wage jobs in the public sector, at around 15 percent.

FIGURE 38: Agriculture and services employ the most people.

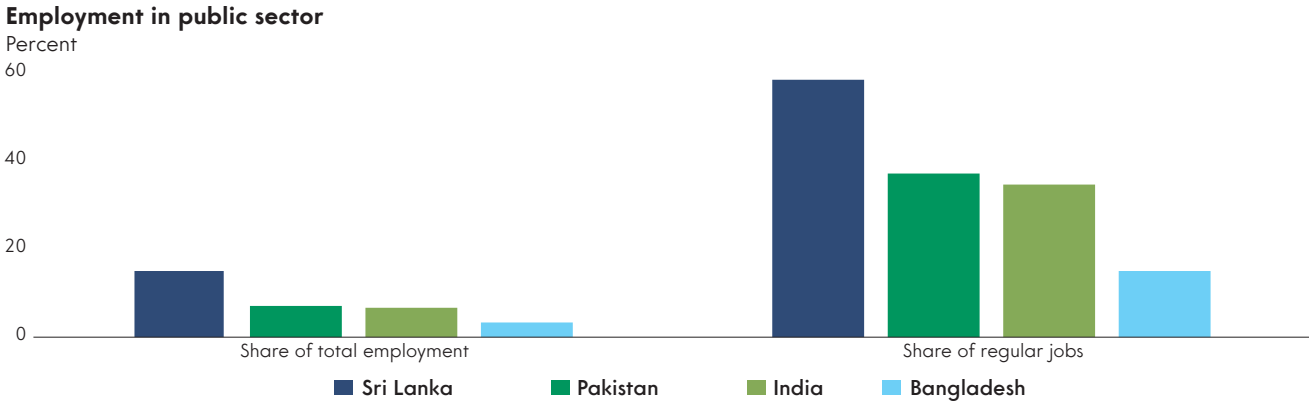


Source: Afghanistan 2013/14 ALCS; Bangladesh 2015/16 LFS; Bhutan 2012 LSS; India 2011/12 NSS-Thick; Nepal 2011/12 LSS; Pakistan 2014/15 LFS; Sri Lanka 2015 LFS.

FIGURE 39: Regular employment is the exception.

Source: Afghanistan 2013/14 ALCS; Bangladesh 2015/16 LFS; Bhutan 2012 LSS; India 2011/12 NSS-Thick; Nepal 2011/12 LSS; Pakistan 2014/15 LFS; Sri Lanka 2015 LFS.
Note: The survey design of Nepal 2011/12 LSS did not allow us to identify unpaid family workers. Therefore, this group of people are very likely to be mixed with self-employed workers.

FIGURE 40: In Sri Lanka, public employment is relatively high.



Source: Bangladesh 2015/16 LFS; India 2011/12 NSS-Thick; Pakistan 2014/15 LFS; Sri Lanka 2015 LFS.

Box 1 A simple analytical framework

Macroeconomists and economists working on development look at the relationship between economic growth and employment in very different ways. But their perspectives are complementary and can be easily integrated in a simple framework. By doing so it is possible to bring together the short- and long-term effects of economic growth on employment.

For economists working on development, the relationship between employment rates and income per capita can be represented in the form of a U-shaped curve. Countries in South Asia are all located on the left-hand side portion of that curve, where increases in income per capita are associated with declines in participation rates. Taking a linear approximation for tractability, the downward-sloping portion of the U-shaped curve can be represented as:

$$E_t^* = \alpha + \beta \frac{Y_t}{N_t}$$

where E_t^* is the equilibrium employment rate, Y_t is total output, N_t is population and parameter β approximates the slope of the U-shaped curve around Y_t. Parameter β can be expected to be negative for countries at South Asia's development level.

For macroeconomists, short-term accelerations in economic growth boost labor demand. In advanced economies the relationship is usually posited as involving the unemployment rate, but this is not a very informative indicator in developing countries, where many of the people at work are farmers or self-employed. However, for a stable labor force participation rate, the relationship considered by macroeconomist can be re-written as:

$$(E_t - E_t^*) = \gamma + \delta \frac{\Delta Y_t}{Y_t}$$

where E_t is the employment rate observed in the short-term, and parameter δ captures the responsiveness of employment to economic growth. Parameter δ can be expected to be positive.

Combining the short- and long-term relationships into a single equation yields:

$$E_t = (\alpha + \gamma) + \beta \frac{Y_t}{N_t} + \delta \frac{\Delta Y_t}{Y_t}$$

The relative scarcity of comparable employment data in South Asia makes it difficult to estimate this equation directly. However, keeping the conceptual distinction between short- and long-term employment effects of growth, it is possible to combine different methodological approaches and estimate these effects separately.

The short-term employment response to growth

The short-term response of employment to growth can be assessed based on quarterly employment and GDP data. Some statistical instruments, such as the Sri Lanka LFS, are explicitly designed to generate quarterly data. For other statistical instruments, the month of the interview can be relied upon to disaggregate annual data by quarters. This approach can be used for Bangladesh, India and Pakistan. Combining genuine quarterly employment data with constructed breakdowns by quarter, 123 observations on quarterly changes in employment can be generated from the over 60 surveys processed for this report. As for GDP data, both India and Sri Lanka publish quarterly series, whereas Bangladesh and Pakistan do not. For the latter two countries, annual GDP can be interpolated with quarterly industrial production imposing the constraint that the interpolated series add up to the annual GDP totals (this is the so-called Denton method).

Despite the fact that both the quarterly employment data and the quarterly GDP series are 'noisy', a positive correlation between them emerges. The strength of the correlation varies depending on whether the GDP series are seasonally adjusted or not, and also depending on the employment aggregate considered. The correlation coefficients are often statistically significant in the case of South Asia. They also have an intuitive interpretation: depending on whether seasonally adjusted GDP series are considered or not, faster economic growth leads to either more jobs in the aggregate, or to a reallocation of jobs away from self-employment. The significance of the

TABLE 5: Quarterly changes in employment rates are correlated with quarterly GDP growth.

	Observations	Quarterly GDP	Between non-seasonally adjusted GDP and			Between seasonally adjusted GDP and		
			total employment	non-self employment	self employment	total employment	non-self employment	self employment
South Asia	123	Interpolated and National Accounts	-0.03 0.7206	0.24*** 0.0078	-0.30*** 0.0006	0.16* 0.0794	0.04 0.6353	0.14 0.1302
India	18	National Accounts	-0.30 0.2224	-0.26 0.301	-0.06 0.8191	-0.11 0.6637	0.04 0.8726	-0.25 0.326
Pakistan	65	Interpolated	-0.06 0.6364	0.27** 0.0305	-0.37*** 0.0021	0.15 0.2299	-0.01 0.9073	0.18 0.1451
Sri Lanka	30	National Accounts	0.32* 0.0821	0.33* 0.0733	-0.01 0.9597	0.15 0.4186	0.29 0.1176	-0.2 0.3017
Bangladesh	10	Interpolated	0.37 0.2879	0.56* 0.0946	0.07 0.851	0.37 0.287	0.56* 0.0915	0.07 0.8573

Note: *** p<0.01, ** p<0.05, * p<0.10

coefficients also varies by countries, and is weakest in India's case. But significance levels are bound to be underestimated, given the significant measurement error in the series.

The conclusions are similar if a regression analysis is conducted, instead of computing correlation coefficients. The key parameter in the regression analysis indicates by how much the employment rate changes for one percentage point of growth. For South Asia as a whole, the largest coefficient is found when changes in total employment are regressed on seasonally-adjusted GDP growth rates. Then, for each percentage point in GDP growth, the employment rate increases by a little more than 0.1 percentage points, a result that is statistically significant at the 10 percent level. This value is lower than the one usually found in advanced economies, but this could be expected for two reasons. First, in developing countries downturns lead to more under-employment rather than to open unemployment. And second, the data is 'noisier' in developing countries, which results in an attenuation of the key coefficient and a lower significance of the regression compared to advanced economies.

The overall impact of growth on employment

More distant points in time need to be considered in order to assess how much employment is created overall per percentage point of growth. A four-step procedure is followed in this respect. First, employment rates are computed from every 'standardized' population census, household survey or labor force survey. Second, the estimated employment rates are applied to consistent demographic estimates of the working-age population. The advantage of using demographic series is that they are comparable over time. Estimates of the working-age population generated out of household surveys and labor force surveys show more erratic movements by comparison. Third, annual changes in employment are computed for all pairs of employment points available for each country. And fourth all the annual changes in employment are divided by the annual percentage change in GDP over the corresponding period.

This four-step procedure is bound to lump together the short- and the long-term impacts of growth on employment. Given the many pairs of employment points, the procedure generates an array of estimates of the number of jobs created per percentage point of GDP growth, rather than a single number. Overall, 136 of these estimates can be computed for South Asia as a whole, with the maximum number of data points (70) being for Sri Lanka, and the lowest (6) for Bangladesh. However, the dispersion of the estimates by countries is not too high, as can be seen by comparing the 25th and 75th percentiles in the distribution. For example, it appears that Bangladesh has created between 90 and 120 thousand jobs per percentage point of GDP growth, and Pakistan between 310 and 410 thousand. However, from a longer-term perspective, the focus should be on the more distant pair of employment points available for each country. By this metric, Bangladesh generates 110 thousand jobs per percentage point of GDP growth, India 750 thousand, Pakistan 200 thousand, and Sri Lanka 9 thousand.

These multiple estimates can be summarized under the form of an 'elasticity', or percentage change in employment per percentage point of GDP growth. Depending on whether the mean of the median of the distribution of estimates is considered, the elasticity of employment to GDP varies between 0.2 and 0.3. Remarkably, this finding is very much in line with the expectations of members of the South Asia Economic Policy Network. In the survey conducted for this report, most respondents said that they expected one

Box 2 Okun's Law in South Asia

The short-term relationship between economic growth and jobs is often interpreted in connection with Okun's Law, which posits that when growth accelerates above potential the unemployment rate falls below its 'natural' level. The intuition is straightforward: if growth accelerates, the demand for labor increases and, given that the labor force is stable in the short term, the unemployment rate must decline. This empirical regularity was first identified by Arthur Melvin Okun in the early 1960s for the US (Okun, 1962). Okun's Law is central to modern macroeconomic analysis and is a key tool for policymaking (Ball et al. 2017).

So far, most of the empirical research on this relationship has focused on advanced economies. Lee (2000), for example, evaluated the relationship based on postwar data for 16 advanced economies and found that while Okun's law is statistically valid for most countries, the quantitative estimates are far from uniform. Harris and Silverstone (2001) found asymmetries in Okun's Law for seven advanced economies and showed that the relationship between unemployment and output depends on the phase of the business cycle. Gordon (2012) showed that cyclical responses of aggregate hours and of productivity have changed sharply from those predicted by Okun's Law.

One of the few studies available for developing countries concluded that the relationship in these countries was half as strong as in advanced economies, and varied considerably across countries (Ball et al. 2016). The weakness of the relationship in developing countries is not surprising: when people are too poor to afford being idle, unemployment is a poor indicator of the situation in the labor market. And the heterogeneity across countries could be anticipated, given the diverse ways in which employment (and hence unemployment) is measured.

An estimation of Okun's Law for South Asian countries, using readily available data from the International Labour Organization (ILO), confirms the weakness of the relationship. The results are based on a specification in which deviations of growth from its potential are regressed on deviations of employment rates from their trend. The estimated relationship has the expected size and significance in the case of Pakistan and Sri Lanka, where one percentage point of economic growth increases the employment rate by roughly 0.16 percentage points. But the relationship is only half as strong as the one observed in Germany, and a third of that in the US. The relationship estimated for Sri Lanka and Pakistan is also weaker than in other developing countries like Russia, Brazil, or the Philippines.

TABLE 6: Based on published employment data, Okun's Law holds in Pakistan and Sri Lanka.

South Asia		Rest of the world	
Afghanistan	0.021	Germany	0.57***
Bangladesh	0.086	United States	0.72***
Bhutan	0.064	Brazil	0.14***
India	-0.11	Malaysia	0.12
Maldives	0.011	Philippines	0.31***
Nepal	0.045	Russia	0.38***
Pakistan	0.16***	Vietnam	-0.089
Sri Lanka	0.17*	China	-0.035***

Note: The coefficients show the percentage point change in employment rates for one percentage point change in GDP growth. All regressions use annual data based on ILO estimates from 1991 to 2016 and are estimated as deviation from potential or trend (HP Filter). The coefficients in the right panel are from Ball et al. (2016).

References:

Ball, L., Furceri D., Leigh D. and Loungani, P. (2017), Okun's Law: Fit at 50?, Journal of Money, Credit and Banking, 49(7):1413-1441.
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Lee, J. (2000). The robustness of Okun's law: Evidence from OECD countries. Journal of Macroeconomics, 22(2): 331-356.
Harris, R. and Silverstone, B. (2001). Testing for asymmetry in Okun's law: A cross-country comparison. Economics Bulletin, 5(2): 1-13.
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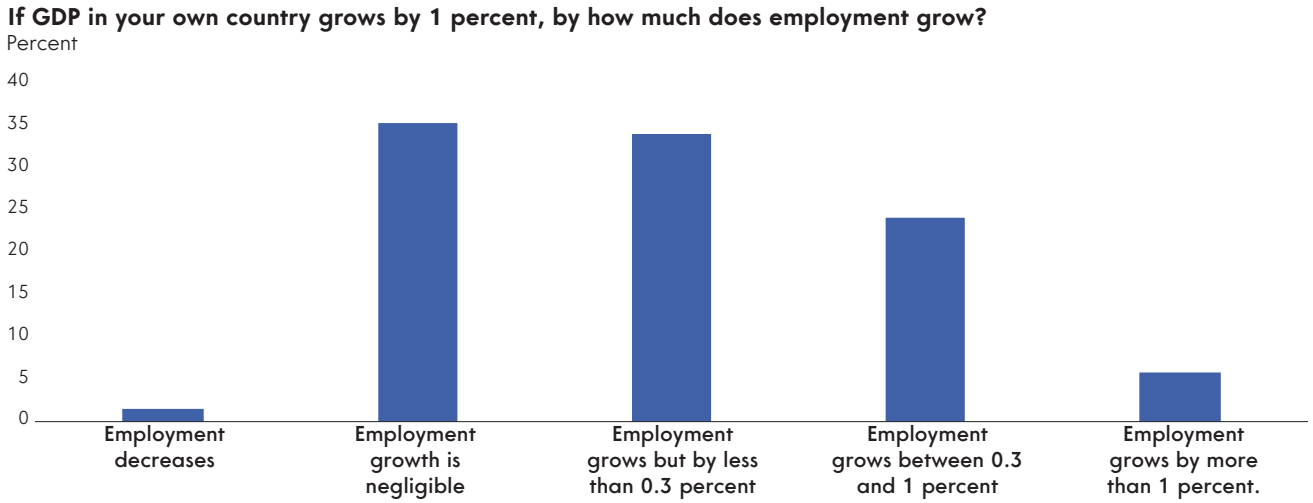
Okun, A. M. (1962). Potential GNP, its measurement and significance. Cowles Foundation, Yale University.

TABLE 7: South Asian countries have created large numbers of jobs.

	South Asia	Bangladesh	India	Pakistan	Sri Lanka
	Elasticity	Jobs created by one percentage point of growth (in thousands)			
25th percentile	0.10	90	400	310	5
Median	0.20	100	540	360	8
75th percentile	0.60	120	730	410	16
Mean	0.34	130	540	360	11
Long-run	0.19	110	750	200	9

Source: All comparable surveys highlighted in Table 2.

FIGURE 41: Results are very much in line with expectations from regional economists.



Source: World Bank South Asia Economic Policy Network.
Note: Results are from a survey conducted for this report and are based on 78 responses from 7 countries.

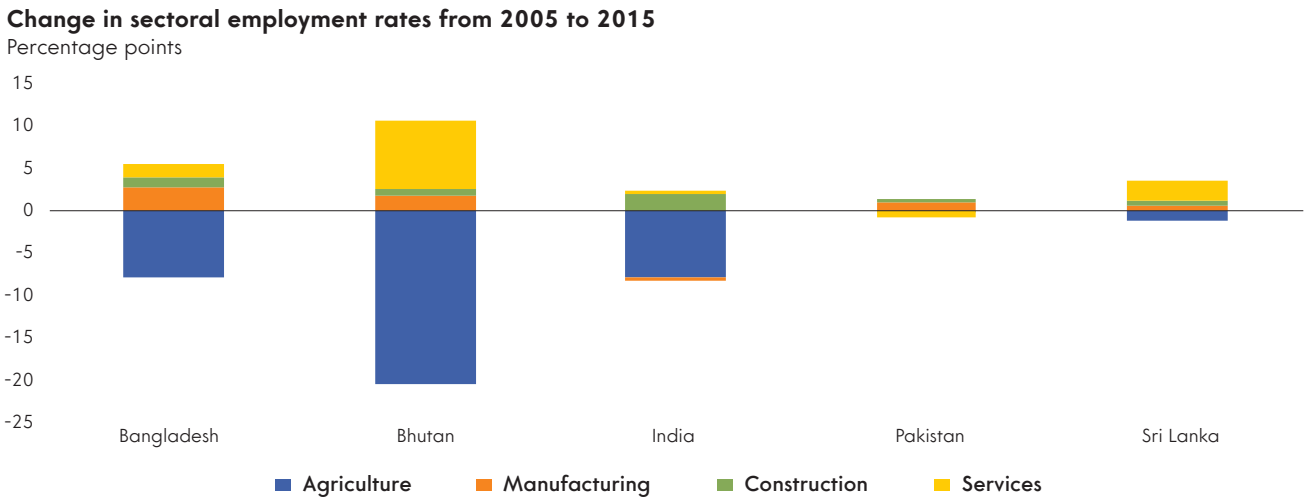
percentage point of growth to translate into less than 0.3 percent increase in employment. More than one third of the respondents actually expected negligible employment growth, and only a quarter foresaw more than 0.3 percent growth in employment per percentage point of growth.

The nature of the jobs created is not encouraging

The 'standardized' employment data generated for this report allows analyzing how economic growth has modified the types of jobs available in South Asia. From a sectoral point of view, it appears that structural transformation has been slow in many countries. As economies develop, it is expected that individuals will move out of agriculture into more productive, non-agricultural employment. Such transformation effectively took place at a rapid pace in Bhutan, where there was a clear shift in employment from agriculture to services. The transformation was slower in Bangladesh and India. The agricultural employment rate decreased by around 5 percentage points in both countries; but while manufacturing employment increased in Bangladesh, it did not in India. In Pakistan, structural changes in employment have been the most muted. Across countries, construction is the only sector that employed a bigger share of the working-age population in 2015 than in 2005. Employment growth in construction has been very large in some countries.

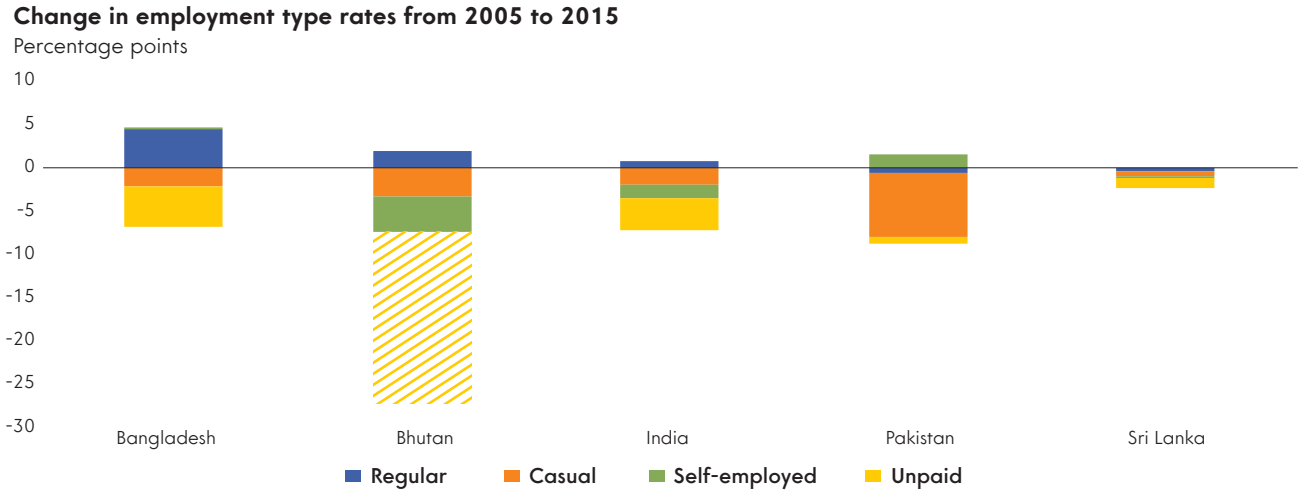
Perhaps more disturbingly, the growth in regular wage employment has been extremely modest across the region. Regular wage jobs are generally seen as better jobs, compared to farming, self-employment or casual work. But the news on this front is not particularly encouraging. No doubt, casual work and unpaid employment declined across the board, but regular wage employment did not increase in a commensurate way. The strongest expansion in regular wage employment in the region was in Bangladesh, where the share of regular wage jobs in the working-age population increased by 4.5 percentage points. Regular wage employment also increased in Bhutan, by 2 percentage points. But in the other countries the share of regular wage employment increased very little.

FIGURE 42: Structural transformation of employment is slow in most countries



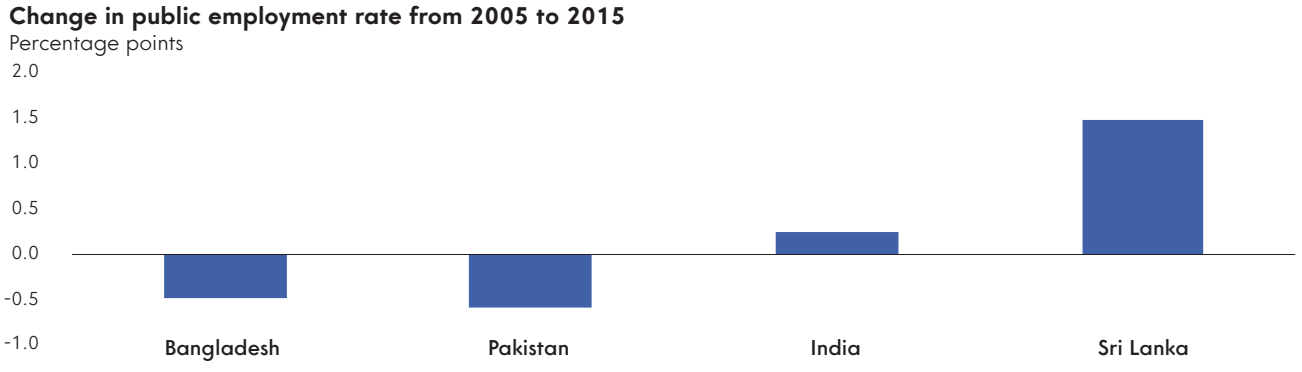
Source: Bangladesh 2005-2015 LFS; Bhutan 2003-2012 LSS; India 2004/05-2011/12 NSS-Thick, Pakistan 2005/06-2014/15 LFS; and Sri Lanka 2006-2016 HIES.

FIGURE 43: Only modest increases in regular employment.



Source: Bangladesh 2005-2015 LFS; Bhutan 2003-2012 LSS; India 2004/05-2011/12 NSS-Thick, Pakistan 2005/06-2014/15 LFS; and Sri Lanka 2006-2015 LFS.
Note: For Bhutan the comparison of unpaid family work between the two surveys is not comparable due to a reframing of the questionnaire.

FIGURE 44: Public employment increased in India and Sri Lanka.



Source: Bangladesh 2005-2015 LFS; Bhutan 2003-2012 LSS; India 2004/05-2011/12 NSS-Thick, Pakistan 2005/06-2014/15 LFS; and Sri Lanka 2006-2016 HIES.

Employment growth is also supposed to be healthier when it is driven by the private sector, but that is not always the case in South Asia. The public sector can create only a limited amount number of jobs, especially in countries where government revenue is modest. In Bangladesh and Pakistan, the share of public sector employment in the working-age population declined by around 0.5 percentage points between 2005 and 2015. In India and Sri Lanka, on the other hand, the share of public sector employment increased during this period. And the increase was substantial in Sri Lanka's case.

Rapid growth alone is not enough

Having established that growth in South Asia is not jobless, the question is how fast does the region need to grow to address its job creation challenge. The answer depends on what the target for the employment rate is. One rather unambitious target would be to accept a gradual decline of the employment rate, as long as the decline is not faster than the U-shaped curve between employment rates and living standards would predict. In this case, the gap between employment rates in South Asia and other countries at a similar level of development would remain constant. A slightly more ambitious target would be to keep employment rates constant at their current levels. An ambitious target could be to catch-up with the employment rates of other countries with similar income levels over a certain period – say, over 20 years.

These three targets for the employment rate – unambitious, status quo, and catch-up – result in three different numbers of jobs 'needed' every year. Once a target employment rate is set, it can be multiplied by the forecast of the working-age population in the following year to obtain the target level of employment. The difference between that target level and the current employment level is the net job creation 'needed'. Setting the target for the employment rate is easy in the constant case, because it simply involves maintaining the current employment rate unchanged. Calculations are slightly more demanding in the unambitious and the catch-up cases, as it becomes necessary to use an estimate of the U-shaped curve. For the unambitious target, the target employment rate is allowed to decline according to the slope of the U-shaped curve; for the catch-up case, the target employment rate is set higher to fill some of the gap with other countries. Proceeding this way, the net number of jobs to be created in the unambitious and the constant case is not too far off the recent experience of South Asian countries, but in the ambitious case the number is much higher than the region's historic record.

High but attainable growth rates would allow to address the jobs challenge in the unambitious and constant cases.

TABLE 8: The annual number of jobs needed depends on the target for employment rate.

	Annual jobs needed (in thousands)		
	Unambitious	Constant	Catch-up
Bangladesh	980	1,100	1,610
India	6,910	8,490	13,480
Pakistan	1,220	1,310	2,140
Sri Lanka	40	65	130

Source: All information contained in Table 1 and Figure 1 plus the longest possible distance between comparable surveys highlighted in Table 2.

If the employment rate is allowed to decrease further, Sri Lanka would only need to grow by 4.6 percent per year, and the other countries between 6 and 9 percent. These growth rates are high, but they have precedents in South Asia's recent history. The growth rate needed to keep employment rates constant would be higher. In Bangladesh, 1.1 million new jobs would be required every year, in Pakistan 1.3 million, and in India over 8 million. The growth rates needed to achieve such remarkable job creation would be between 6 and 11 percent. These growth rates are high and all above current performance. But conceivably they can be attained if there is a concerted effort to boost economic performance.

However, growth alone will not be sufficient for employment rates to catch-up with those of comparable countries. Even allowing for a 20-year transition period for the catch-up, the number of new jobs needed every year would be gigantic. Bangladesh would have to create over 1.6 million jobs every year, Pakistan more than 2 million, and India close to 13 million. Much smaller Sri Lanka would need to create more than 120 thousand new jobs every year. Assuming the same job creation per percentage point of growth as before, growth rates in excess of 10 percent per year would be needed in all countries, and growth rates should reach 15 percent per year in Bangladesh and 18 percent in India. These rates are implausibly high, implying that rapid growth alone will not be enough. If South Asian countries are serious about increasing employment rates, more jobs will need to be created for every percentage point of growth.

Data and economic policy agendas

The results of the analyses above call first of all for a data development agenda. Despite substantial efforts to generate comparable employment numbers, the data used in this report remained 'noisy' and was not frequent enough. Strengthening statistical systems is a priority in South Asia,

Box 3 How much growth is needed?

Each of the three cases considered – unambitious, constant, and catch-up – involves a target employment rate E_{t+1} for the next year. Demographic projections provide a credible estimate of the working-age population in the next year, A_{t+1}. Multiplying the target employment rate by the predicted working-age population yields the net job creation ΔL_t needed to meet the target:

$$\Delta L_t = E_{t+1}A_{t+1} - L_t$$

Meanwhile, the analysis of all pairs of employment estimates available for each country had led to an assessment of the overall effect of growth on employment per country. This assessment can be summarized by the following relationship:

$$\Delta L_t = \mu g_t$$

In this expression g_t is the growth rate of GDP and μ is the net number of jobs created in recent times for every percentage point of economic growth. Therefore, if the target employment rate E_{t+1} is known, the two equations above allow computing the growth rate needed to address the jobs challenge.

Consider the constant case first. In this case the employment rate E_{t+1} of next year is supposed to be the same as this year, namely E_t:

$$E_{t+1}^{constant} = E_t$$

Therefore, the growth rate needed to address the jobs challenge satisfies:

$$g_t^{constant} = \frac{E_t A_{t+1} - L_t}{\mu}$$

The unambitious and the catch-up cases are slightly more complicated to solve, as they both involve using the U-shaped curve that links employment rates with income per capita:

$$E_t^* = \alpha + \beta \frac{Y_t}{N_t}$$

where parameter β approximates the slope of the U-shaped curve around the level of income per capita of the country, Y_t is output and N_t is population.

In the catch-up case the goal is to reduce the gap between the actual employment rate E_t and the employment rate E_t^* that the U-shaped curve would predict. Suppose that the intention is to reduce this gap over T years. The target employment rate is then:

$$E_{t+1}^{catch-up} = \frac{T-1}{T} E_t + \frac{1}{T}\left(\alpha + \beta \frac{Y_t}{N_t}\right)$$

Combining this equation with the first two in the box implies:

$$g_t^{catch-up} = \frac{\left[\frac{T-1}{T} E_t + \frac{1}{T}\left(\alpha + \beta \frac{Y_t}{N_t}\right)\right] A_{t+1} - L_t}{\mu}$$

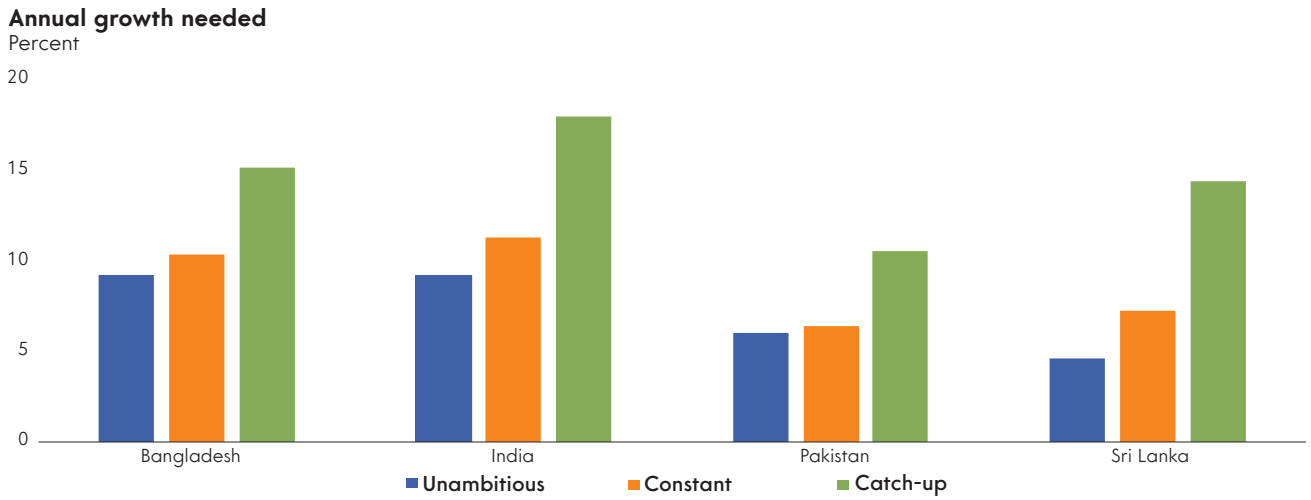
The most laborious calculation arises in the unambitious case. Here, the employment rate is allowed to decline at the speed predicted by the U-shaped curve, which implies:

$$E_{t+1}^{unambitious} = E_t + \beta\left(\frac{Y_{t+1}}{N_{t+1}} - \frac{Y_t}{N_t}\right)$$

where Y_{t+1} is equivalent to $Y_t(1+g_t)$. Again, combining the equation above with the first two equations in the box yields:

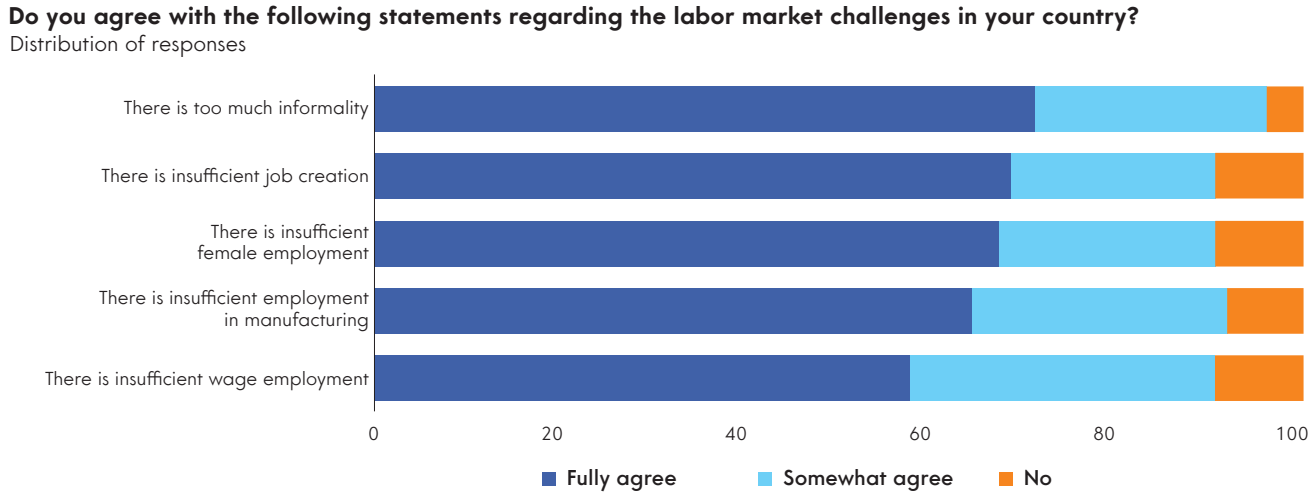
$$g_t^{unambitious} = \frac{(E_t A_{t+1} - L_t) - \beta \frac{Y_t}{N_{t+1}} \frac{\Delta N_t}{N_t} A_{t+1}}{\mu - \beta \frac{Y_t}{N_{t+1}} A_{t+1}}$$

FIGURE 45: High growth alone, will not suffice to reach ambitious employment targets.



Source: All information contained in Table 1 and Figure 1 plus the longest possible distance between comparable surveys highlighted in Table 2.

FIGURE 46: Informality and insufficient wage employment are the main concerns.



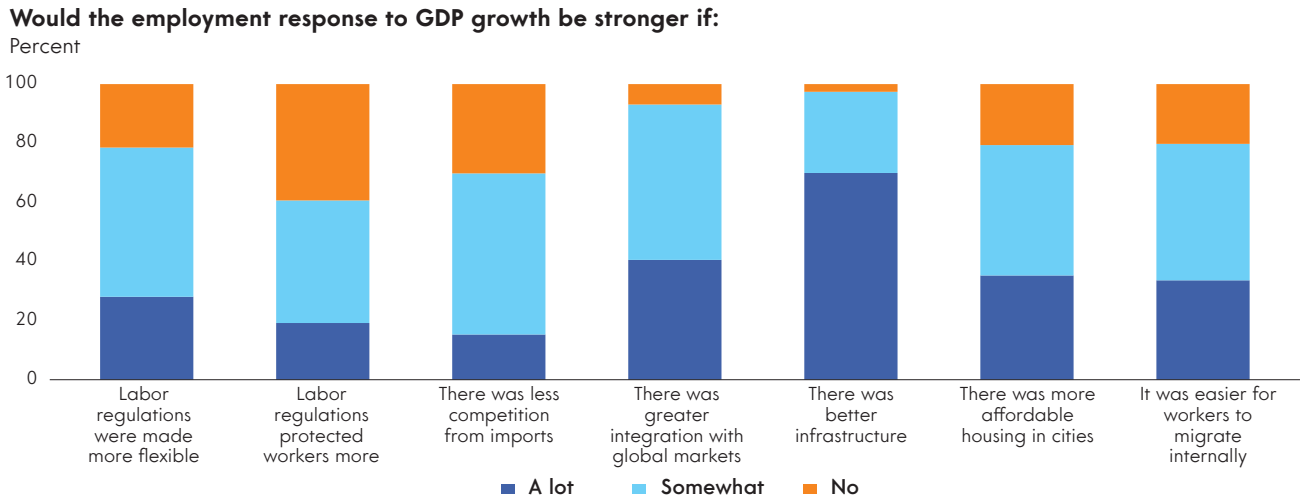
Source: World Bank South Asia Economic Policy Network.
Note: Results are from a survey conducted for this report and are based on 78 responses from 7 countries.

and some of the focus should be on labor market data. Employment definitions and classifications that are better aligned with international practice would help. And, with the exception of Pakistan and Sri Lanka, employment information should be generated more frequently. India's recent initiative in this respect is highly welcome; it can only be hoped that the frequency of data points will increase in other South Asian countries as well.

The results above also imply that the relationship between growth and job creation needs to be strengthened, but what exactly should be done is less clear. Asked about the key employment challenges faced by their countries, the members of the South Asia Economic Policy Network emphasized informality and insufficient job creation. In the survey conducted for this report, multiple challenges were identified. But more than two thirds of the respondents fully agreed that informality and insufficient job creation were serious challenges in their countries, with nearly all other respondents agreeing somewhat with this proposition. Slightly less than two thirds of the respondents agreed that insufficient female employment was a key challenge. About 64 percent thought that insufficient employment in manufacturing was a key challenge and 58 percent saw insufficient wage employment as the main problem.

Better infrastructure and greater integration with global markets are seen as the most promising strategies to

FIGURE 47: Infrastructure and trade are seen as most promising drivers of job creation.



Source: World Bank South Asia Economic Policy Network.
Note: Results are from a survey conducted for this report and are based on 78 responses from 7 countries.

address these challenges. In the survey conducted for this report, labor policy reform was not perceived as a magic wand. Close to a third of the respondents viewed more flexible labor markets as key to improve labor market performance, but in parallel almost a quarter thought that more protection for workers was needed. On the other hand, there was general acceptance that more affordable housing would support job creation, confirming the need for orderly urbanization. And a stunning 70 percent of the respondents said that better infrastructure was key to strenghtening the employment response to growth. This is more than twice the number of respondents who agree with any of the other options proposed, with the exception of a greater integration with global markets, which received the second highest level of endorsement.

The views from the region resonate with the findings of recent analytical work emphasizing the need for more vibrant urban development and a greater export orientation. South Asia is a rapidly urbanizing region, and successful cities have a very important role to play in economic development. Cities are the hubs connecting a country to the rest of the world, and they are also its engines of job creation. But urbanization in South Asia has been messy. Cities are sprawling and congested, service delivery is uneven and trade logistics inefficient. South Asian countries have also been reluctant globalizers. The region is home to many success stories in terms of exports, but it has not tapped the abundance of its labor as a source of competitiveness, in the way East Asia did. A policy focus on better cities and greater global integration could result in both faster economic growth and more bountiful job creation.

Box 4 Views from the region

A one-day workshop on 'Jobless Growth in South Asia?' was jointly organized by the India Statistical Institute and the World Bank to discuss recent research on employment issues by economists from all of South Asia. The workshop took place in New Delhi on March 8, 2018.

The call for papers went to the members of the South Asia Economic Policy Network, launched by the office of the Chief Economist for South Asia at the World Bank in 2017. This Network is a platform to engage more strongly with thinkers and doers across the region. Members of the network are academics at renowned universities, researchers in central banks and think tanks, and staff of policy-making units in government. Short opinion surveys have been conducted among the group for the last few editions of the South Asia Economic Focus report, to gather views on economic developments and challenges in the region. But this was the first time that a regional workshop became an integral part of the preparation of the report.

A central theme of the presentations at the workshop was the pace of job creation and its long-term determinants. Some of the papers focused on structural transformation. Using data from 273 districts over a 25-year period, Subrata Kumar Ritadhi (Reserve Bank of India) and Madhur Gautam (World Bank) showed that agricultural productivity growth has had a positive and significant impact on the share of rural workers employed in the manufacturing sector; this is so for both male and female workers. Also building on a structural approach, Mohammad Akhtaruzzaman and Iftekhar Ahmed Robin (both with Bangladesh Bank) illustrated how sectoral growth patterns are likely to affect job creation and unemployment in Bangladesh toward 2021.

The relationship between productivity growth and job creation was discussed as well. Relying on a growth decomposition for the period 1993-94 to 2011-12 Vinoj Abraham (Center for Development Studies, Trivandrum) conjectured that structural transformation could be a possible explanation for the perceived jobless growth in India. Structural transformation results indeed in higher productivity growth, reducing the labor requirement per unit of output. In a similar spirit, Dipti Ghosh (Jadavpur University) and Chandana Ghosh (India Statistical Institute Kolkata) used a small macro model to show how labor-saving technological progress and managerial changes can slow down employment growth. And Izza Aftab and Umair Mazher (both with Information Technology University, Lahore) showed that between 2010 and 2014, Pakistani districts characterized by higher assets-related income had lower employment levels.

Other papers focused on short-term employment dynamics. Poongothai Venuganan and Chandranath Amarasekara (both with the Central Bank of Sri Lanka) assessed whether Okun's Law holds in Sri Lanka. They found that the relationship between growth and unemployment is weak overall, but has strengthened over time. Debjyoti Majumdar (Indian Institute of Management Indore) and Chetan Ghate (India Statistical Institute Delhi) discussed how macroeconomic policy can have adverse employment effects. Using a model with job search and matching, they showed that employment targeting by the authorities can result in higher unemployment and increase the size of the informal sector.

The employment consequences of foreign trade featured prominently in the discussion. Christian Viegelahn (International Labour Organization) provided evidence that differences in the workforce size between trading and non-trading firms are larger in South Asia than elsewhere. In addition, South Asian trading firms tend to have a more educated workforce than their non-trading counterparts. Biswajit Nag and Saloni Khurana (both with India Institute of Foreign Trade, Delhi) found that between 2008-09 and 2013-14, employment growth in exporting industries was higher than in the manufacturing sector as a whole. And Soumyatanu Mukherjee (Indian Institute of Management Kozhikode) used a general equilibrium model allowing for different transmission channels to analyze the effect of trade liberalization on net job creation and wages.

Last but not least, several of the papers focused on employment informality. P.P. Krishnapriya (India Statistical Institute Delhi) and Radhicka Kapoor (Indian Council for Research on International Economic Relations, Delhi) reported evidence of increasing employment informality among formal firms in India's manufacturing sector. Using enterprise level data between 2000-01 and 2013-14, they found that the largest increases in employment informality were among large and capital-intensive firms. But they also found that the wage differential between regular and contract workers has narrowed over time. This informalization process was also highlighted in a study along similar lines by Rubina Verma (Georgetown University) and Rahul Giri (International Monetary Fund).

PHOTO: World Bank

South Asia country briefs

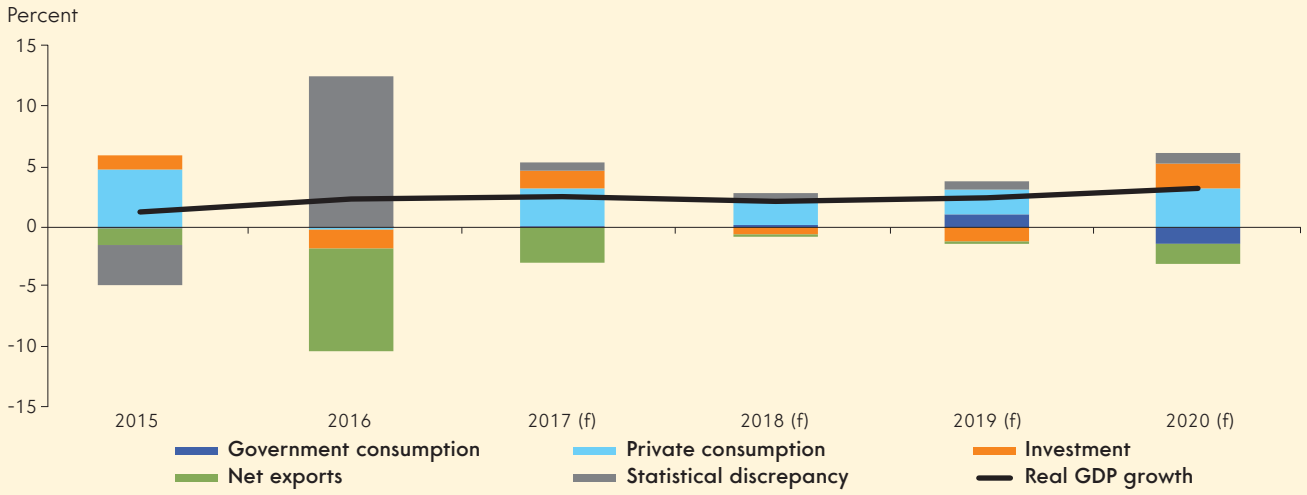
Afghanistan

The political and security context continues to shape Afghanistan's socio-economic outcomes. Forthcoming elections are expected to depress economic activity in the short term. Deficient rainfall in the ongoing wet season along with unprecedented levels of conflict-induced displacement will likely exacerbate the deterioration in welfare since the 2014 security transition. Business sentiment remains suppressed but recovered modestly in 2017. Stronger revenue performance and ongoing expenditure management reforms have improved the fiscal position over the past two years.

	2017
Population, million	35.4
GDP, current US$ billion	20.5
GDP per capita, current US$	580

Source: World Bank WDI.
Note: GDP (2017) is estimate.

Contributions to real GDP growth



Source: Central Statistics Organization and World Bank staff estimates.
Note: (f) = forecast.

Recent economic developments

Afghanistan continues to face significant challenges to its economic and social development. Civilian casualties in the ongoing conflict reached the highest levels since 2002. In 2017, internal displacement was at unprecedented levels - more than 1.7 million Afghans or 5 percent of the total population is internally displaced due to conflict. The situation is further exacerbated by an influx of more than 2 million returning refugees since 2015 due to push factors from neighboring countries.

Growth is projected to have reached 2.6 percent in 2017, only slightly higher than 2.2 percent in 2016. Worsening security, fluid political situation, and a looming humanitarian crisis driven by internal displacement, refugee repatriation and food security concerns, feed into each other in a vicious cycle. The fragile security situation reduces the appropriability of gains from economic activity, increases uncertainty and elevates the cost of doing business. On the supply side, agricultural output remained largely unchanged in 2017, and economic growth was mostly driven by services. On the demand side, a lack of economic opportunities has depressed incomes thereby reducing private consumption from close to 75 percent of GDP in 2015 to less than 74 percent in 2016.

Meanwhile, the United Nations Office on Drugs and Crime estimates that the poppy production almost

doubled to 9000 tons in 2017 and the area under poppy cultivation increased to 328 thousand hectares – over 63 percent growth since last year and the highest ever recorded. This increase was due to the absence of diseases that impacted the 2016 crop, reduced government control in some opium-growing areas, and increased uptake of fertilizers, and pesticides by opium farmers. Overall it reflects weakening rule of law, lack of other economically viable agriculture or employment opportunities, and limited access to finance and markets. Population growth continues to outstrip economic growth, with adverse welfare and poverty implications. GDP per capita has dropped from USD 691 in 2012 to USD 572 in 2016.

Average inflation in 2017 reached 5 percent, slightly above 4.4 percent in 2016, driven by higher food prices and depreciation during the early period of the year. After peaking at 7.5 percent in June, inflation slowed steadily to 3.1 percent in December as the exchange rate stabilized.

Official exports declined by 3 percent while official imports increased by around 15 percent (y-o-y) in the first half of 2017. The annual trade deficit is projected at around 33 percent of GDP, and has been largely financed by foreign aid inflows. Gross foreign exchange reserves remained at comfortable levels – USD 7.7 billion as of August 2017, more than 7 percent higher than in end-2016, and equivalent to more than 10 months of imports.

The fiscal position remains nearly balanced, with donor grants being disbursed as planned and domestic revenues surpassing targeted levels for the third consecutive year. Domestic revenues (excluding one-off revenues) reached Afs 166.7 billion in 2017 (18 percent increase y-o-y), equal to 11.4 percent of GDP, up from 10.5 percent of GDP in 2016. Expenditures moderated marginally in real terms, remaining close to previous year's nominal level.

Outlook

Projected growth has been revised downwards to 2.2 percent in 2018, reflecting expected contraction in agricultural output. Precipitation in the wet season (October to May) is expected to be around 25 percent lower than historical averages. This combined with higher average winter temperatures will adversely impact snow accumulation – critical for water supply to agriculture. Expected contraction in agriculture will likely further weigh on the poverty situation. Despite its declining GDP contribution in recent years, agriculture remains an important source of livelihoods for the rural poor, while supplying low-cost basic food items and inputs to manufacturing. Slow agriculture growth threatens welfare and food security, compounded by widespread insecurity, demographic pressures, a low human capital base, and the lack of productive employment. Industry and services are expected to grow at 3.0 percent and 3.2 percent respectively, driven by slightly improved investor confidence. Inflation is expected to remain close to the 2017 level, assuming a continued current account surplus with stable donor aid flows and subdued domestic demand.

The current account surplus is projected to gradually narrow from 4.1 percent of GDP in 2017 to around 1 percent of GDP by 2020, driven by a gradual decline in foreign aid inflows.

Domestic revenue growth is expected to moderate in 2018, as recent revenue reform efforts encounter diminishing returns. The fiscal account is expected to stay close to balance, on account of donor grants reaching budgeted levels and improved expenditure management. The 2018 budget was set based on actual expenditures in previous years to address the recent pattern of over-budgeting and under-execution.

Risks and challenges

In the short-term, Afghanistan faces continued slowdown, likely to be exacerbated by low rainfall and the potential disruption from upcoming elections, with continuing negative impacts on poverty and welfare. Declining per capita incomes, internal displacement, and the influx of refugee returnees is putting huge pressure on urban areas in particular. Lack of livelihood opportunities, land, shelter, and access to basic services could exacerbate pre-existing risks of conflict.

Fiscal space is limited. An important short-term priority is to maximize the impact of public expenditure, including through: i) improving budget execution and the overall efficiency of public expenditure; ii) reorienting expenditure towards sectors that directly stimulate domestic demand, including labor-intensive and community-based schemes; and iii) moving an increased share of aid on-budget, to maximize alignment with government priorities and local economic impacts. Boosting private sector confidence through continued implementation of planned reforms is also vital.

Over the longer-term, Afghanistan faces interlinked growth, fiscal, and poverty challenges. New sources of growth are needed to generate revenues, foreign exchange, and jobs. Agriculture, extractive industries, and regional connectivity offer strong growth prospects but rely on tight

	2015	2016	2017 (est)	2018 (f)	2019 (f)	2020 (f)
Real GDP Growth, at Constant Market Prices	1.3	2.4	2.6	2.2	2.5	3.3
Private Consumption	6.8	-0.2	4.2	2.9	2.7	4.4
Government Consumption	-0.5	0.3	1.5	1.9	10.2	-11.2
Gross Fixed Capital Investment	4.8	-6.0	6.3	-2.1	-4.7	9.2
Exports, Goods and Services	2.4	-0.3	7.0	8.0	8.0	8.0
Imports, Goods and Services	4.6	25.8	8.0	1.5	1.5	5.0
Real GDP Growth, at Constant Factor Prices	1.0	2.1	2.6	2.2	2.5	3.3
Agriculture	-5.7	6.0	1.4	-3.6	2.5	2.5
Industry	4.2	-0.8	1.8	3.0	1.5	2.5
Services	1.9	2.2	3.4	3.8	3.0	3.9
Inflation (Consumer Price Index)	-0.7	4.4	5.0	5.0	5.0	5.0
Current Account Balance (percent of GDP)	4.6	4.2	4.1	2.3	1.9	1.1
Financial and Capital Account (percent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0
Net Foreign Direct Investment (percent of GDP)	0.8	0.3	0.2	0.1	0.1	0.1
Fiscal Balance (percent of GDP)	-1.2	-0.2	-1.7	0.2	-1.3	0.0
Debt (percent of GDP)	9.1	6.5	5.7	5.8	6.6	5.4
Primary Balance (percent of GDP)	-1.2	-0.1	-1.7	0.3	-1.3	0.0

Source: World Bank.
Note: (est) = estimate, (f) = forecast.

prioritization of available fiscal resources and sound public investment management processes. Given Afghanistan's continued aid dependence (domestic revenues covered only around 47 percent of total expenditures in 2017), delays or shortfalls in the disbursement of pledged aid would immediately strain the fiscal position, undermine mobilization of new sources of growth, and forestall progress towards self-sufficiency, growth, and poverty-reduction.

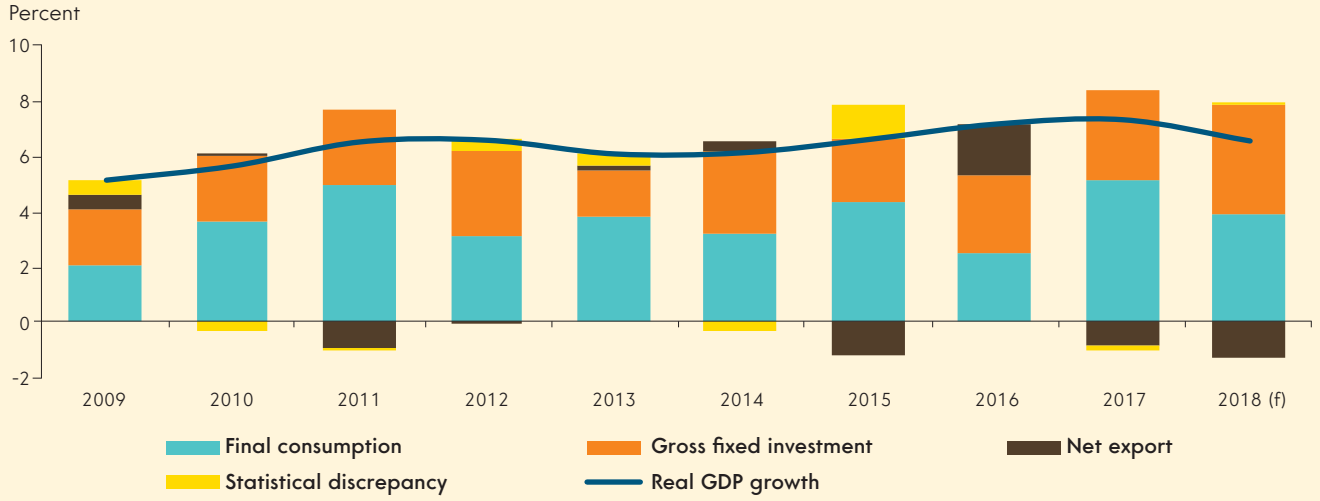
Bangladesh

Industrial and services growth remained resilient, but financial sector vulnerability increased. Notwithstanding a recovery in exports and remittances, the external current account deficit swelled in the first half of FY18, driven by a surge in imports. Fiscal outturns remained below budget targets and monetary policy has been accommodative. Growth is projected at 6.5 percent while macro stability may be challenged in FY19. Downside risks pertain to solvency of banks and the run up to elections elevating instability and policy uncertainty.

	2017
Population, million	164.9
GDP, current US$ billion	249.7
GDP per capita, current US$	1515

Source: World Bank WDI.

Contributions to real GDP growth



Source: Bangladesh Bureau of Statistics (BBS) and World Bank staff estimates.
Note: (f) = forecast.

Recent economic developments

Officially reported output growth rose to 7.3 percent in FY17, up from 7.1 percent in the preceding fiscal year, driven by both services and manufacturing. On the demand side, private consumption and investment contributed, while weak exports and strong imports dragged growth. Private investment stagnated as a percentage of GDP. Official growth figures are almost exclusively based on production statistics, which are often not very reliable. While incomes are certainly increasing, they may not do so as rapidly as one would infer from the official growth statistics.

With 5.4 percent, inflation in FY17 was at its lowest level in five years, but it increased to 5.8 percent in the first half of FY18. Monetary growth has been restrained below nominal GDP growth, but supply shocks have accelerated food inflation from 6 percent in FY17 to 7.1 percent in the first half of FY18. A liquidity crunch in the banking system has put upward pressure on deposit and lending rates. Non-performing loans remain a major concern for financial stability.

The sum of current and capital account turned into a USD 422 million deficit in July-December 2017, compared with over USD 2 billion surplus during the same period in 2016. This was driven by an increase in the current account deficit from USD 1.5 billion in FY17 to USD 4.7 billion in the first half of FY18, primarily due to surge in imports. Consequently, the nominal taka-US dollar rate

has tended to depreciate. Bangladesh Bank's intervention to smoothen the exchange rate adjustment eroded foreign exchange reserves by more than USD 1.5 billion in the first eight months of FY18.

Fiscal outturn in the first half of FY18 differed markedly from the original budget. A large underperformance in spending offset a revenue shortfall, thus containing the deficit. Public debt increased modestly to 32.1 percent of GDP. However, excessive reliance on relatively more expensive nonbank sources of domestic financing has continued.

Outlook

Growth is projected to remain resilient. Output growth in FY18 is expected to be around 6.5 percent, driven by industry and services. Exports will grow faster than last year, in which exports grew 7.1 percent driven by garments, benefitting from a recovery in global trade. Remittances grew by 12.5 percent, driven by increases from the UK, US and GCC countries, in the first half of FY18 and the turnaround in remittances will continue as GCC economies benefit from higher oil prices and incentives for remitting through informal channels weaken. Investment will maintain a growth of 8 to 9 percent.

Inflation is projected to increase as global commodity prices pick up. A possible overheating of the economy driven by an expansionary fiscal policy and election induced rise in private expenditures, may add to inflationary pressures. Monetary accommodation will continue. Growing import payments are expected to keep the current account in deficit, which is manageable with a flexible exchange rate. A large shortfall in revenue due to the jettisoning of the implementation of the new VAT law and additional pressures on expenditures due to food imports, expanded export subsidies, bank recapitalization exceeding the budgetary provisions, or the Rohingya crisis could lead to overshooting the 5 percent of GDP deficit target.

Risks and challenges

The downside risks to the outlook include a revival of political unrest in the run-up to the elections, the recovery of exports and remittances running out of steam, and a failure to improve corporate governance in the banking system. A surge in private credit growth could deepen the banking sector's problems related to non-performing loans. The quasi-fiscal deficit could rise should state owned enterprises experience large losses. Export demand and remittances could surprise on the upside due to stronger demand from North America, Europe or the GCC economies.

Sustaining the development progress requires not just high growth, but also that the growth delivers income gains for poor or near-poor households. Increasing job-oriented growth by accelerating the reform momentum, while avoiding reversal of reforms (for example, Banking Companies Act, VAT Law), is a key near-term challenge. Taking advantage of the prevailing but fading tailwinds (low international commodity prices, comfortable foreign exchange reserves) could help build greater economic resilience. This means focusing policy on regulatory reforms, better infrastructure management, and skill development to raise the economy's jobs oriented growth potential.

Exchange rate flexibility can mitigate external risks. The Bangladesh economy will remain exposed to global uncertainties and external shocks and the Bangladesh Bank must maintain sufficient foreign exchange reserves. Weaker than projected remittances growth and export demand, commodity price spikes, and large lumpy imports could reduce coverage considerably. The Bangladesh Bank should allow the level of the nominal exchange rate to adjust as needed to preserve reserve buffers.

Getting close to the overambitious FY18 revenue targets will require harnessing efficiency gains from ensuring compliance improvements, streamlining tobacco taxes, and rationalizing tax incentives. Expenditure saving can be harnessed by reducing low priority expenditures in the recurrent and capital budget.

	2015	2016	2017	2018 (f)	2019 (f)	2020 (f)
Real GDP Growth, at Constant Market Prices	6.6	7.1	7.3	6.5	6.7	7.0
Private Consumption	5.8	3.0	7.4	5.5	5.5	5.6
Government Consumption	8.8	8.4	7.8	8.0	8.4	8.8
Gross Fixed Capital Investment	7.1	8.9	10.1	11.9	10.5	10.2
Exports, Goods and Services	-2.8	2.2	-2.3	7.5	7.2	7.2
Imports, Goods and Services	3.2	-7.1	2.9	14.0	10.5	9.0
Real GDP Growth, at Constant Factor Prices	6.5	7.2	7.2	6.5	6.7	7.0
Agriculture	3.3	2.8	3.0	3.3	3.1	3.1
Industry	9.7	11.1	10.2	9.4	9.5	9.6
Services	5.8	6.2	6.7	5.7	5.9	6.3
Inflation (Consumer Price Index)	6.4	5.9	5.4	5.9	6.2	6.2
Current Account Balance (percent of GDP)	1.5	1.9	-0.6	-2.8	-2.3	-0.9
Financial and Capital Account (percent of GDP)	1.2	0.7	1.8	2.8	1.6	1.1
Net Foreign Direct Investment (percent of GDP)	0.9	0.6	0.7	0.9	1.0	0.9
Fiscal Balance (percent of GDP)	-3.9	-3.8	-5.0	-5.4	-5.1	-5.1
Debt (percent of GDP)	31.5	31.2	32.1	35.1	37.1	39.0
Primary Balance (percent of GDP)	-2.1	-1.9	-3.2	-3.5	-2.9	-2.6

Source: World Bank.
Note: (f) = forecast.

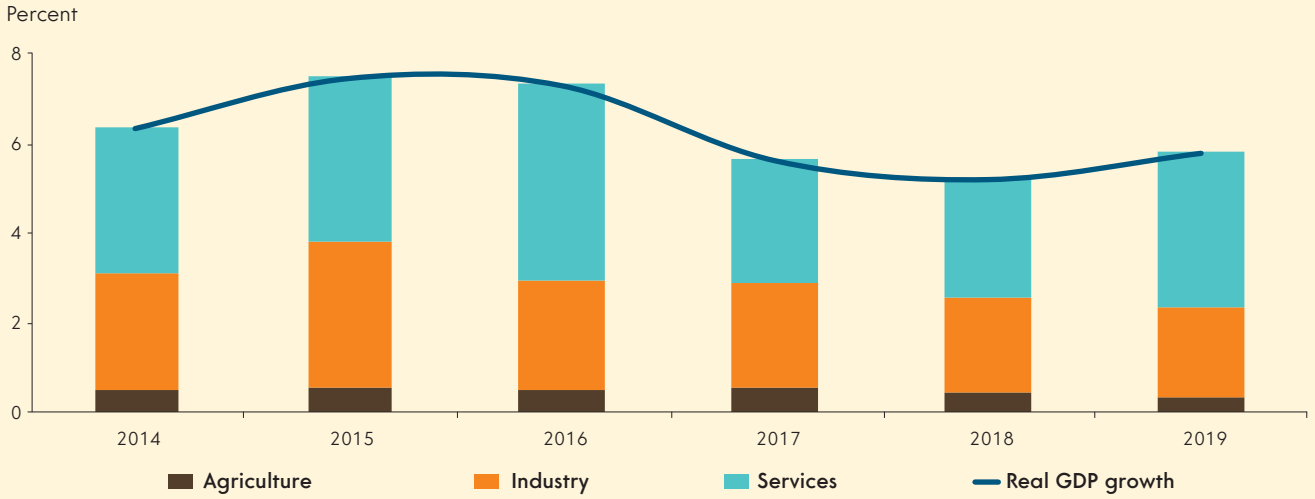
Bhutan

Bhutan maintained solid growth and macroeconomic stability during 2016/17. However, delays in hydropower construction are likely to lower growth prospects over the medium term. The fiscal deficit is likely to reduce over the projected period because of lower public capital expenditures during the initial years of the 12th five-year plan (FYP) 2018-23.

	2017
Population, million	0.8
GDP, current US$ billion	2.7
GDP per capita, current US$	3276

Source: World Bank WDI.

Contributions to real GDP growth



Source: National Statistics Bureau, Royal Monetary Authority, Ministry of Finance and World Bank forecasts.

Recent economic developments

GDP growth in 2016/17 is estimated at 7.4 percent, about 1 percentage point higher than the last estimate. During the year, growth was driven by the hydropower sector, a good agricultural harvest and the services sector (especially financial services, hotels and restaurants, and transportation). On the demand side, gross fixed capital formation, primarily in hydropower and government financed infrastructure projects, supported output expansion.

To support the last year of the implementation of the 11th FYP, the government boosted spending, raising the fiscal deficit from 1.1 percent of GDP in 2015/16 to an estimated 3.3 percent in 2016/17. As a result, public debt exceeded 100 percent of GDP in 2016/17. High imports to finance increased government spending as well as construction of hydropower projects, kept the current account deficit elevated at 23 percent of GDP in 2016/17. The deficit was almost fully financed by loans from India. As a result, as of November 2017, gross international reserves remained comfortable at USD 1.2 billion, equivalent to 11 months of imports of goods and services.

The ngultrum, pegged to the Indian rupee, appreciated slightly in the second half of 2017. With stable non-food prices and nominal effective exchange rate appreciation, the Consumer Price Index (CPI) decelerated from 5.8 percent in April 2017 to 3.3 percent in December. The introduction of the Goods and Services Tax (GST) in India in July 2017 did not have a significant impact on prices in the Bhutanese economy, although impact on growth and trade is yet unknown. The financial sector remained sound with the risk weighted capital adequacy ratio at 16.3 percent in September 2017, above the minimum requirement of 12.75 percent. The gross non-performing loan ratio stood at 14.4 percent in September 2017.

Outlook

Economic growth is projected to average 6 percent a year over the medium-term largely supported by the on-going hydropower projects and the services sector, especially tourism. However, downside risks to growth remain, particularly from the delay in the completion of two mega hydropower projects and the general elections scheduled in the summer of 2018. In addition, lower capital spending during the first few years of the new 12th FYP will also impact growth. It will however help reduce the fiscal deficit to -0.9 percent by 2019/20. With the completion of the Mangdechhu hydro project, exports are likely to increase while imports will decline because of lower public capital spending. This will help narrow the current account deficit to 12 percent of GDP by 2019/20 and reduce external debt to 89 percent.

Risks and challenges

There are four key risks facing the Bhutanese economy: (a) given the size of hydropower projects relative to the size of the economy, any further delays in hydropower construction will negatively affect the economy through lower exports and revenues; (b) with sustained growth, donor financing in Bhutan is getting scarce while domestic debt markets are not yet developed. Limited financing sources could constrain government spending and negatively affect growth and development; (c) the upcoming 2018 general election could lead to policy uncertainty which could impact growth and investments; and (d) adverse weather events could negatively impact the economy through lower electricity generation from existing hydropower plants and lesser tourist traffic. In terms of longer-term challenges, the country needs a vibrant job creating private sector.

	2015	2016	2017 (est)	2018 (f)	2019 (f)	2020 (f)
Real GDP Growth, at Constant Market Prices	7.3	7.4	5.8	5.4	6.0	8.7
Private Consumption	3.4	3.7	-2.0	0.8	7.0	9.6
Government Consumption	7.3	4.6	8.5	6.1	0.6	8.8
Gross Fixed Capital Investment	14.1	7.2	1.8	-0.6	3.5	3.5
Exports, Goods and Services	-2.7	-2.0	-1.4	-2.0	6.3	4.4
Imports, Goods and Services	3.4	-2.4	-10.3	-11.5	1.7	0.4
Real GDP Growth, at Constant Factor Prices	7.8	7.5	5.9	5.4	6.0	8.7
Agriculture	4.3	3.9	4.5	3.7	2.8	2.8
Industry	7.5	5.7	5.4	5.0	4.8	12.1
Services	9.2	10.7	6.7	6.3	8.1	6.9
Inflation (Consumer Price Index)	3.3	4.3	5.0	5.0	5.0	5.0
Current Account Balance (percent of GDP)	-29.3	-24.7	-21.7	-17.5	-11.7	-11.4
Financial and Capital Account (percent of GDP)	39.9	23.1	14.3	13.6	9.5	11.7
Net Foreign Direct Investment (percent of GDP)	0.4	-0.6	1.0	1.2	1.5	1.4
Fiscal Balance (percent of GDP)	-4.6	-3.3	-2.4	-0.7	-0.9	-0.9
Debt (percent of GDP)	118.4	102.8	94.6	87.8	84.1	81.8
Primary Balance (percent of GDP)	-3.1	-2.0	-1.3	1.1	0.8	0.9

Source: World Bank.
Note: (est) = estimate, (f) = forecast.

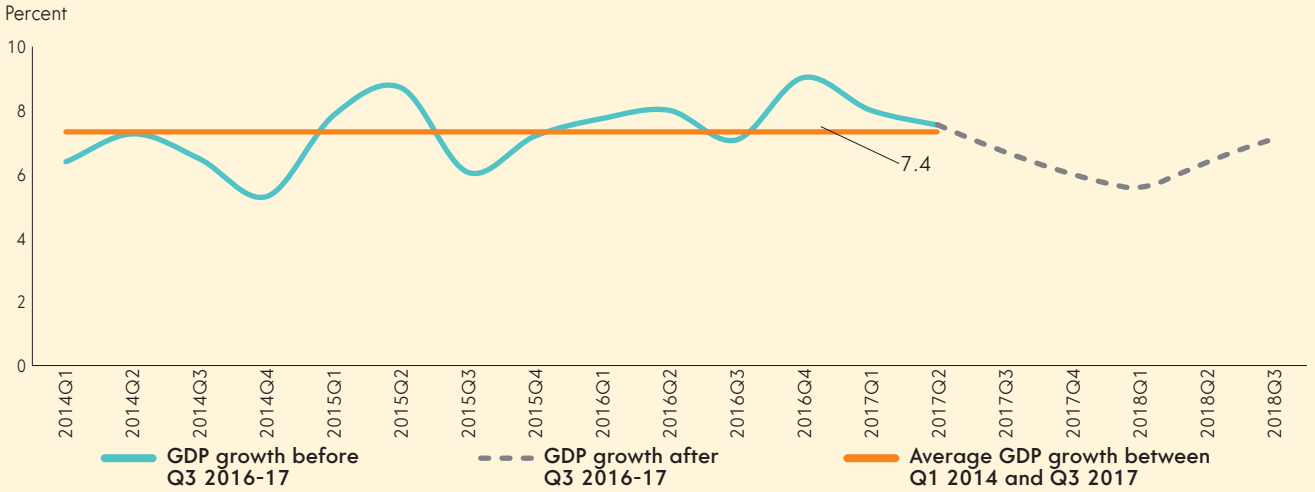
India

India's economy has recovered from the impact of the twin policy events – demonetization and GST. Growth is likely to stabilize and reach 7.5 percent by FY 19/20. While the pace of consolidation moderated, public finances remain stable.

	2017
Population, million	1341.7
GDP, current US$ billion	2474.6
GDP per capita, current US$	1844

Source: World Bank WDI.

Real GDP growth



Sources: Indian Central Statistics Office.

Recent economic developments

India's economy has bottomed out from the deceleration caused by one-time policy events such as demonetization and GST introduction. Real GDP growth has accelerated to 6.5 and 7.2 percent in Q2 and Q3 FY17/18, with private consumption remaining its main driver. While investment growth picked up and grew at 12 percent year-on-year in Q3 FY17/18, investment rates remain below levels experienced before the financial crisis. Services accelerated further during FY17/18, with sectoral value-added growing at 7.7 percent in Q3 FY17/18. In contrast, agricultural growth decelerated to 2.7 percent growth during the summer, driven by uneven rainfall and a high base effect. Growth in manufacturing and construction, most affected by GST and demonetization, accelerated to 8.1 and 6.8 percent growth during Q3 FY17/18.

Inflation remained within a 4 (+/-) 2 percent range since the adoption of inflation targeting by the central bank, averaging 3.4 percent between April 2017 and January 2018. While momentum has picked up since July 2017, following rising global crude oil and domestic food prices, inflation is expected to remain within the target range in the medium-term. The Reserve Bank of India maintained a neutral policy stance and held rates at 6 percent since Q2 FY17/18 after some easing in earlier quarters. Despite a decline in real lending rates, credit growth remains subdued and burdened by the prevalence of non-performing assets in the banking sector.

The current account and merchandise trade deficit moved in tandem and widened due to strong import growth. Exports remain sluggish and, constrained by temporary working capital constraints after GST implementation and existing structural weakness in competitiveness, were outpaced by imports. Capital inflows increased in early FY17/18 due to strong portfolio inflows. FDI remained stable. Reserves reached an all-time high of USD 421 billion or 11 months of imports in January 2018. The real effective exchange rate appreciated by 6.9 percent during 2017.

Public finances remain stable, though the pace of consolidation has moderated. The federal government's fiscal deficit reached 3.5 percent of GDP, missing its fiscal deficit target in FY17/18 by 0.3 percentage points, due to compensation to the states for GST revenue shortfalls. Capital expenditures declined marginally in FY17/18. While GST collections have yet to stabilize, tax collections and one-time disinvestment receipts increased in recent quarters, compensating for a decline in non-tax revenue. Subnational fiscal deficits have risen in recent years because of assumption of contingent liabilities. General government debt has declined for nearly a decade to 69.3 percent in FY16/17, and is considered sustainable.

Outlook

Growth has bottomed out and is expected to stabilize at 7.5 percent in the medium-term. GDP growth is projected at 6.7 percent during FY17/18. A further acceleration to 7.5 percent by FY19/20 is dependent on a sustained recovery in private investments, which is expected to be supported by policy measures that improve the investment climate. Private consumption will remain the primary driver of growth, with the services sector and increasingly the industrial sector leading production growth.

Inflation is projected to remain within the target range of 4 (+/-) 2 percent, with oil prices projected to remain range bound in the medium term. The current account deficit is projected to widen moderately, with export and import growth accelerating in line with increasing global trade volumes.

The fiscal outlook is sustainable. India's general government fiscal deficit is projected to decline in the medium term. The implementation of GST may provide an additional impetus to revenue collections in the medium-term. States' fiscal deficits could rise in the near-term due to increasing pressures from contingent liabilities, such as debt accumulated by the power sector and measures to provide agricultural debt relief.

Risks and challenges

Two crucial engines of growth have underperformed. First, private investment has been low compared to pre-crisis levels, driven by factors that constrain credit supply and investment opportunities. Second, exports have slowed and India's share in world trade has stagnated. While external conditions seem to be turning more supportive of growth, India's ability to leverage these will depend on a sustained revival of investments and exports. The fiscal outlook is sustainable, but state and central finances face risks emanating from salary revisions in the civil service, possible realization of contingent liabilities from stressed bank balance sheets and extension of further farm loan waivers.

	2015	2016	2017 (est)	2018 (f)	2019 (f)	2020 (f)
Real GDP growth, at Constant Market Prices	8.2	7.1	6.7	7.3	7.5	7.5
Private Consumption	7.4	7.3	6.8	7.9	7.6	7.6
Government Consumption	6.8	12.2	10.9	10.2	9.8	9.8
Gross Fixed Capital Investment	5.2	10.1	6.7	5.5	6.8	6.8
Exports, Goods and Services	-5.6	5.0	4.0	5.7	6.8	7.0
Imports, Goods and Services	-5.9	4.0	6.0	5.3	6.5	6.2
Real GDP Growth, at Constant Factor Prices	8.1	7.1	6.6	7.1	7.3	7.3
Agriculture	0.6	6.3	3.2	2.7	2.7	2.7
Industry	9.8	6.8	4.9	6.8	7.0	6.9
Services	9.6	7.5	8.5	8.5	8.6	8.7
Inflation (Consumer Price Index)	4.9	4.5	3.9	4.1	3.9	3.9
Current Account Balance (percent of GDP)	-1.0	-0.7	-1.2	-1.6	-1.9	-2.0
Financial and Capital Account (percent of GDP)	1.5	0.1	0.7	1.2	1.5	1.7
Net Foreign Direct Investment (percent of GDP)	1.6	1.5	1.1	1.4	1.6	1.8
Fiscal Balance (percent of GDP)	-7.3	-6.4	-5.8	-5.7	-5.6	-5.6
Debt (percent of GDP)	69.4	69.1	69.1	67.7	65.9	64.1
Primary Balance (percent of GDP)	-2.6	-1.5	-0.9	-0.9	-1.0	-1.0

Source: World Bank.
Note: (est) = estimate, (f) = forecast.
Projections for 2017-18 are based on incomplete quarterly profile for the years FY15-16 to FY17-18, as released by Central Statistics Organization. A full and consistent quarterly profile is due to be released in end-May and data are expected to be revised thereafter.

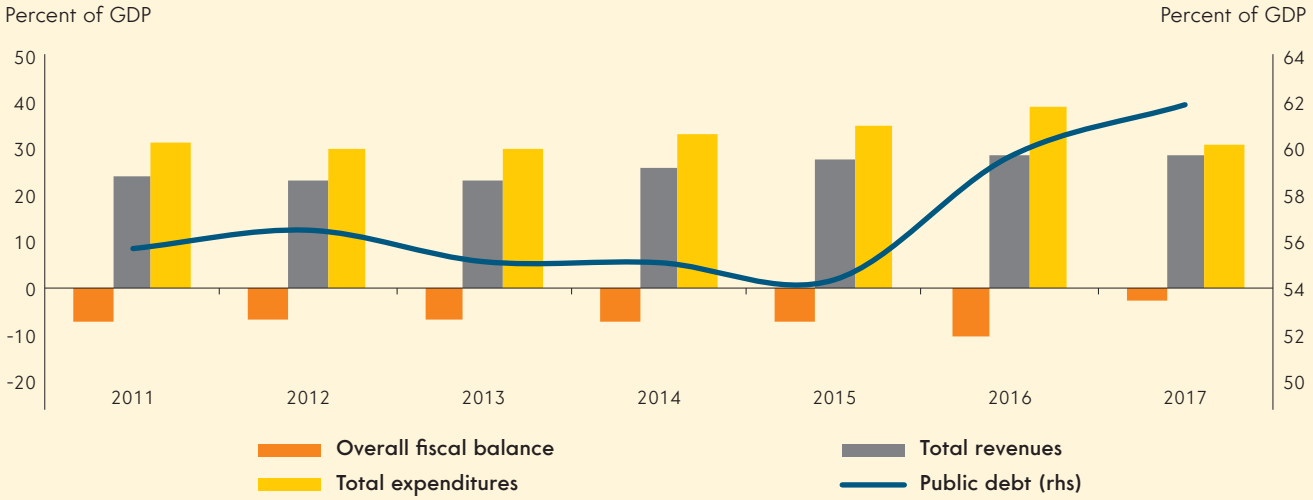
Maldives

Growth and a pick-up in tourism are expected to continue to drive growth. The government has succeeded in containing current fiscal expenditure to create space for capital expenditure, but the level of public debt is projected to rise further and foreign exchange reserves recovered slightly but are still low. A 45-day state of emergency from February 5 to March 22 led to arrests, protests and widespread travel advisories. While the impact on tourism is not yet clear, it may have a negative impact on growth, fiscal revenue and the current account. Meanwhile, Presidential elections in September will add further uncertainty.

	2017
Population, million	0.4
GDP, current US$ billion	4.6
GDP per capita, current US$	10468

Source: World Bank WDI.

Fiscal balance and debt level



Source: Ministry of Finance and Treasury and World Bank estimates.
Note: (rhs) = right hand side.

Recent economic developments

Construction has been the main driver of growth, growing at an average of 19 percent in 2015-17. After peaking at 10.1 percent growth in 2013, the tourism sector slowed down between 2014 and 2016, due to a slowdown in tourist arrivals especially from China and Russia. Tourism bed night growth started to recover in 2016 and reached 10.8 percent in 2017. Bank staff estimates that real GDP growth in 2017 remained around 6.2 percent as in 2016, below the government's projection of 6.9 percent.

CPI inflation increased from below 0.5-1 percent in 2015 and 2016 to 2.8 percent in 2017, reflecting the partial removal of food subsidies and the pass-through of rising electricity prices. It is expected that fast price rises of food and beverages (5.6 percent in 2017) and of rents (4.6 percent) has hit Maldivian households particularly hard. Inflation was higher in the atolls, with food prices rising even more significantly. This may have affected poor households even further, since the uptake of the cash transfer to compensate for the partial removal of the food subsidies was limited so far.

The current account deficit widened sharply from 3.2 percent in 2014 to an estimated 21.4 percent of GDP in 2017, driven by the large increase in investment-related

imports, with FDI inflows reflecting investment into opening 13 resorts in 2017, and project loan disbursements into large infrastructure projects. Thanks to a USD 250 million sovereign bond issuance, gross official reserves recovered from USD 467 million at end-2016 to USD 586 million at end-2017, although usable reserves (after netting out short-term foreign currency liabilities to domestic banks) are only USD 206 million, equivalent to 1.1 months of goods imports.

The government has made progress in rebalancing fiscal expenditure to accommodate increased capital expenditure. The fiscal balance shifted from a 10.6 percent of GDP deficit in 2016 to a 2.5 percent of GDP deficit in 2017, driven mainly by a reduction in public investment from 10.9 percent of GDP in 2016 to 8.2 percent of GDP 2017, and a reduction in spending on food subsidies and on the Aasandha health care system. Excluding the Public Sector Investment Program, the underlying current fiscal balance went from a deficit of 2.0 percent of GDP in 2015 to an estimated surplus of 5.7 percent of GDP in 2017, reflecting revenue increases and current expenditure reforms.

Public debt excluding guarantees is estimated to have reached 61.9 percent of GDP, an increase from 59.7 percent of GDP in 2016, driven by external projected-related borrowing and the sovereign bond, while domestic T-bills were redeemed.

Outlook

In the baseline scenario, growth is expected to be driven by construction and by tourism arrivals, facilitated by the opening of new resorts in 2017. The current account is projected to narrow gradually to 19.3 percent of GDP by 2020 as new capital investment projects are gradually tapering off. Reserve coverage is projected to remain weak. Despite the one-off impact of promised civil service wage increases, the fiscal deficit is projected to narrow gradually as public investment projects are tapering off. Public debt is projected to rise to 2020 and peak soon after. The recent World Bank-IMF Debt Sustainability Analysis assessed Maldives' risk of external debt distress as high, due a widening current account deficit, low international reserves, pipeline of guarantees, and rapid debt buildup.

However, the immediate outlook is highly uncertain given the probable impact of the February-March state of emergency on the tourism and non-tourism sector, which may not be visible in the data immediately. Widespread travel advisories may lead to cancellations affecting the tourism sector. If a significant negative shock to tourism bed nights materializes, it may lead to a reduction in fiscal revenue, tourism exports and activity in the tourism and ancillary sectors. This may require a fiscal adjustment to rebalance the fiscal accounts and the balance of payments.

A reduction in tourism may also likely have a negative impact on employment, as Maldivians face strong competition from a relatively cheaper foreign workforce for low-skilled jobs and a relatively better educated foreign workforce for high-skilled jobs. The Maldives face other risks that may impact macroeconomic stability. Other risks stem from exogenous factors such as a downturn in global economy, concerns about global terrorism, health pandemics, or natural disasters that may also impact tourism. Another is a risk of increasing global commodity prices (for example, fuel prices) that can impact the economy given its heavy reliance on imports. There is also a concern about fiscal slippages, especially due to delays in controlling current expenditure and the realization of contingent liabilities through guarantees.

Risks and challenges

The immediate challenge is dealing with the macro-fiscal impact of the state of emergency and travel advisories. Structural challenges include improving medium-term fiscal sustainability by addressing key expenditure drivers in the budget. These include increasing the efficiency of spending on Aasandha and replacing the electricity subsidies by a targeted cash transfer to help poor families pay electricity bills. It is also important to improve budget credibility by making ministry and agency budget ceilings binding.

The recent public-sector employment freeze was positive from a fiscal perspective. However, it may put pressure on the absorption capacity of the Maldivian labor market, since public sector employment is the main sector of employment of 25 to 64-year-old Maldivians, and the working age population is increasing. It is critical to foster private sector job creation, since the main drivers of growth, construction and resort tourism, are highly reliant on foreign labor.

In this context, the consolidation of population from vulnerable islands and atolls to larger islands in Greater Malé, while also reducing pressure on Malé, is a country priority. If successful, it may eventually allow for new forms of economic activity in line with the aspirations of Maldivian youth and provide employment, improve the quality of public services such as health and education, and make the country more resilient to climate change.

	2015	2016 (est)	2017 (f)	2018 (f)	2019 (f)	2020 (f)
Real GDP Growth, at Constant Market Prices	2.2	6.2	6.2	5.5	4.5	4.9
Real GDP Growth, at Constant Factor Prices	2.8	6.0	6.2	5.5	4.5	4.9
Agriculture	-0.5	1.4	0.6	0.2	0.0	0.1
Industry	16.5	15.1	10.4	17.3	15.3	13.5
Services	1.4	5.2	5.9	4.1	3.0	3.6
Inflation (Consumer Price Index)	1.0	0.5	2.8	2.8	3.0	3.0
Current Account Balance (percent of GDP)	-7.6	-24.4	-21.3	-19.8	-19.5	-19.3
Net Foreign Direct Investment (percent of GDP)	7.5	10.8	15.8	8.6	6.8	6.5
Fiscal Balance (percent of GDP)[a]	-7.1	-10.6	-2.5	-5.2	-4.8	-4.0
Debt (percent of GDP)[a]	54.4	59.7	61.9	63.3	64.7	65.0
Primary Balance (percent of GDP)	-4.9	-8.8	-0.8	-3.1	-2.7	-2.0

Source: World Bank.
Note: (est) = estimate, (f) = forecast.
(a) A large volume of expenditure was recorded in 2016, but the bills were settled with funds borrowed in 2017, which has led to a significant discrepancy been fiscal and debt numbers. It has been recorded as an additional positive financing item of 2.4 percent of GDP in 2016 (bills and arrears carried over) and a negative financing item of 3.1 percent of GDP in 2017 (bills and arrears clearance).

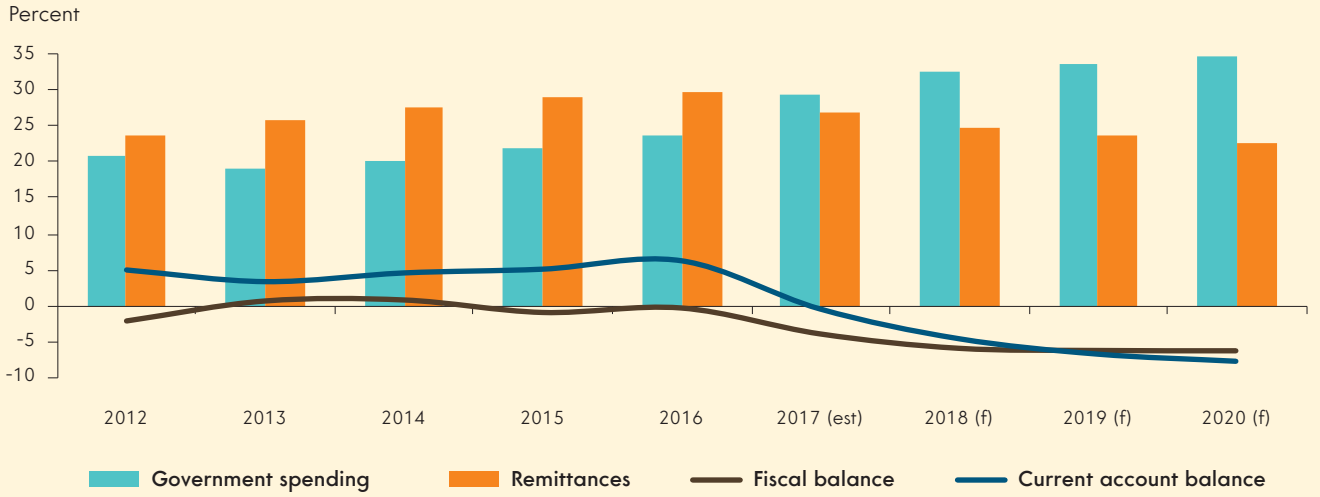
Nepal

Despite subdued inflation, robust government spending, and the prospect of a stable government, economic growth is expected to moderate in FY2018 as a result of the heaviest flooding in decades, a modest recovery of exports, higher interest rates and a tightening of credit. As departures of Nepali migrant workers going abroad continues to decline, the risk of a sharper slowdown in remittances and resulting adverse effects on the broader economy increase.

	2017
Population, million	29.2
GDP, current US$ billion	24.5
GDP per capita, current US$	839

Source: World Bank WDI.

Twin deficits increase



Source: Nepal Rastra Bank (NRB) and World Bank staff estimates and forecasts.
Note: (est) = estimate, (f) = forecast.

Recent economic developments

After a strong rebound in FY2017, economic activity, particularly agriculture, was adversely affected by floods during the first half of FY2018. As a result of severe flooding in the southern plains, paddy production is estimated to have contracted by 1.5 percent from the record high output the year before. The contribution of industry is expected to have remained strong with the addition of hydropower capacity and the post flood and earthquake reconstruction. Growth in the services sector continues to be driven by trade and hotels. On the demand side, a pick-up in both private and public investment supported growth. Though still very low as a share of GDP, FDI in the first half of FY2018 was at a record high of USD 140 million, an increase of 94 percent year-on-year. Consumption, however, is expected to soften as remittances have grown at one of the lowest rates in years. Government consumption is robust, especially as the transition to a new federal structure is necessitating an increase in spending at sub-national levels.

Inflation moderated in the first half of FY2018 because of stable food prices and stood at 4.0 percent in January 2018. Owing to a slow growth in remittances, growth of deposits in the banking sector has also slowed down. Credit growth, which peaked during first half of FY2017, moderated to 16 percent, but remained higher than the growth of deposits at 12 percent. Consequently, the availability of loanable funds at the banks has remained tight. Banks can lend up to 80 percent of their local currency deposits and core capital, and are running up against this limit. As a result, banks have increased interest rates to attract new

deposits, and with unchanged spreads, lending rates have also reached a 5-year high.

Exports are showing signs of recovery, primarily driven by higher exports to India. However, imports have continued to surge on the back of reconstruction with related capital and industrial goods, resulting in a higher trade deficit. With slower growth in remittances, the current account deficit increased to 737 USD million during the first six months of FY2018, up from 9 USD million during the same period in FY2017.

With increased imports, tax collection was strong in the first half of FY2018, growing at 19.3 percent year-on-year. Public spending on capital goods has also increased. The first year of a budget system under a federal setup has resulted in a sizable increase in the fiscal transfers to sub-national governments. However, given the unfinished fiscal architecture in the federal set-up, execution of the transfers has been low. Out of NPR 225 billion transferred to the sub-national governments so far in FY2018, less than 40 percent has been spent.

Outlook

Economic growth in FY2018 is projected at 4.6 percent and is expected to average 4.3 percent during the forecast period, as growth moderates in line with the potential. Construction is expected to remain strong, driven by reconstruction efforts and construction of several big hotels. The industrial sector may also remain robust with the commissioning of new hydropower projects and cement factories, and due to improvements in power supply to industries. The service sector, however, may be adversely affected by a further slowdown in remittances.

Inflation is expected to be below the Central Bank's target of 7.5 percent. Meanwhile, the current account deficit, which was marginal in FY2017, is expected to widen as the growth of imports remains strong, while remittances ease and exports grow modestly. The persistence of a large trade deficit and a continued slowdown in the growth of remittances will likely put pressure on Nepal's foreign exchange reserves, which are currently adequate.

With increased government spending related to federalism implementation, earthquake recovery, flood response, elections, and social assistance programs, the fiscal deficit is expected to widen in FY2018 and during the forecast period. Financing is not expected be a challenge, due to ample fiscal space and a low debt-to-GDP ratio of 27 percent in FY2017, as well as large government deposits at hand. Debt is likely to grow relatively faster, but remain sustainable during the forecast period.

Risks and challenges

Nepal successfully conducted elections at all three tiers of government (local, province and federal), which is no small feat for a country coming out of conflict. The new prime minister has been sworn in and the coalition government has a 2/3 majority in the parliament, improving the prospects for stable government over the next five years. However, the new government faces a challenging agenda with the transition to a federal state.

The cost of establishing and running a federal system of government, the need for post-earthquake and flood reconstruction, higher spending on social assistance programs and larger outlays on much-needed infrastructure, could all lead to significant increases in spending. Additionally, improving human resource capacity in the newly created sub-national governments is a critical priority.

The risks from the external environment are increasing as well. The decline in migrant workers' outflow has continued. Remittances continue to slow down and a further deceleration is likely, possibly resulting in a sharper deterioration in the balance of payments. Furthermore, this can adversely affect growth of deposits in the financial sector, which could result in a persistent shortage of loanable funds and a sudden stop of new credit.

	2015	2016	2017 (est)	2018 (f)	2019 (f)	2020 (f)
Real GDP Growth, at Constant Market Prices	3.3	0.4	7.5	4.6	4.5	4.2
Private Consumption	2.9	-0.8	2.4	1.9	1.8	1.7
Government Consumption	7.4	-0.4	24.2	21.1	15.5	9.5
Gross Fixed Capital Investment	19.6	-12.3	34.3	15.0	9.7	7.1
Exports, Goods and Services	6.8	-13.7	16.9	8.0	8.8	9.8
Imports, Goods and Services	9.6	2.8	22.0	7.4	5.6	3.5
Real GDP Growth, at Constant Factor Prices	3.0	0.0	7.0	4.6	4.5	4.2
Agriculture	1.1	0.0	5.3	2.7	3.0	3.0
Industry	1.4	-6.3	10.9	5.5	3.7	3.5
Services	4.8	2.0	7.0	5.7	5.7	5.1
Inflation (Consumer Price Index)	7.2	9.9	4.5	4.5	5.0	5.0
Current Account Balance (percent of GDP)	5.1	6.2	-0.4	-4.5	-6.6	-7.6
Fiscal Balance (percent of GDP)	-1.1	-0.4	-3.9	-5.9	-6.2	-6.2
Debt (percent of GDP)	25.5	27.9	27.0	30.7	34.3	37.6
Primary Balance (percent of GDP)	-0.6	-0.1	-3.6	-5.3	-5.4	-5.3

Source: World Bank.
Note: (est) = estimate, (f) = forecast.

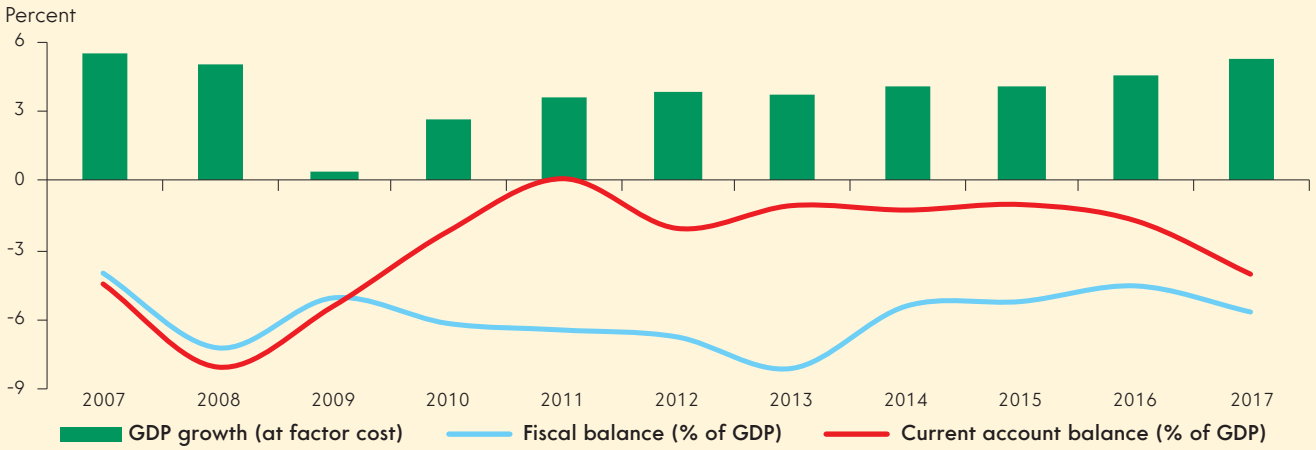
Pakistan

Pakistan's growth continues to accelerate but macroeconomic imbalances are widening. Macroeconomic stability is a major concern for the near-term economic outlook. Several short-term measures are required to correct external and domestic imbalances, which must be complemented with implementation of medium term reforms.

	2017
Population, million	196.6
GDP, current US$ billion	304.3
GDP per capita, current US$	1548

Source: World Bank WDI.

Annual GDP growth (at factor cost) and twin deficits



Source: Ministry of Finance and State Bank of Pakistan.

Recent economic developments

Pakistan's GDP growth increased by 0.8 percentage points over the previous year to reach 5.4 percent in FY17. Major impetus came from improved performance of services and the agricultural sector. The industrial sector also saw some recovery. The low interest rate environment contributed to the growth in private sector credit, which supported businesses. On the demand side, consumption made up almost 92 percent of GDP, and contributed nearly eight percentage points towards GDP growth at market prices. Average headline inflation for Jul-Mar FY18 was 3.8 percent, compared to 4.0 percent in Jul-Mar FY17, well below the target of 6 percent for FY18.

The balance of payments is under stress due to relatively high current account deficit (CAD) at 4.1 percent of GDP (US$12.4 billion) in FY17. This trend continued in Jul-Feb FY18, and CAD reached US$10.8 billion (3.4 percent of GDP). Exports, after contracting for three consecutive fiscal years, have started to recover in FY18, but relatively stronger import growth has resulted in a higher trade deficit. Government imposed regulatory duties on some imports to slowdown import growth. In addition, the exchange rate depreciated in December 2017 (by 5 percent) and in March 2018 (4 percent), and the policy interest rate was raised by 25 bps in January 2018 to ease demand pressures. Despite this, official international reserves have declined to USD 12.2 billion by end-February 2018 (2.3 months of imports), compared to USD 16.1 billion at end-June 2017. To support declining reserves, government issued international bonds of USD 2.5 billion in November 2017.

The fiscal deficit deteriorated rapidly to 5.8 percent of GDP in FY17, 2.0 percentage points higher than the target set at the start of the year and 1.2 percentage points higher than that of the previous year. The fiscal deficit has been somewhat lower in the first half of FY18 at 2.2 percent of GDP compared to 2.5 percent in the first half of FY17. Tax revenues of Federal Board of Revenue (FBR) during Jul-Jan FY18 stood at PKR1,992 billion compared to PKR1,696 billion in the same period last year – 17.5 percent year-on-year growth. The public debt to GDP ratio deteriorated to 65.7 percent of GDP

by end of the first half of FY18 compared to 64.5 percent of GDP at end of the first half of FY17.

Outlook

Supported by infrastructure projects of the China Pakistan Economic Corridor (CPEC), improved energy supply, and persistent private consumption growth, GDP growth is projected to reach 5.8 percent in FY18. This growth estimate is based on actual data from the first eight months of this fiscal year. After the election, expected policy adjustments to correct for macroeconomic imbalances are projected to lead to a slowdown in growth in FY19, driven by a contraction in domestic consumption and investment. However, growth is expected to recover in FY20 and reach 5.4 percent. This recovery is contingent upon restoring and preserving macroeconomic stability, as well as steady progress in implementing reforms which tackle key growth constraints. The outlook assumes that oil prices will increase moderately but remain low, and that political and security risks will be managed.

The pressure on the current account is expected to persist as the trade deficit is projected to remain at an elevated level during FY19. Increased exchange rate flexibility should support exports and imports are expected to slow down in FY19. Remittances will continue to partly finance the current account deficit; nonetheless, slower growth in GCC countries will affect migrants' employment options and growth in remittances. Foreign Direct Investment (FDI), multilateral, bilateral, and private debt-creating flows are expected to be the main financing sources in the medium-term. To meet external financing needs, the Government will continue to access international markets.

Fiscal deficits are projected to narrow in FY19 as authorities adjust macroeconomic policies. The adjustment will come initially on the back of scaling down in investment spending both at the federal and provincial level. However, bolstering of revenues as a result of expanding the tax base and other administrative measures will support fiscal consolidation.

Inflation is expected to rise in FY19 and remain high in FY20. The increase in prices will be driven by exchange rate passthrough to domestic prices and a moderate increase in international oil prices.

Risks and challenges

Macroeconomic and political risks have increased in FY18. The balance of payments position is particularly vulnerable at the current level of reserves. Upcoming elections may delay decisive policy adjustment, such as increased exchange rate flexibility and fiscal consolidation, until after the elections. In the medium-term, the government needs to put considerable effort in reforming its tax system and tackle competitiveness challenges. A strategy based on lowering the cost of doing business and improving productivity would be critical for higher and sustainable export growth.

	2015	2016	2017	2018 (f)	2019 (f)	2020 (f)
Real GDP Growth, at Constant Market Prices	4.7	5.5	5.7	5.4	5.0	5.4
Private Consumption	2.9	7.6	8.7	6.3	3.3	3.5
Government Consumption	8.1	8.2	5.3	14.2	2.0	3.5
Gross Fixed Capital Investment	15.8	7.5	10.0	5.7	7.0	7.0
Exports, Goods and Services	-6.3	-1.6	-0.8	9.9	12.0	14.0
Imports, Goods and Services	-1.6	16.0	21.0	17.5	0.2	1.1
Real GDP Growth, at Constant Factor Prices	4.1	4.6	5.4	5.8	5.0	5.4
Agriculture	2.1	0.2	2.1	3.8	3.3	3.4
Industry	5.2	5.7	5.4	5.8	7.0	7.3
Services	4.4	5.7	6.5	4.8	4.8	5.3
Inflation (Consumer Price Index)	4.5	2.9	4.2	5.0	8.0	7.5
Current Account Balance (percent of GDP)	-1.0	-1.7	-4.1	-5.1	-4.4	-3.1
Financial and Capital Account (percent of GDP)	2.0	2.5	3.4	3.7	4.3	3.5
Net Foreign Direct Investment (percent of GDP)	0.3	0.8	0.9	1.0	1.2	1.4
Fiscal Balance (percent of GDP)	-5.2	-4.5	-5.7	-5.4	-5.0	-4.7
Debt (percent of GDP)	64.3	68.6	68.1	68.7	68.1	66.2
Primary Balance (percent of GDP)	-0.5	-0.2	-1.4	-1.0	-0.9	-1.2

Source: World Bank.
Note: (f) = forecast.

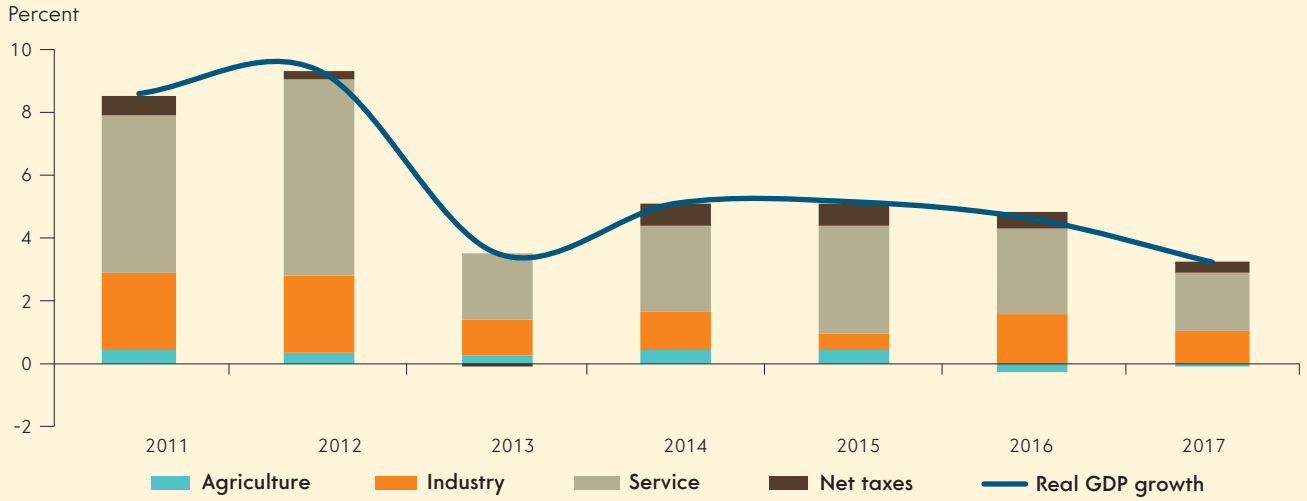
Sri Lanka

In 2017, Sri Lanka's improvement in its macroeconomic performance was masked by inclement weather. Fiscal and monetary policy measures contributed to stabilization; however, a prolonged drought took a toll on growth and the external sector while contributing to raising inflation. Expediting reforms to promote competitiveness, governance and continued fiscal consolidation are critical for sustained growth and development. Nevertheless, the challenging political environment has already slowed the pace of the reform agenda and remains the key risk to a favorable medium-term outlook.

	2017
Population, million	20.9
GDP, current US$ billion	87.8
GDP per capita, current US$	4207

Source: World Bank WDI.

Contributions to real GDP growth



Source: Department of Census and Statistics, Sri Lanka and World Bank staff estimates.

Recent economic developments

In 2017, Sri Lanka's improvement in its macroeconomic performance was masked by inclement weather. Fiscal and monetary policy measures contributed to stabilization; however, a prolonged drought took a toll on growth and the external sector while contributing to raising inflation. Expediting reforms to promote competitiveness, governance and continued fiscal consolidation are critical for sustained growth and development. Nevertheless, the challenging political environment has already slowed the pace of the reform agenda and remains the key risk to a favorable medium-term outlook.

Growth decelerated to a 16-year low of 3.1 percent in 2017 due to adverse weather conditions, with floods in May in the South and West, and prolonged drought across the country. Agriculture contributed negatively to growth for the second consecutive year, while slower growth was recorded in the previously buoyant construction sector. The tight monetary policy maintained in 2016 and 2017 dampened high monetary growth; however, disruptions in food supplies, the impact of VAT reforms and rising global oil prices contributed to relatively high inflation.

On the external front, gradually rising oil prices and increased imports of food and petroleum due to the

drought offset the growth in exports, led by a recovery of the tea industry. Tourism grew, albeit at a slower rate than in 2016, while remittances shrank because of adverse economic conditions in the Middle East. Nevertheless, proceeds of sovereign bonds and syndicated loans, increased FDI mainly thanks to long-leasing of a port asset and a large land reclamation project, and forex purchases by the monetary authority lifted the reserve cover of imports to 3.8 months of imports. The currency depreciated by 2 percent against the US Dollar.

A primary surplus recorded for the first time in decades, albeit small, and passing of the new Inland Revenue Act helped with the successful completion of the third review of the IMF program. However, a sharp increase in interest expenditure forced the overall deficit to slightly increase, while public debt to GDP ratio marginally decreased thanks to the primary surplus and relatively low currency depreciation.

Political uncertainties slowed the implementation of reforms. The uneasy relationship of the ruling coalition surfaced after the victory of the party backed by the former President, at the local government elections. Recent communal tensions that led to violence in some parts of the country also added to the challenging political environment.

Outlook

The outlook remains favorable, provided the government is committed to the reform agenda of improving competitiveness, governance and public financial management. Together with the IMF program, these reforms will add to confidence and support fiscal consolidation efforts.

Growth is projected to rebound in 2018 from a low base and continue to be around 4.5 percent in the medium term, driven by private consumption and investment. Inflation will stabilize at the mid-single digit level as the impact of natural disasters wears off, although the upward trend in oil prices may exert some upward pressure. The external sector will continue to benefit from the GSP+ preferential access to the European Union and tourism receipts, despite the deceleration of remittances. External buffers are expected to improve, with emphasis on purchasing foreign exchange, maintaining a more market-determined exchange rate, and increased FDI. The overall fiscal deficit is projected to fall in the medium term, supported by the ongoing implementation of revenue measures. Growth should continue to translate into poverty reduction and improvement in living standards.

Risks and challenges

A further slowdown in reform implementation, in a challenging political environment, remains the key risk to the baseline. The impending election cycle elevates this risk. External risks include disappointing growth in key countries that generate foreign exchange inflows to Sri Lanka: exports, tourism, remittances, FDI, and other financing flows. Steeper than expected global financial conditions would increase the cost of debt and make rolling over the maturing Eurobonds from 2019 more difficult; however, the enactment of the Liability Management Act will help mitigate this refinancing risk. Faster than expected rises in commodity prices would increase pressure on the balance of payments and make domestic fuel and electricity price reforms more difficult. On the fiscal and debt management front, risks include the delay in implementing revenue measures, and slower than expected improvement in tax administration. The increasing occurrence and impact of natural disasters could have an adverse impact on growth, the fiscal budget, the external sector and poverty reduction.

Sri Lanka faces several challenges that increasingly put its future economic growth and stability at risk, which must be addressed through macro and structural reforms: (1) stay on the fiscal consolidation path by broadening and simplifying the tax base and aligning spending with priorities. This is important given high public debt, SOE debt and guarantees and large gross financing requirements; (2) shift towards a private investment-tradable sector-led growth model by improving trade, investment, innovation and the business environment; (3) improve governance and accountability by implementing the Right to Information Act for citizens engagement and improve SOE performance and service delivery; and (4) reduce vulnerability and risks in the economy by enhancing disaster preparedness and mitigating the impact of reforms on the poor and vulnerable with well-targeted spending.

	2015	2016	2017 (est)	2018 (f)	2019 (f)	2020 (f)
Real GDP Growth, at Constant Market Prices	5.0	4.5	3.1	4.8	4.5	4.5
Private Consumption	8.6	0.7	3.1	4.8	4.5	4.6
Government Consumption	10.2	2.3	1.4	1.7	1.5	2.8
Gross Fixed Capital Investment	5.4	8.3	5.1	5.8	6.1	5.6
Exports, Goods and Services	4.7	-0.7	4.8	5.0	4.0	3.9
Imports, Goods and Services	10.6	7.9	3.4	3.4	3.4	3.5
Real GDP Growth, at Constant Factor Prices	5.0	4.5	3.1	4.8	4.5	4.5
Agriculture	4.7	-3.8	-0.8	4.0	3.0	3.0
Industry	2.2	5.8	3.9	4.3	4.8	4.8
Services	6.0	4.7	3.2	4.6	4.6	4.6
Inflation (Consumer Price Index)	0.9	4.0	6.6	5.0	5.0	5.0
Current Account Balance (percent of GDP)	-2.3	-2.4	-2.8	-2.5	-2.7	-2.7
Financial and Capital Account (percent of GDP)	2.9	2.4	2.8	2.5	2.7	2.7
Net Foreign Direct Investment (percent of GDP)	0.6	0.7	1.4	1.7	1.0	0.8
Fiscal Balance (percent of GDP)	-7.6	-5.4	-5.5	-4.9	-4.1	-3.6
Debt (percent of GDP)	77.6	79.3	78.1	78.2	76.6	74.7
Primary Balance (percent of GDP)	-2.8	-0.2	0.0	0.8	1.5	1.8

Source: World Bank.
Note: (est) = estimate, (f) = forecast.

PHOTO: World Bank

South Asia at a glance

			Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	South Asia
BALANCE of PAYMENTS	Real GDP Growth	2015	1.3	6.6	7.3	8.2	2.2	3.3	4.1	5.0	7.1
		2016	2.4	7.1	7.4	7.1	6.2	0.4	4.6	4.5	7.5
		2017 (est)	2.6	7.3	5.8	6.7	6.2	7.5	5.4	3.1	6.6
		2018 (f)	2.2	6.5	5.4	7.3	5.5	4.6	5.8	4.8	6.9
		2017 Q3 (CY)	..	..	..	6.5	..	..	..	2.9	..
		2017 Q4 (CY)	..	..	..	7.2	..	..	..	3.2	..
	Inflation (Consumer Price Index)	2015	-0.7	6.4	3.3	4.9	1.0	7.2	4.5	0.9	4.5
		2016	4.4	5.9	4.3	4.5	0.5	9.9	2.9	4.0	4.4
		2017	5.0	5.4	5.0	3.9	2.8	4.5	4.2	6.6	3.8
		2018 (f)	5.0	5.9	5.0	4.1	2.8	4.5	5.0	5.0	3.1
		2018 February	3.6	5.7	4.0	4.4	2.1	..	3.8	4.5	4.4
		2018 March	..	5.7	..	4.3	..	..	3.2	4.2	4.5
	REER (CY)	2015	..	..	..	103.7	..	..	110.3	..	104.3
		2016	..	..	..	105.0	..	..	109.6	..	105.5
		2017	..	..	..	109.8	..	..	106.4	..	109.4
		2018 (f)	..	..	..	105.9	..	..	99.9	..	105.3
		2018 March	..	..	..	104.3	..	..	110.7	..	103.9
		2018 April	..	..	..	104.0	..	..	109.5	..	103.6
	Current Account Balance (% of GDP)	2015	4.6	1.5	-29.3	-1.0	-7.5	5.1	-1.0	-2.3	-3.7
		2016	4.2	1.9	-24.7	-0.7	-24.4	6.2	-1.7	-2.4	-5.2
		2017 (est)	4.1	-0.6	-21.7	-1.2	-21.4	-0.4	-4.1	-2.8	-6.0
		2018 (f)	2.3	-2.8	-17.5	-1.6	-20.2	-4.5	-5.1	-2.5	-6.5
	Trade Balance (% of GDP)	2015	-41.8	-7.4	-28.5	-2.3	9.2	-29.9	-6.4	-7.5	-3.7
		2016	-42.1	-4.7	-23.4	-1.5	4.0	-29.9	-6.9	-7.6	-2.8
		2017 (est)	..	..	..	..	..	..	..	..	..
	Import Growth (%, y-o-y)	2015	4.6	3.2	3.4	-5.9	..	9.6	-1.6	10.6	-3.8
		2016	25.8	-7.1	-2.4	4.0	..	2.8	11.7	7.9	0.3
		2017 (est)	8.0	2.9	-10.3	6.0	..	22	24.0	3.4	6.2
		2018 (f)	1.5	14.0	-11.5	5.3	..	7.4	14.0	3.4	7.5
		2018 January	..	..	..	20.2	..	..	14.0	..	..
		2018 February	..	..	..	5.5	..	..	5.8	..	..
	Export Growth (%, y-o-y)	2015	2.4	-2.8	-2.7	-5.6	..	6.8	-6.3	4.7	-5.0
		2016	-0.3	2.2	-2.0	5.0	..	-13.7	-1.6	-0.7	0.9
		2017 (est)	7.0	-2.3	-1.4	4.0	..	16.9	-0.2	4.8	4.5
		2018 (f)	8.0	7.5	-2.0	5.7	..	8.0	7.0	5.0	5.7

			Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	South Asia
BALANCE of PAYMENTS	Export Growth (%, y-o-y)	2018 January	..	..	..	-0.4	..	..	6.0	..	..
		2018 February	..	..	..	-4.6	..	..	12.4	..	..
	Foreign Reserves, Months of Goods Import Cover (CY)	2015	..	7.6	..	10.7	4.1	..	4.6	4.5	9.8
		2016	..	8.7	..	12.1	3.4	..	5.4	3.8	11.0
		2017	..	8.3	..	10.4	2.8	..	4.0	3.8	9.5
		2018 January	..	7.1	..	10.0	..	..	3.0	4.0	9.0
		2018 February	..	..	..	10.4	..	..	3.1	..	9.4
	Personal Remittances, Received (USD Million, CY)	2015	301	15,296	20	68,910	4	6,730	19,306	7,000	117,565
		2016	431	13,529	34	62,744	4	6,612	19,761	7,257	110,373
		2017	..	13,535	..	37,998	..	..	19,591	6,884	..
		2017 Q3	..	3,391	..	10,022	..	..	4,790	1,635	..
		2017 Q4	..	3,541	..	10,541	..	..	4,955	1,767	..
GOVERNMENT FINANCES	Fiscal Balance (% of GDP)	2015	-1.2	-3.9	-4.6	-7.3	-7.1	-1.1	-5.2	-7.6	..
		2016	-0.2	-3.8	-3.3	-6.4	-10.6	-0.4	-4.5	-5.4	..
		2017 (est)	-1.7	-5.0	-2.4	-5.8	-2.5	-3.9	-5.7	-5.5	..
		2018 (f)	0.2	-5.4	-0.7	-5.7	-5.3	-5.9	-5.4	-4.9	..
	Public Debt (% of GDP)	2015	9.1	31.5	118.4	69.4	54.4	25.5	64.3	77.6	..
		2016	6.5	31.2	102.8	69.1	59.7	27.9	68.6	79.3	..
		2017 (est)	5.7	32.1	94.6	69.1	62.4	27.0	68.1	78.1	..
		2018 (f)	5.8	35.1	87.8	67.7	64.2	30.7	68.7	78.2	..
CONSUMPTION and INVESTMENT	Private Consumption Growth (%, y-o-y)	2015	6.8	5.8	3.4	7.4	..	2.9	2.9	8.6	5.5
		2016	-0.2	3.0	3.7	7.3	..	-0.8	6.9	0.7	8.4
		2017 (est)	4.2	7.4	-2.0	8.0	..	2.4	8.6	3.1	7.6
		2018 (f)	2.9	5.5	0.8	7.9	..	1.9	7.3	4.8	6.6
	Gross Fixed Capital Investment Growth (%, y-o-y)	2015	4.8	7.1	14.1	5.2	..	19.6	15.8	5.4	5.5
		2016	-6.0	8.9	7.2	10.1	..	-12.3	6.7	8.3	4.7
		2017 (est)	6.3	10.1	1.8	4.0	..	34.3	8.3	5.1	10.3
		2018 (f)	-2.1	11.9	-0.6	5.5	..	15.0	7.0	5.8	7.6
	Net Foreign Direct Investment (% of GDP)	2015	0.8	0.9	0.4	1.6	7.7	0.2	0.3	0.8	1.9
		2016	0.3	0.6	-0.6	1.5	10.6	0.5	0.8	0.8	1.7
		2017 (est)	0.2	0.7	1.0	1.1	..	..	0.9	1.6	..
		2018 (f)	0.1	0.9	1.2	1.4	..	..	1.0	1.8	..
	Net Foreign Portfolio Investment (USD million, CY)	2015	-85	203	..	9,487	-123	..	-916	-686	..
		2016	-105	101	..	-4,725	5	..	-154	-993	..
		2017	..	-363	..	30,645	..	..	458	..	..
		2017 Q4	..	138	..	5,314	..	..	2,338	..	..

Notes

(est)	Estimate
(f)	Forecast
CY	Series for Calendar Year
FY	Series for Fiscal Year Afghanistan's fiscal year is the calendar year. Bangladesh's fiscal year runs from July 1st to June 30th. Bhutan's fiscal year runs from July 1st to June 30th. India's fiscal year runs from April 1st to March 31st. Maldives's fiscal year is the calendar year. Nepal's fiscal year runs from July 16th to July 15th. Pakistan's fiscal year runs from July 1st to June 30th. Sri Lanka's fiscal year is the calendar year.
Real GDP Growth	Note: Real GDP growth rates (percent change, y-o-y) at Market Prices; Pakistan is in Factor Costs. Source: World Bank. Government of India, Ministry of Statistics and Programme Implementation.
Inflation (Consumer Price Index)	Note: Period average percent change in CPI inflation. Source: World Bank MTI, DEC GEM, and Trading Economics.
REER (CY)	Note: Real effective exchange rate is the nominal effective exchange rate (a measure of the value of a currency against a weighted average of several foreign currencies) divided by a price deflator or index of costs. An increase in REER implies that exports become more expensive and imports become cheaper. Source: World Bank DEC GEM.
Current Account Balance (% of GDP)	Note: Does not include grants unless otherwise stated. Source: World Bank MTI and staff calculations.
Trade Balance (% of GDP)	Note: Trade balance in goods and services is derived by offsetting imports of goods and services against exports of goods and services as ratio to GDP. Source: World Bank WDI and staff calculations.
Import Growth (%, y-o-y)	Note: Annual trade change is in (respective) fiscal year and covers goods and non-factor services (GNFS) imports. Monthly trade change is in calender year and covers only merchandise. Source: World Bank MTI, DEC GEP, and staff calculations.
Export Growth (%, y-o-y)	Note: Annual trade change is in (respective) fiscal year and covers goods and non-factor services (GNFS) exports. Monthly trade change is in calender year and covers only merchandise. Source: World Bank MTI, DEC GEP, and staff calculations.
Foreign Reserves, months of import cover (CY)	Source: World Bank DEC GEM.
Remittances (US$ million) (CY)	Note: Personal remittances including personal transfers and compensation of employees in Current US$. Source: World Bank WDI, Haver Analytics, and World Bank staff calculations.
Fiscal Balance (% of GDP)	Note: Does not include grants unless otherwise stated. Source: World Bank MTI.
Public Debt (% of GDP)	Note: Gross public debt stock including domestic and foreign liabilities, End of Period. Source: World Bank MTI.
Private Consumption Growth (%, y-o-y)	Note: Annual (respective) fiscal year percent change in gross consumption expenditure. Source: World Bank MTI.
Gross Fixed Capital Investment Growth (%, y-o-y)	Note: Annual (respective) fiscal year percent change in gross fixed capital expenditure. Source: World Bank MTI.
Net Foreign Direct Investment (% of GDP)	Note: Net balance of Foreign Direct Investment assets and liabilities as ratio to GDP. Source: World Bank MTI and WDI.
Portfolio Investment (US$ million)	Note: Net balance of Foreign Portfolio Investment assets and liabilities in Current US$. Source: World Bank WDI, Haver Analytics, and World Bank staff calculations.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