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INSIDE:
**THE ECONOMIC
IMPACT OF
COVID-19 ON
SOUTH ASIA**

THE CURSED BLESSING OF PUBLIC BANKS

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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 6, 2020.

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

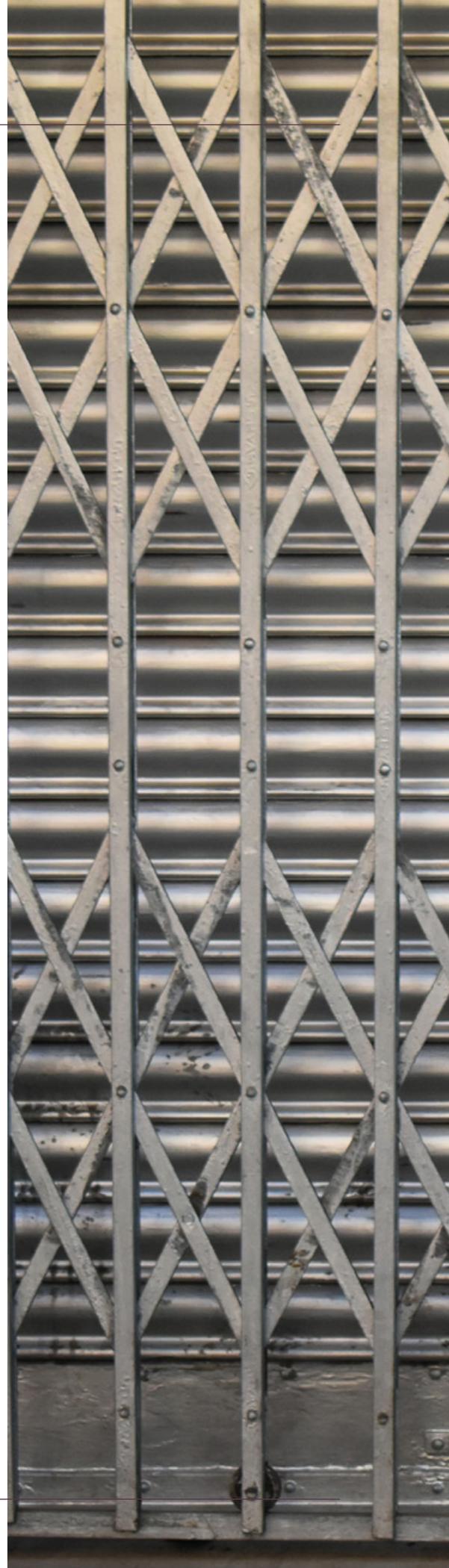






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Executive summary

South Asia Economic Focus Spring 2020

The unprecedented COVID-19 crisis comes with a dire economic outlook. South Asia might well experience its worst economic performance in 40 years, with at least half of the countries falling in a deep recession. The harsh reality of inequality in South Asia is that poor people are more likely to become infected with the coronavirus, as social distancing is difficult to implement for them. They also have less access to health care or even soap, are more likely to have lost their job, and are more vulnerable to spikes in food prices.

Public banks, discussed in the focus chapter of this edition, were at the center of weaknesses in financial sectors that cumulated during recent years. However, during this crisis, they might be part of the solution by providing countercyclical lending to the most vulnerable parts of the economy.

Chapter 1: An unprecedented crisis

The difficulties involved in limiting domestic transmission of COVID-19 in South Asia are enormous. South Asia has some of the highest population densities in the world, particularly in urban areas. This makes contagion easier, especially among the most vulnerable people: slum dwellers and domestic migrant workers. These poor people also have lower access to health services or even to water and soap.

The unfolding economic crisis is unique in several ways. While normal downturns are caused by lack of effective demand, this crisis is caused by supply constraints. While typically manufacturing is the most cyclical part of the economy, this time service sectors are hardest hit. While usually, GDP decelerates faster than consumption, as consumers smooth their spending over economic cycles, this time consumption is falling sharply. Moreover, supply disruptions and panic buying can jeopardize food security. The sudden disappearance of service sector jobs and the rise in food prices have created economic hardship, especially for people in the informal sector.

All governments in South Asia have responded rapidly to the crisis, but their task is daunting. Governments have imposed social-distancing measures, introduced relief packages to secure access to food, and provided for delays in payments on taxes, rent, utilities and debt service. Central banks have loosened monetary policy to increase liquidity. This all has been done in the face of a deteriorating global environment, and while dealing with fiscal stress and problems in financial markets that were caused by pre-existing vulnerabilities.



Chapter 2: A dire outlook

The economic outlook for South Asia is dire. South Asia will likely experience the worst economic performance of the last 40 years. Because of the unparalleled uncertainty, this report presents a range forecast, estimating that regional growth will fall to a range between 1.8 and 2.8 percent in 2020, down from 6.3 percent projected six months ago. Hardest hit is Maldives where GDP is expected to decline by between 8.5 and 13 percent this year, as tourism has dried up. Also, for Afghanistan, Pakistan, and Sri Lanka, the full range of their forecast GDP growth for this fiscal year is in negative territory. In a worst-case scenario, the whole region would experience a contraction of GDP.

The dire forecast is based on the analysis of several adverse impacts. South Asia finds itself in a perfect storm. Tourism has dried up, supply chains have been disrupted, demand for garments has collapsed, consumer and investor sentiments have deteriorated, international capital is being withdrawn and inflows of remittances are being disrupted. On top of the deterioration of the international environment, the lockdown in most countries has frozen large parts of the domestic economy.

The crisis will reinforce inequality in South Asia. Even more worrisome than the grim macroeconomic outlook is the realization that the impact on the poorest in the population will be much harsher than the consequences for more affluent people. Analysis shows that poor people have a higher likelihood of having lost their work, and domestic migrant workers who had escaped rural poverty by finding work in cities are being forced back into rural poverty again. Many of the poorest face higher risk of food insecurity.

Policy makers are in uncharted territory and must consider innovative policies. In their immediate response, the focus has been rightly on mitigating the spread of COVID-19. While doing that, conditions should be created to jumpstart the economy, once countries emerge out of the immediate health crisis. A combination of temporary work programs and a moratorium on debt servicing and rent payments could help prepare for the restart of the economies. After tackling the immediate COVID-19 threat, South Asian countries must keep their sovereign debt sustainable through fiscal prudence and debt relief initiatives. In the longer run, South Asia would do well by diversifying its international connections, while there are great opportunities to expand digital technologies for payment systems and distant learning to unlock remote areas in South Asia.

Chapter 3: The cursed blessing of public banks

Public sector banks are more prevalent in South Asia than elsewhere. Over 40 percent of South Asia's banking assets are owned by the public sector, the largest share among global regions and more than twice the level of East Asia (excluding China). The share of bank assets owned by public banks is highest in India (62 percent) and Bhutan (56 percent), followed by Sri Lanka and the Maldives (somewhat over 40 percent).

Public banks play both a positive and negative role in economic development. On the positive side, their lending can be countercyclical, and they are more likely than private banks to provide services to people in remote areas and poor people. That is an opportunity in the current crisis. On the negative side, they suffer from inefficiency and are likely to reduce competition and thus slow innovation, while they face severe agency problems, leading to political interventions that result in an inappropriate use of public money. These negative characteristics were at the root of the rise in non-performing assets in recent years.

To reap the benefits and mitigate the problems of public banks, they should be reformed according to best practices. They need much better-defined objectives and missions, in order to separate social mandates from profit-maximizing objectives. They need to be more transparent in their financial results, including in the amounts of implicit government subsidies and in contingent liabilities assumed by governments. Stronger governance and accountability could improve the performance of public banks. Finally, creditor rights must be strengthened, in order to recover parts of non-performing assets.



CHAPTER 1
RECENT ECONOMIC DEVELOPMENTS

An unprecedented crisis

The difficulties involved in limiting domestic transmission of COVID-19 in South Asia are enormous. South Asia has some of the highest population densities in the world, particularly in urban areas. This makes contagion easier, especially among the most vulnerable people: slum dwellers and domestic migrant workers. These poor people also have lower access to health services or even to water and soap.

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The coronavirus pandemic has disrupted the livelihoods of people in South Asia. Up to the beginning of March, the South Asian economies were mainly hit by disruptions in cross-border connections. Travel restrictions had decimated tourism and had delayed infrastructure projects that depend on foreign workers. Global value chains were interrupted, and international capital was flowing out of South Asia to support the balance sheets of foreign investors. Volatility in equity markets sharply increased and the value of stock markets fell, in tandem with developments in international stock markets. In March, when the coronavirus started spreading in South Asia through domestic contagion, domestic containment policies further disrupted economic activities, multiplying the impact of the cross-border shocks.

The character of this truly global economic crisis is unique in several ways:

- » Service sectors are hardest hit, as tourism dried up, shops and restaurants have been ordered to close, and demand for transport services has all but disappeared. Normally, demand for services is relatively stable. Investments and demand for durable consumption goods are usually the most cyclical components of demand, sharply declining in downturns, while demand is catching up during up-swings. In this case, it is unlikely that lost services will translate in more future demand, reducing the strength of a future rebound. For South Asia, the fall in service activities is especially challenging because of the many low-income, and often informal workers in the hospitality and transport sector.
- » This crisis is caused by supply constraints, not merely lack of effective demand. That means increasing effective demand via macroeconomic stimulus will not bring back in the short run jobs for restaurant employees or taxi drivers.
- » Social panic can lead to hoarding of food, while food supply might be hampered by logistical disruption. This means that access to basic needs is not guaranteed for the poorest people in South Asia.

Policy makers in South Asia are dealing with a plethora of challenges. The first task is to prepare the, still underdeveloped, health-care system for the fight against COVID-19. Another immediate task is to secure access to food and basic needs to the most vulnerable people in society. Similarly, it is important to secure other vital functions in the economy, such as payment systems and banking operations. This all has to be achieved in a deteriorating global environment, while dealing with fiscal stress and problems in financial markets that were caused by pre-existing vulnerabilities.

The remainder of this chapter is organized as follows. We first discuss the authorities' responses to the health crisis, i.e. the measures taken to contain or mitigate the spread of the virus. After that the economic consequences of these measures and of the global shocks will be analyzed. This will be followed by a discussion of pre-existing vulnerabilities and how these interact with the current economic crisis. Finally, this chapter will summarize the economic policies already taken to address the most urgent economic needs.

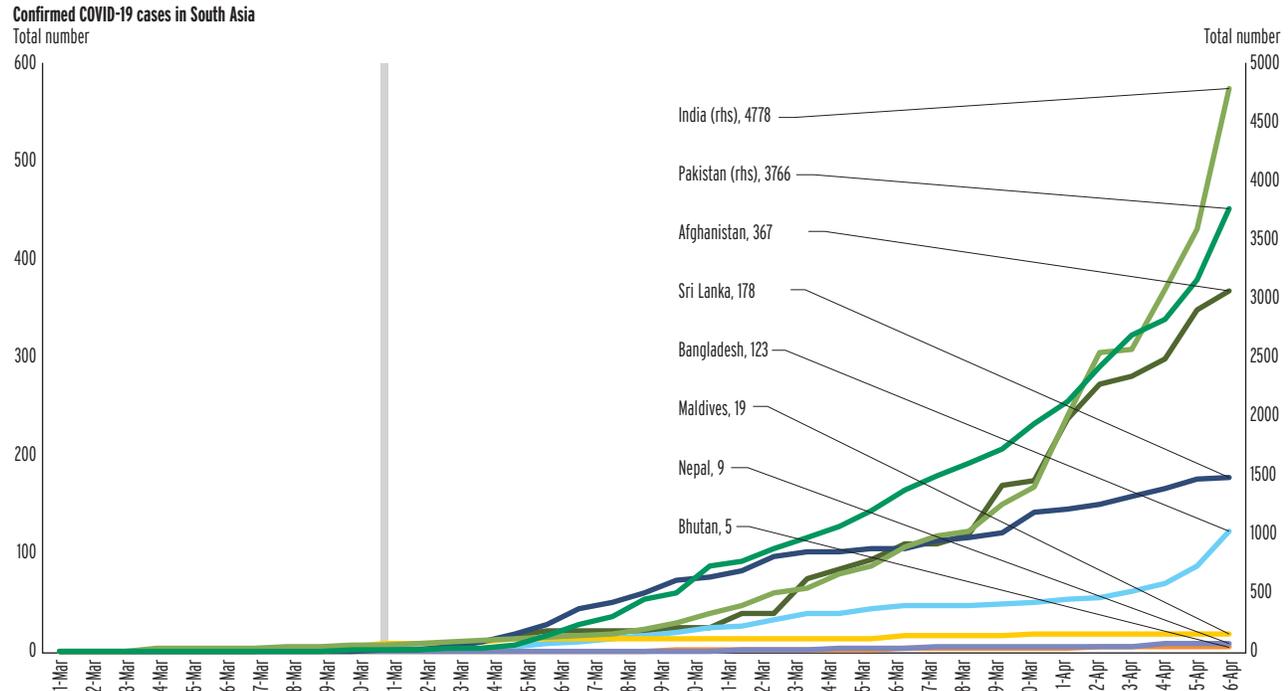
Containing the health crisis

Up until March, governments had mainly focused on restricting international arrivals. At the beginning of March there were still only a few identified cases of COVID-19 in South Asia (Figure 1.1). Governments attempted to keep the virus out by restricting foreigners from entering and by isolating individual cases. In Afghanistan, the outbreak has been highly concentrated in Herat province which hosted thousands of refugees from neighboring Iran. Similarly, Pakistan was affected through pilgrims returning from Iran. All other countries reportedly had the first case originate from travelers, and the policy response was to isolate those cases in the hope to minimize community contagion. The international travel restrictions were especially consequential for Maldives and Nepal, which heavily depend on tourism. Maldives prohibited visitors from COVID-19 affected countries, subsequently ceased issuing visas on arrival, and banned travel between resort and local islands, which effectively slowed down the tourism sector. Bhutan's minimal caseload has allowed a full isolation of those affected, with only a handful of active cases, but disruptions are still an issue due to the large number of people under quarantine.

During March, the policy measures shifted towards prevention of domestic contagion. Shortly before the World Health Organization declared the COVID-19 outbreak a global pandemic on March 11, domestic transmission of the coronavirus in South Asia became evident. For example, in Pakistan and India, cases have doubled every five days since local contagion began in mid-March, while India's new cases accelerated in the second week of April (Figure 1.1). Most countries banned large gatherings and subsequently implemented a full or partial domestic lockdown (Table 1.1). The objective is to flatten the pandemic curve (Figure 1.2). By mitigating contagion rates, the stress on health-care systems (and thus the number of unnecessary deaths) is minimized. This is crucial, because the ability of the health system to manage a very large breakout is significantly lower in South Asia than in China or the US, according to various indicators of the capacity of public health system (Table 1.2). The mitigation measures come at high economic costs

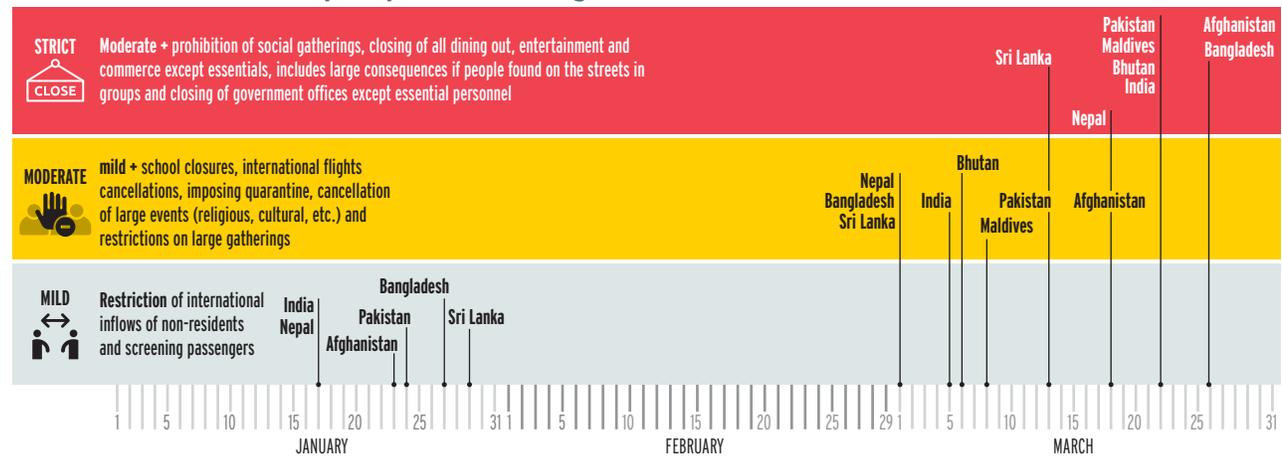


FIGURE 1.1: COVID-19 confirmed cases are growing in South Asia.



Notes: All cases are reported as of April 6, 2020 (11pm EST). The shaded line reflects the announcement of COVID-19 as a pandemic by World Health Organization.
Source: JHU CSSE Dashboard.

TABLE 1.1: South Asia has ramped up social distancing measures.



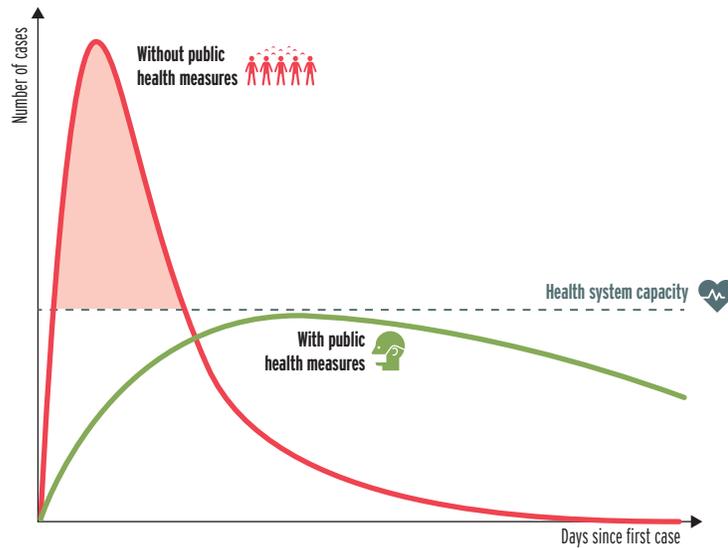
Sources: World Bank and national government websites.

but are vital to prevent the outcome of earlier pandemics. For example, during the Spanish flu in 1918, it is estimated that India lost about 18 million people – equal to 6 percent of the population at the time (Biswas 2020).

However, the challenges to prevent domestic transmission in South Asia are enormous. South Asia has some of the highest population densities in the world, particularly in urban areas. This makes contagion easier, especially among the most vulnerable people: slum dwellers and migrant workers. In India, Bangladesh and Pakistan, the time between the announcement of suspension of inland passenger transport and its enforcement was less

than a day, which created chaos as migrants scrambled to get back to their provinces, exacerbating the crowding and making enforcement of social distancing impossible. The flow of migrant workers could easily become vectors carrying the coronavirus back to other states and villages (Box 1.1). One minor advantage of South Asia is that the population over 65 years of age is lower than in the US and China, which could also limit the death rates (Table 1.2). However, household sizes are large. As in other countries, the inadequate availability of medical equipment (such as sanitizers, masks, and ventilators), and a scarcity of mostly imported medical products led countries to stock domestic supplies. India, which produces masks, had earlier

FIGURE 1.2: The first line of defense against COVID-19 is to minimize health costs.



Source: Following Gourinchas (2020).

TABLE 1.2: South Asia is affected by COVID-19 and health systems are not prepared.

	India	Pakistan	Afghanistan	Sri Lanka	Bangladesh	Maldives	Nepal	Bhutan	China	US
Number of confirmed cases (as of April 6)	4778	3766	367	178	123	19	9	5	82,665	366,614
Cases per million persons (as of April 6)	3.52	18.7	10.1	8.2	0.7	48	0.3	7.1	59.3	1120.5
Death rate per confirmed cases	3%	1%	3%	3%	10%	0%	0%	0%	4%	3%
Recovery rate per confirmed cases	8%	7%	5%	21%	27%	68%	11%	40%	94%	5%
Population density (persons per sq km)	454.9	286.5	56.9	338.5	1239.7	1719	196	19.8	152.1	35.8

Health outcomes

COVID-19 tests administered per million persons	20	39	-	-	6	1995	27	844	229	1653
Number of hospital beds (per 1,000 people)	7	6	5	3.5	8	4.9	3	17	42	29
Global Health Index rank (out of 195 countries)	57	105	130	120	113	121	111	85	51	1
Share of population under 65 years of age	94%	95%	97%	90%	94%	96%	94%	92%	90%	85%
Country Population (million)	1356.6	201	36.4	21.7	166.9	0.4	29.6	0.7	1395	327.2

Notes: Data for COVID-19 cases is reported as of April 6 11 PM EST. Population and Population density as of 2018 is reported; Share of population as of 2015 is reported. For hospital beds the data for Afghanistan and Bangladesh is 2015; Pakistan is 2014; USA is 2013; Bhutan, Nepal and China is 2012; India is 2011; Sri Lanka is 2010 and; Maldives is 2009. The Health Index Score is calculated for 195 countries, 195 being the lowest rank for any country.

Sources: JHU CSSE Dashboard, Country Health Ministries, Central bank websites, WHO, UN Data, Global Health Index, World Bank and staff calculations.

ramped up exports to Italy, but ran into isolated domestic shortages by March 21. The number of COVID-19 tests conducted per million people is very low due to lack of test kits. In Bangladesh, there have been reports of people near Dhaka dying of COVID-19-type symptoms, which would not appear in the statistics. Social-distancing measures can also clash with vital economic interests. In Bangladesh, the decision was hard given the tradeoff between

shutting down garment factories to protect workers and preventing the economy’s main industry from coming to a screeching halt. The garment exporters association (BMGEA) appealed to international buyers to honor recent orders and received some positive responses, however shortage of raw material due to supply disruptions and a nationwide lockdown led temporary to closure of most factories as of April 7.



BOX 1.1. Predicting the Spread of COVID-19 in South Asia through migration corridors.

Lockdown policies have affected hundreds of millions of migrants across the subcontinent many of whom are day laborers and no longer have work in urban centers, leading to mass migrations, often by foot, back to their rural homes (Biswas 2020). Migrants face a stark choice between potentially starving in urban centers without work or long and potentially fatal journeys over hundreds of miles to their home districts.

According to the National Sample Survey 2007-2008 (NSS), 1 in approximately 6 households in India has a member who is a migrant worker, while according to the Bangladesh Household Income and Expenditure Survey 2016-2017 (HIES) approximately 1 in 6 households in Bangladesh also has a member who is a migrant worker in another district. Similarly, approximately 1 in 10 workers in the most recent Labour Force Survey (LFS) in Pakistan was a migrant. The total number of migrant workers in India may be as high as 120 million or more, according to the migrant advocacy nongovernmental organization Aajeevika Bureau.

This poses a public health risk as returning migrants may spread the virus to rural areas in South Asia which are not well equipped to handle the crisis, especially in terms of the capacity of hospitals and clinics. As initially reported in the Dhaka Tribune and later analyzed by the World Bank, according to the National Telecom Monitoring Centre (NTMC) in Bangladesh, data from sim cards' geolocations indicate as many as 10 million sim cards or between 5.5 million and 10 million individual subscribers have left Dhaka for the rural areas of Bangladesh since the crisis began.

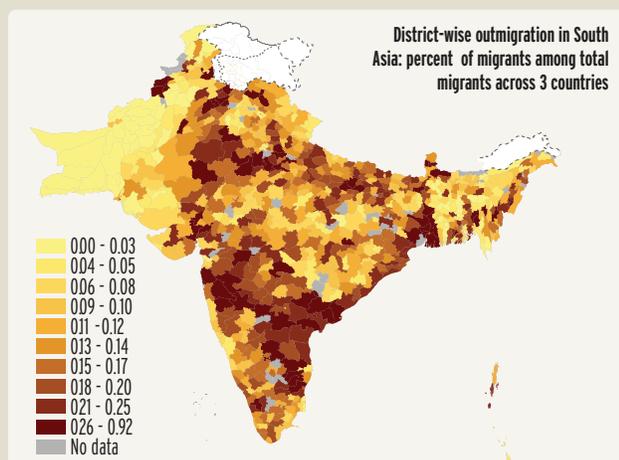
Data on migration may provide a way of predicting high risk areas for the spread of coronavirus for policy makers. Figure 1.3 below shows the prevalence of internal migration by district in India, Pakistan and Bangladesh. In data from the NSS in India, the top three sending districts were: West Tripura in the state of Tripura, Solapur in Maharashtra, and Imphal West in Manipur. In data from the HIES in Bangladesh, the top three sending districts were: Jhalokhoti and Patuakhali in Barisal division and Noakhali in Chittagong division. In data from the LFS in Pakistan, the top three sending districts were: Karachi East in Sindh, Faisalabad in Punjab and Lahore in Punjab.

These areas are potentially at the highest risk of COVID-19 outbreaks. Indeed, as reported in early work by Shonchoy (2020) with epidemiologists from the International Centre for Diarrhoeal Disease Research, Bangladesh, outbreaks outside of Dhaka have been strongly correlated with migration patterns, potentially due to returning migrants bringing the disease from Dhaka, Chittagong or internationally. Lee *et al.* (2020) extend this analysis to India and Pakistan using data on migration for the three countries (from the sources cited above) combined with locality level data on coronavirus cases. Preliminary findings indicate that in India, high-outmigration areas are more likely to have COVID-19 cases.

Policy responses to this aspect of the pandemic could include the following:

1. Direct early resources to high-risk areas as defined by high-migration corridors, including medical equipment and staff.
2. Use available big data and digital data to analyze patterns of reverse migration and movement around the country, to more precisely identify potential hot-spots. The telecoms industry data cited above could be analyzed in a more fine-grained manner to determine where the most reverse migration out of Dhaka has been.
3. Establish social safety nets to help limit reverse migration. For example, in Bangladesh, the New York Times is reporting that the government is planning a large-scale bailout of the ready-made-garments sector targeted to paying worker salaries and allowances (New York Times, 2020). However, creativity will be needed to address the large numbers of migrant workers who are informal laborers in construction, domestic work, transportation and other related sectors. The extent of cash transfers through bank accounts may be limited by low uptake of bank accounts and other financial products in the bottom 40 percent by income (Demirgüç-Kunt *et al.* 2018).
4. Support institutions that are likely to provide social insurance to those affected by the loss of income from migrant work, including microfinance institutions and rural banks.
5. Promote social distancing and preventive behaviors even in rural areas, as they are likely to be eventually affected due to reverse migration.
6. If not possible to prevent reverse migration to rural districts via urban-centered social protection programs, governments should consider immediate assistance to migrants to limit suffering and loss of life during the strenuous long-distance journeys, by providing information and food and water to journeying migrants.

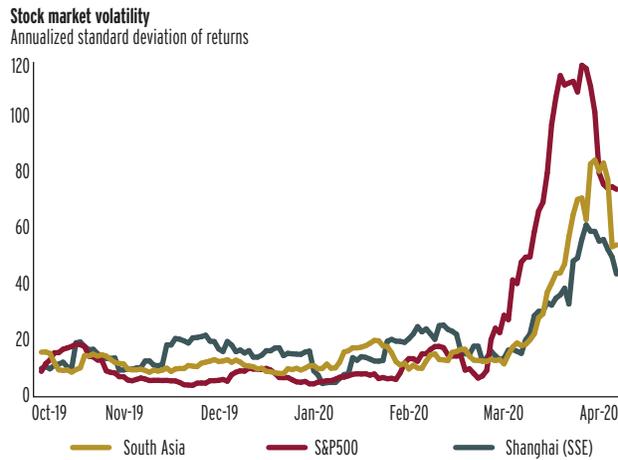
FIGURE 1.3: District-wise outmigration varies across South Asia.



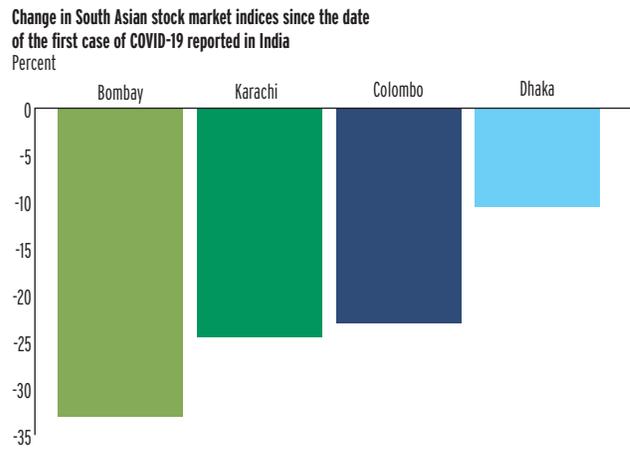
Notes: The map plots district-wise out-migration rates, defined as the number of migrants who migrated out of the district to another district in the same country as a fraction of the total number of such migrants across India, Pakistan, and Bangladesh. The data on migrants for India is obtained from the 2007-08 National Sample Survey and considers migrants who left their household within the past 5 years. Data was collected for 588 districts out of the 640 districts in India as per the 2011 Indian Census. The data on migrants for Pakistan is obtained from the 2007-08 Labor Force Survey. The data on migrants for Bangladesh is obtained from the 2016 Household Income and Expenditure Survey (HIES) and considers migrants who left their household within the past 5 years. District boundary changes over the years have been manually accounted for in the plot. The plots reweights the number of migrants surveyed in each survey by the proportion of the population of the country surveyed to reflect estimates of the number of migrants in each district. The cutoff values reflect deciles of out-migration rates, which range from 0 to 0.92 percent.

Sources: National household surveys and World Bank.

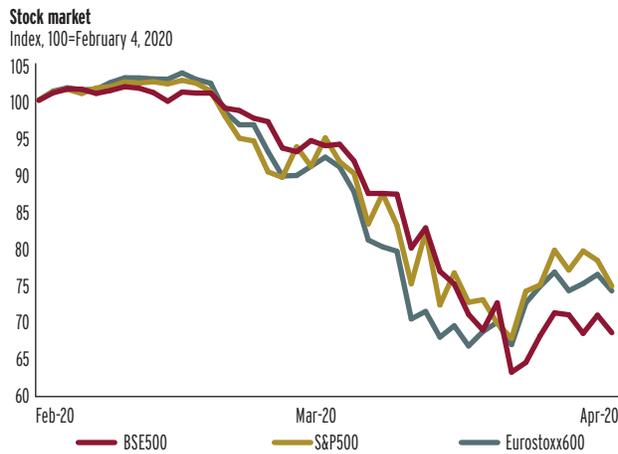
FIGURE 1.4: Economic activity and equity markets in South Asia and the world react to COVID-19.



Notes: Data is updated until April 3. South Asia represents the average of Colombo stock exchange ASPI, Bombay stock exchange SENSEX, Karachi stock exchange 100, and Dhaka stock exchange DSEX.
Source: Haver Analytics and staff calculations.



Notes: The first case was reported in India (imported from Wuhan China) on Jan 29. Data is updated until April 3.
Source: Haver Analytics and staff calculations.



Note: Data is updated until April 3.
Source: Google Finance and staff calculations.



Notes: The decline refers to the change of visits and length of stay as of March 29, compared to a baseline period. The baseline period is defined as the median value, for the corresponding day of the week, during the 5-week period from January 3 to February 6. The mobility trends for retail and recreation places include restaurants, cafes, shopping centers, theme parks, museums, libraries, and movie theaters.
Source: Google COVID-19 Community Mobility Reports.

An unprecedented economic crisis

Many of the economic impacts of the measures to contain the pandemic are not yet observable. Either economic data will only become available with a delay, or the current situation is very fluid and can change daily. The former is very much true for loss of employment in the service sector, potentially one of the most consequential impacts in South Asia. The latter is true for local food prices and remittances. Data on financial markets and on international commodity prices are readily available, and they show a dramatic picture.

High-frequency economic indicators reflect the initial shock. The regional volatility in equity markets (as indicated by the volatility in regional stock prices) and indicators of reduced economic activity have grown many times larger than the average over the past 3 years (Figure 1.4, panel 1). Since the announcement of the first imported case in India on January 29, the values of the region's equity indices have fallen sharply – by 33 percent in Mumbai, 25 percent in Karachi and 23 percent in Colombo as of April 3 (Figure 1.4, panel 2). The fall in India's stock price marked the end of a fairly strong run, in line with other stock markets (Figure 1.4, panel 3). Portfolio outflows in Pakistan and Sri Lanka have been reported since the onset, although these have not been large. Moreover, indicators showing other sectors of the economy are quite



stark: since social distancing measures began to be implemented throughout March, activity in the retail and recreation services in five countries has plummeted, as measured by Google's mobility index (Figure 1.4, panel 3). All in all, the drop of asset prices and the weak capital inflows exacerbate already existing vulnerabilities in South Asia's banking sectors, while economic activity in services is suffering.

The fall in international commodity prices reflects the exceptionally weak global economy. This is best illustrated by the collapse in oil prices. Oil prices entered a precipitous downward spiral since January, as the Chinese authorities took measures to contain the pandemic by shutting down production in Wuhan. The oil price plummeted from USD 65/barrel on January 20 to USD 32/barrel on April 7, lower than any monthly average since August 2003. The drop reflected expectations of declining global demand, exacerbated by the current indecision of OPEC producers and the United States to agree on a coordinated level of production cuts. This is a dramatic change from only a few months ago: Brent oil prices averaged USD 64/barrel during 2019, a year in which monthly volatility was the lowest since the price spike of 2007. Futures prices suggest that oil prices could average USD 60/barrel by December 2020, when global economic activity is expected to resume.

There are signs of rising food prices, but many price increases are localized. Food prices have been volatile during this crisis. Price rises in local food markets have occurred in reaction to supply disruptions and panic buying. However, there are no signs yet of widespread food shortages, in part because governments quickly took steps to ensure that all basic goods were made available. If the coronavirus spreads further and lockdown measures remain in place for a long period, it will become more challenging to guarantee food security, especially for the most vulnerable in the population (Box 1.2).

There are indications of disruptions in flows of remittances to South Asia. One reason is that money transfer agencies in either the sending or receiving countries are closed due to lockdown measures. Another reason is that many migrants have lost their work, while struggling to return to their home country. A sharp drop in remittances would be atypical, as normally remittances are countercyclical. In case of a crisis in their country of origin, migrants tend to send more money home to support their families. In case of a crisis in their host country migrants tend to return home with all accumulated savings. The global nature of the current crisis, slumping oil prices and the disruptions of payment systems could reduce remittances, aggravating the problem of many countries in South Asia that rely on remittance inflows (Box 1.3).

This crisis is unique because of the sudden loss of work for people in the hospitality and transport sectors.

Among those workers are many that have low incomes, are in the informal sector, and have limited or no access to social safety nets. A complication is that this work cannot be recreated through fiscal or monetary stimulus, because of travel restrictions, closure of restaurants, and a ban on large events. There is no up-to-date information available about the extent of the job losses, but it is important to explore indirect evidence of who is currently affected and how vulnerable the affected workers are. Chapter 2 contains an analysis of the income position of those that are affected. Poor people are not only at risk of losing their income but are also more likely to be directly affected by the health crisis (Box 1.4).

Pre-existing vulnerabilities

South Asia entered the pandemic with serious economic vulnerabilities after a year of weak growth. South Asia experienced in 2019 its weakest growth in 10 years, in line with weak global growth in investments and trade. After the United States–China trade agreement there were first signs of a mild rebound, but these green shoots never had the opportunity to mature because of the pandemic. This weak growth in South Asia came with, and was partly caused by, rising public debt levels and mounting non-performing assets (NPAs) in banking sectors. This means that in their response to the current crisis, authorities are dealing with tight fiscal positions, while they must ensure that the banking sectors remain liquid. There was one silver lining at the start of the crisis. Because of weak growth and contracting imports, current account deficits declined, and they further improved because of the collapse in oil prices. That means that several countries in South Asia have some buffer to absorb capital flow reversals and declining remittances.

The global economy seemed to have hit the trough around November 2019, but with the spread of the virus in the manufacturing hub in Wuhan, China, hopes for a quick global recovery evaporated. For most of 2019, global trade was not growing, and leading indicators were in negative territory. At the end of 2019, the announcement of a phase 1 trade agreement between the United States and China had reduced global uncertainty, signaling that the decline in trade and manufacturing output may have been ending (Figure 1.7). The world semiconductor industry in November 2019 forecast a 10 percent recovery in sales, meaning that manufacturing was expected to ramp back up as the electronics cycle finally picked up. Some improvement in the global Purchasers'

BOX 1.2. Food price increases need to be addressed with decisive measures.

The COVID-19 outbreak in South Asia has resulted in disruptions in food markets across countries. Traditionally, global food and oil prices and rainfall patterns, which are correlated across South Asian countries, have been the main determinants of food prices in South Asia (World Bank 2019; Mittal 2009; Cudjoe *et al.* 2010). However, city and nationwide lockdowns, border closures and social distancing measures in the region to contain COVID-19 have now resulted in localized supply disruptions and panic buying, resulting in food price hikes. In Afghanistan, the prices of wheat and wheat flour rose by almost 15 percent, and the price of cooking oil by 9 percent, at the end of March compared to mid-March. Similarly, in Pakistan the price of wheat flour increased by nearly 13 percent due to supply-side interruptions. Traders also reported increases in the prices of pulses, cooking oil prices and sugar. In Bangladesh, wholesale prices for food surged in the initial days after the lockdown announcement. In Bhutan, an import ban on meat, fruits and vegetables (mainly imported from India) caused an immediate surge of people in markets, until the reversal of the fruit and vegetable ban. Many countries reported shortages of various essential commodities, in part because of bottlenecks as suppliers of essential goods grappled to cope with the sudden surge in demand.

Millions of poor households across the region fear starvation, inadequate food supply and soaring prices. Those most affected by the food price increases, the rural and urban poor in South Asia, spend up to four-fifths of their income on food (Hertel *et al.* 2004; Mittal 2009; Akter and Basher 2014). South Asia is vulnerable to increasing food inflation especially because of the large segment of the population living near the poverty line (Carrasco and Mukhopadhyay 2012; Mittal and Sethi 2009; World Bank 2019). All South Asian countries rank between low and serious on the Global Hunger Index (Sri Lanka ranking the highest at 66th and Afghanistan the lowest at 108th out of 117 countries). The majority of the region's urban population also works in the unorganized sector and is heavily dependent on daily wages for survival. In Afghanistan, nearly 14.3 million people are projected to be in crisis because of food insecurity as a result of lockdowns. In Pakistan, India, Nepal and Bangladesh, with high levels of food insecurity and widespread malnutrition among children, the consequences of the virus spreading widely could reverse the recent positive trends in poverty and prove to be catastrophic and far reaching.

Governments in South Asia are taking measures to prevent bottlenecks in the supply of food and to ensure price stability amidst lockdowns.

- » In Afghanistan, the government announced a plan to supply 24,000 tons of wheat from the government's strategic reserves to mitigate food supply shocks and provide public reassurance.
- » In Bangladesh, the government decided to operate special open market sales of coarse rice for the poor across all city corporations, pricing rice at a third of its current market price. The government is also operating mobile courts to monitor market prices and prevent hoarding.
- » In Bhutan, the Ministry of Agriculture and Forests encouraged all farmers and other interested individuals to increase food production by offering concessions and subsidies. The government also encouraged wholesale and large retailers to ensure continued food supply across the country.
- » In India, the central government announced the free provision of 5 kg of rice or wheat and 1 kg of preferred pulses per person, each month for the next three months for 800 million people, which will be above the existing entitlements under the National Food Security Act. Governments of the wealthy states Kerala, Delhi, Rajasthan and Tamil Nadu have initiated their own measures, such as cash grants for poor households, subsidized meals, home delivered dry rations and provision of cooked meals for school children.
- » Pakistan announced a USD 7 billion relief package that includes USD 1.6 billion for wheat procurement, USD 300 million to support utility stores and USD 90 million of tax expenditures on food supplies. In
- » Sri Lanka, the government has imposed price ceilings on essential food items, as well as concessional loans and food allowances for low-income consumers (beneficiaries of the Samurdhi program).

Managers Index in January were also suggestive of a mild recovery in November-December, but because of the pandemic this never materialized.

With strong headwinds, South Asia's growth and production indicators followed a pattern of steady decline throughout most of 2019 (Figure 1.8, left panel). China, a key market for South Asia's service exports, continued on a path of moderating growth, before industrial production plunged in February. And other markets also slowed, as trade tensions and Brexit were increasing uncertainty (Figure 1.8, right panel). China's and EU's slowdown especially impacted demand for garments from Pakistan and steel exports from India. Towards the end of the year, Bangladesh garment exports also fell.

Even more than exports, investments weakened in 2019 due to uncertainty in global markets. Very much in line with other countries in the world, investments were weak in India and Sri Lanka, and even contracting in Afghanistan, Bhutan, and Pakistan (Figure 1.9). Exceptions were Bangladesh, where public infrastructure investments were continuing, but orders in the manufacturing sector weakened; and Nepal, where public investment projects in support of the upcoming Visit Nepal 2020 campaign had grown steadily. By comparison, investment in 2018 had grown in all countries except Bhutan and was mostly flat in Sri Lanka.

Before the COVID-19 breakout, the high level of non-performing loans contributed to a lower supply of loanable funds as lending from state banks was limited,

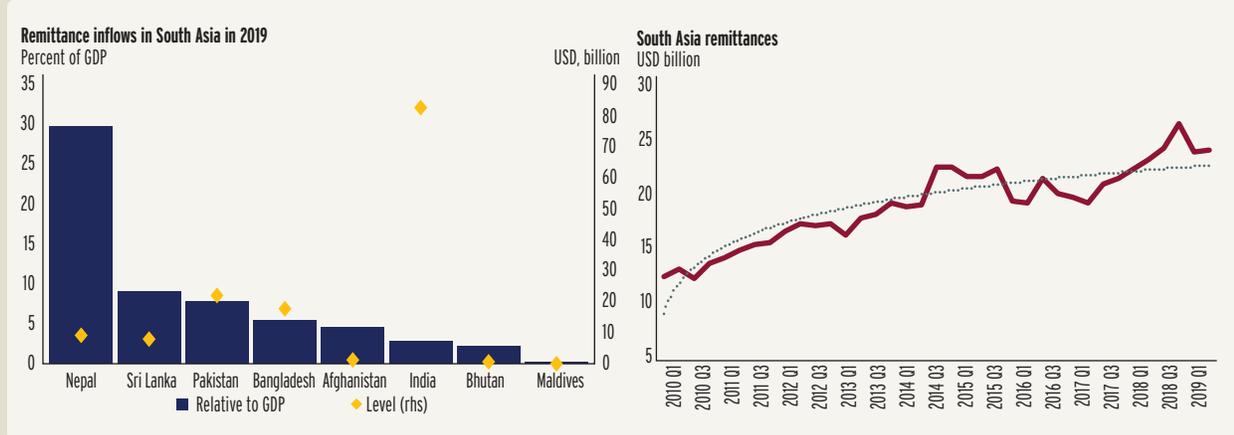


BOX 1.3. Migrant remittances in South Asia may decline during the time of COVID-19.

Remittances sent by international migrants worldwide are an important source of external finance and foreign exchange. In South Asia official inflows of remittances range from negligible in the Maldives to 25 percent of GDP in Nepal, one of the highest rates globally (Figure 1.5, Panel 1). Recorded remittances grew steadily over the last decade, particularly during the first part, at an average of 8 percent a year (Panel 2). About half of all international migrants from South Asia work in the Gulf countries at oil facilities, construction projects and related sectors. (Panel 3). Most of the other half work in the United States and the EU—particularly the higher skilled migrants—and a small percentage work in South Asia. For example, there are many Indian migrants working in Bhutan, Sri Lankan workers in Bangladesh and Nepalese workers in India. Remittances have thus been a relatively steady source of income for households in South Asia and an important source of foreign exchange.

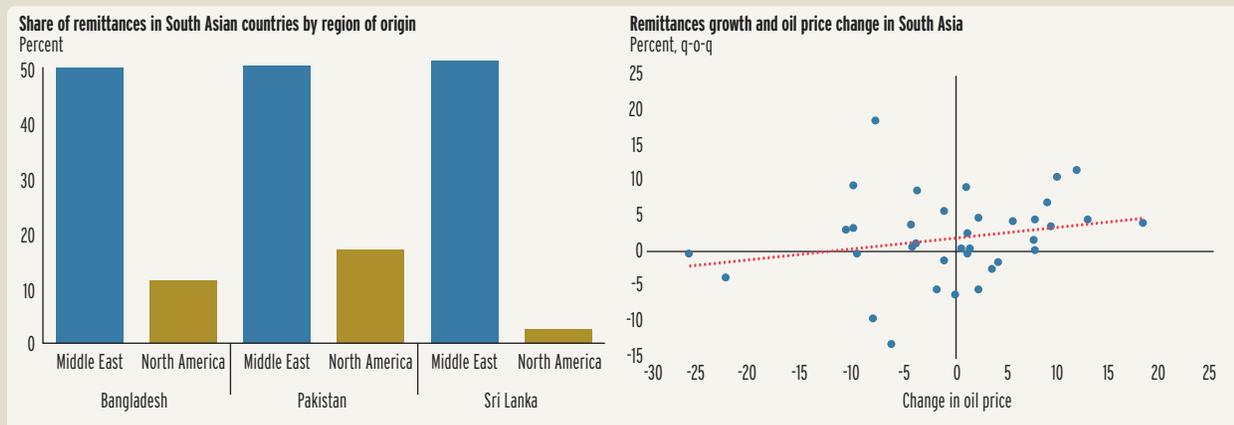
Historically, income from remittances has been a stable or even countercyclical source of external income (Mohapatra and Ratha 2010). Remittance receipts change much less than investments or other flows because they come from a cumulative number of workers abroad, so are unlikely to change with a small change in migrant flows in a particular year. For example, Malaysia recently restricted the number of new migrants from Bangladesh, while the completion of large construction projects in the Gulf may have led to a small temporary decline in migration, but the rate of decline of remittances in Bangladesh as a share of GDP has been small. Studies show that remittances increase during hard times because migrants living abroad send more money to help their families back home. For example, remittance inflows increased to Mexico following the country’s financial crisis in 1995, to the Philippines and Thailand after the Asian crash in 1997, and to Central America after Hurricane Mitch in 1998. However, this may not be the case if the host country is hit by the shock, as during the global financial crisis (GFC). Part of the offset occurred because returning migrants brought their savings with them.

FIGURE 1.5: Remittances, a major source of income, have grown steadily since 2010, but most migrants are based in the Middle East, so falling oil prices with COVID-19 could lower them.



Source: World Bank and staff calculations.

Note: South Asia includes Bangladesh, India, Nepal, Pakistan and Sri Lanka. Sources: IMF, CEIC database, Haver Analytics and staff calculations.



Notes: Data shown for Sri Lanka corresponds to 2018. The Middle East region include the following countries: United Arab Emirates, Saudi Arabia, Qatar and Bahrain. In Bangladesh, North America is only represented by the United States. In Pakistan, North America includes the United States and Canada. Source: CEIC database and staff calculations.

Note: The period covered is from 2010Q1 to 2019Q1. Sources: IMF, CEIC database, Haver Analytics and staff calculations.

BOX 1.3. Migrant remittances in South Asia may decline during the time of COVID-19 (continued).

The COVID-19 crisis in South Asia, however, may be accompanied by a decline in remittances. First, unlike past market crises, the COVID-19 outbreak has affected all countries. In particular, the outbreak of the disease in large advanced economies where migrants work (US and EU) has likely resulted in sharp reductions in migrant incomes, which may reduce remittances to South Asia. Second, oil prices have halved to around USD 30/barrel since the beginning of the year, suggesting that oil-related activities may shut down. This differs from the period after the Global Financial Crisis, when oil supply problems led prices to quickly recover to over USD 70/barrel. Indeed, a USD 1 drop in the price of oil is associated with a 0.28 percentage point drop in total remittance inflows to South Asia over the last 10 years (Panel 4, Figure 1.5). Taking this into account, a fall of USD 25/barrel in the price of oil could have reduced remittances to South Asia by 7 percent in the first quarter of 2020, all else being equal.

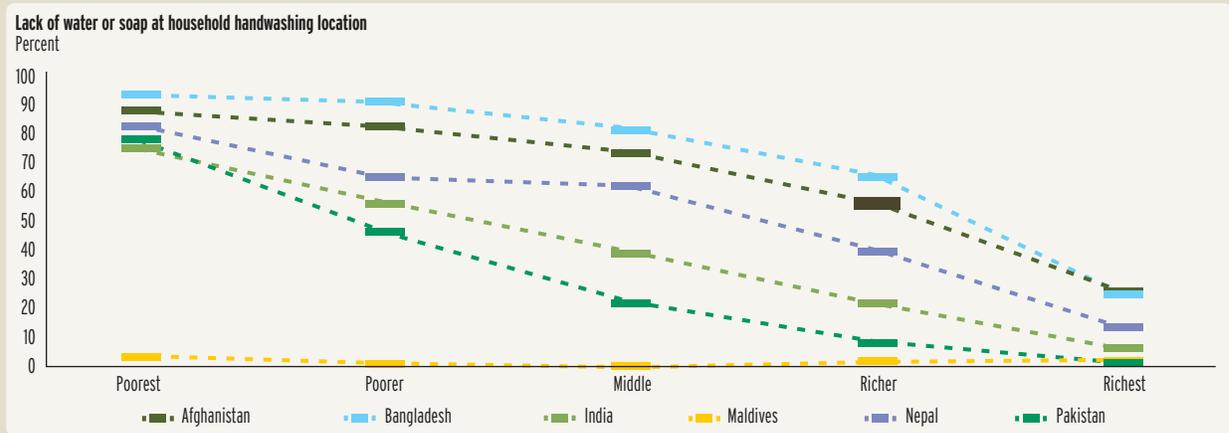
Migrant workers face other risks. Due to travel restrictions, many migrants will not be able to return home. So far, many countries in the Middle East, US and EU have announced that sick-day benefits and other help for employees will also be extended to migrant workers. But it is unclear how long that protection will last. There is a risk that payment systems are affected, particularly informal ones. Over the medium-term, countries whose migrants are more diversified geographically and have established diasporas abroad will be able to sustain stable and growing remittances flows. Governments can help by reducing the costs of sending them through formal channels, particularly using digital banking.

BOX 1.4. Distributional impact of COVID-19. Whose health is affected?

Although COVID-19 contagion does not discriminate by income, poorer people are not able to respond as quickly through containment measures. Therefore, the impacts of the health and economic crises linked to the COVID-19 pandemic are far from uniform along the income distribution of the populations in South Asia. Previous evidence shows that poorer people are more exposed to communicable diseases. Poorer households usually suffer from multiple deprivations and tend to have worse initial health conditions and less access to health services and care. These factors can make the health consequences of the pandemic more severe for people toward the bottom of the distribution.

While evidence for the incidence of COVID-19 across socio-economic groups is not yet available, earlier data have shown that poorer people may be affected more severely. A highly cited global study (Gwatkin, Guillot, and Heuveline 1999) stated: “in 1990, communicable diseases caused 59 percent of death and disability among the world’s poorest 20 percent. Among the world’s richest 20 percent, on the other hand, noncommunicable diseases caused 85 percent of death and disability.”

FIGURE 1.6: Many poor in South Asia lack water or soap for handwashing.



Source: Demographic and Health Surveys (most recent years available) and staff calculations.

An important reason for this gradient of morbidity-related deaths is that poor people have lower access to health services or even to simple water and soap. In Nepal and Afghanistan, for example, women in around 80 percent of the poorest households report that distance is a ‘big’ problem in using health services, while this is the case only for about 20 percent for the richest group in Nepal, and 40 percent in Afghanistan. The differences across households in terms of basic hygiene conditions due to the simple availability of soap and/or water for handwashing are staggering (Figure 1.6). For example, close to 90 percent of the poorest group lacks either soap or water for handwashing in Nepal and Afghanistan. But even in countries at a higher level of GDP per capita, such as India and Pakistan, still around 70 percent suffer from this basic deprivation. It should not be a surprise that a highly transmissible disease could spread more quickly among those in poorer groups.



FIGURE 1.7: Global trade and economic activity indicators have weakened since the trade war started, but early signs of recovery at the end of 2019 abruptly ended with COVID-19.

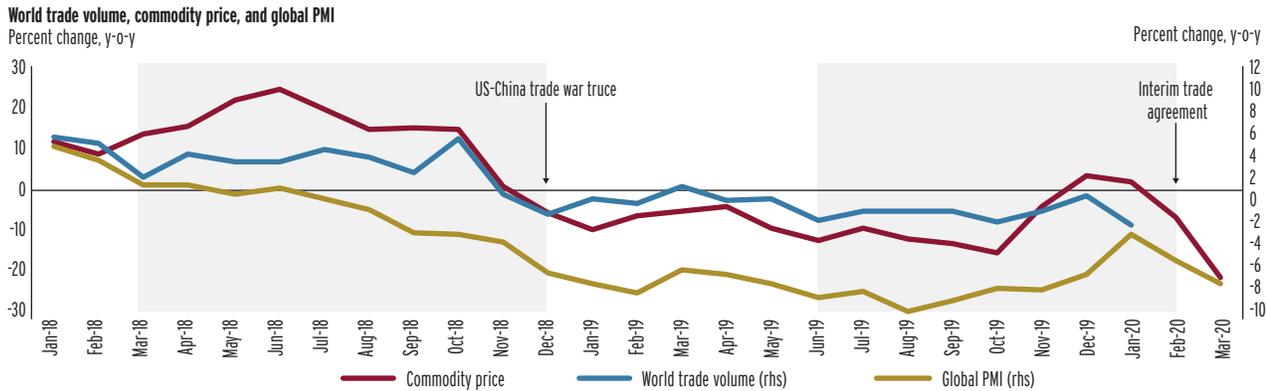
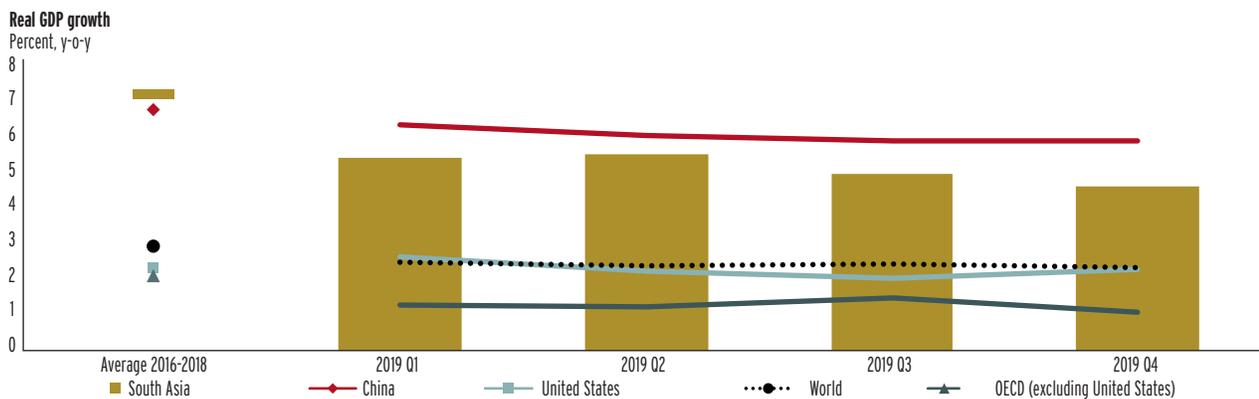
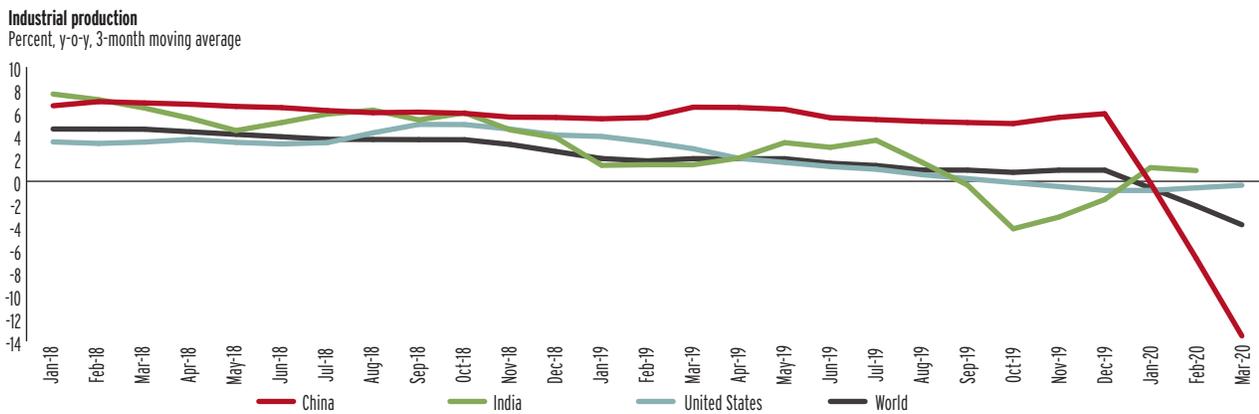


FIGURE 1.8: Weakening growth and industrial production (IP) in large economies came to a head with the COVID-19 crisis.



especially in India and Bangladesh. Growth of private sector credit has slowed in most countries since around September 2019, reflecting lower availability of loanable funds (Figure 1.10, left panel). For India and Bangladesh this is mostly related to state banks' high non-performing loans (NPL) to total loans ratio, weak deposit growth and public sector borrowing from domestic banks, which

reduced the availability of credit and led to slower private sector credit growth (see Chapter 3). In Sri Lanka, multiple measures, including a reduction of policy rates as well as caps on lending rates, did not prevent private credit growth from decelerating from 15.9 percent in 2018 to 4.5 percent in 2019. In Bangladesh, a surge in public sector borrowing from domestic banks raised broad money

FIGURE 1.9: Investment weakened in several countries in 2019.

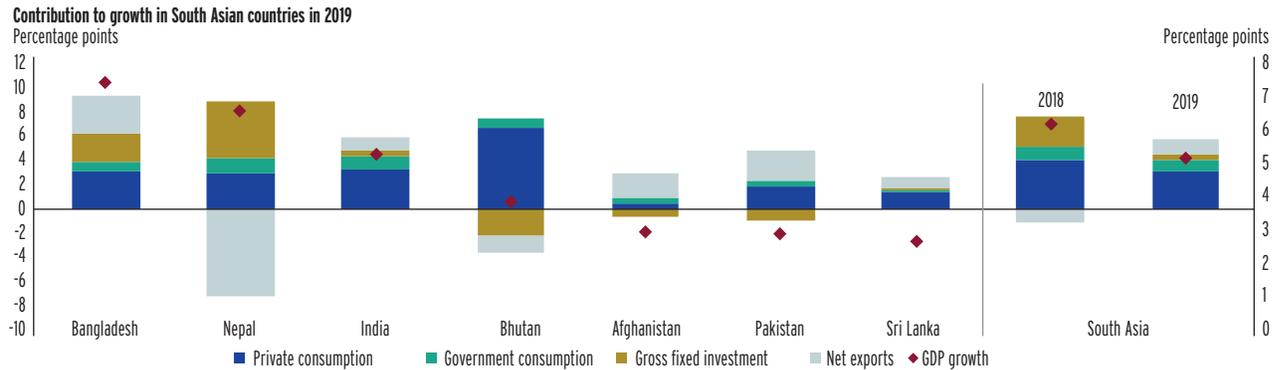
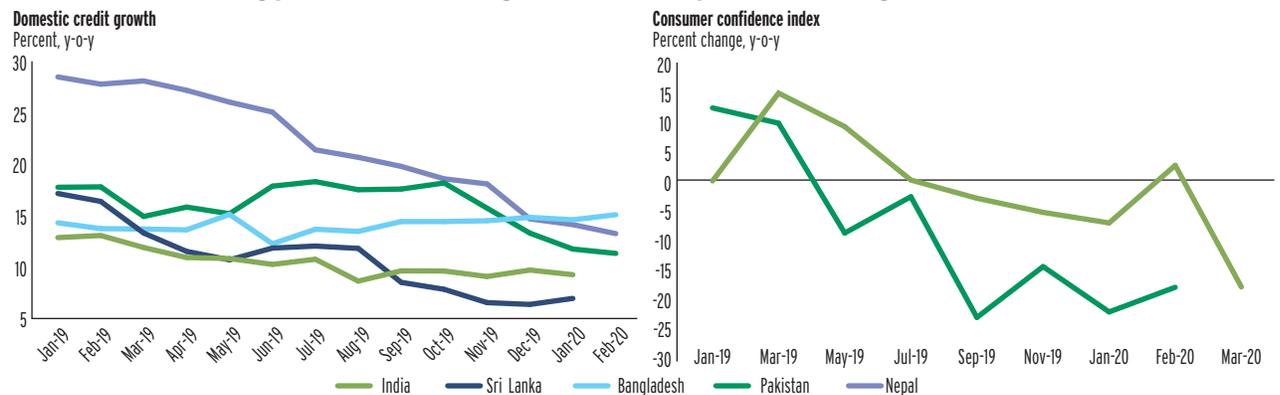


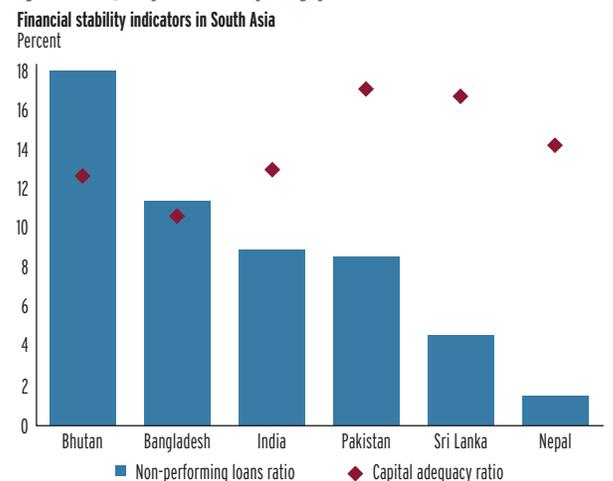
FIGURE 1.10: Weakening private sector credit growth reflects in part deteriorating consumer confidence.



growth to 12 percent in December 2019. Although regulatory provisions at the end of 2019 eased rescheduling conditions on some overdue corporate loans, NPLs were still 9.3 percent of total bank loans by the end of 2019, and private sector credit growth declined to 9.8 percent in December 2019. Weak credit growth has been accompanied by low consumer confidence (Figure 1.10, right panel). In Bhutan, the NPL ratio in the financial sector rose to 18.4 percent in September 2019, up from 12.8 percent in September 2018. While this reflects mid-year cyclical factors, NPL and provisioning ratios have deteriorated, overall, in recent years.

Most financial sectors in the region have sufficiently high capital adequacy ratios to absorb potential losses in normal times, but capital buffers will likely be eroded during the lockdown period (Figure 1.11). Capital adequacy ratios in India (12.9) and Bangladesh (10.5) remain above the Basel III recommended levels of 8 percent. In India, tighter regulations for state banks with non-performing loans and measures to quell shadow loans were creating a perfect storm for a further credit squeeze. The announcement of the fall and consolidation of Yes Bank left the authorities grappling with the fallout, so credit would continue to be affected. Still, given these exceptional circumstances of a virtual standstill in economic activity,

FIGURE 1.11: Non-performing loans in India and Bangladesh remain high despite some capital injections; capital adequacy provides a buffer.

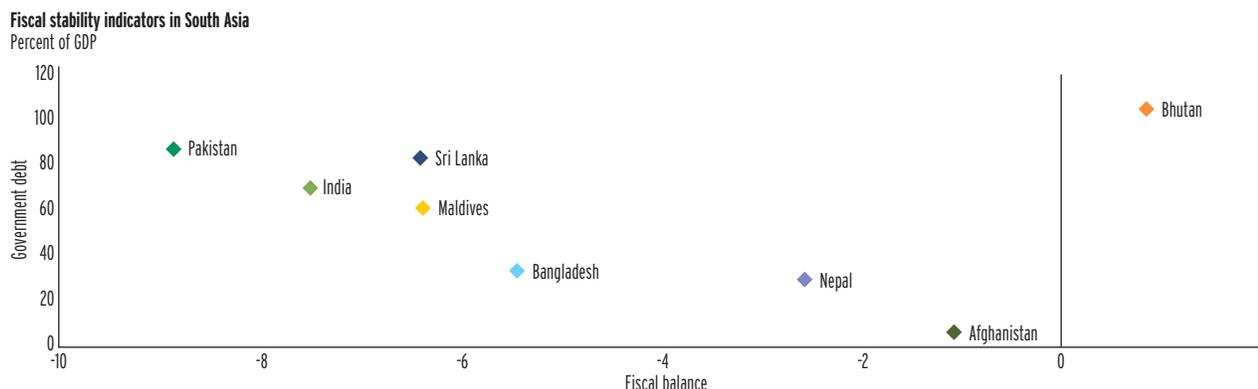


Notes: For the non-performing loans ratio, the year 2019 is an average of the first three quarters of 2019. For the capital adequacy ratio, Nepal, Pakistan and Sri Lanka latest observation is 2019. For the rest it is 2018.
Sources: IMF, CEIC database and staff calculations.

the Indian authorities will need to find a way to improve working capital to otherwise viable businesses who need to weather the lockdown, and public banks could be a source for countercyclical support (see Chapter 3).



FIGURE 1.12: With spending above budgeted amounts, fiscal deficits deteriorated further. Debt sustainability is a concern for the region, but the risk of debt distress varies.



Note: Data is for latest available fiscal year.
Source: World Bank.

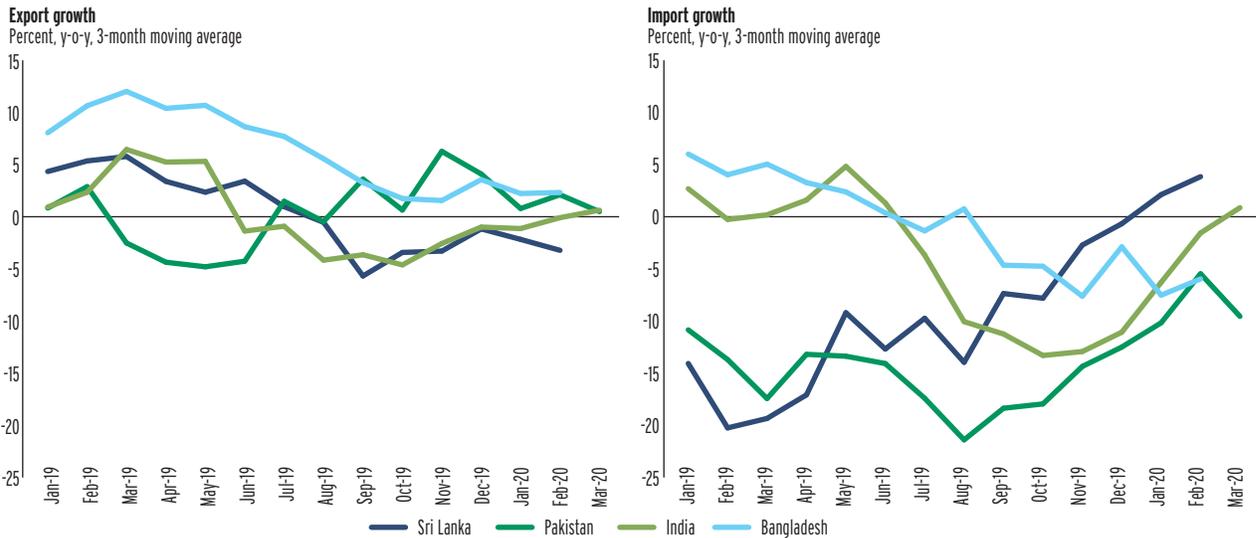
Several countries used fiscal stimulus in the Fall of 2019 to counteract weak economic growth, which may have resulted in widening fiscal deficits. Amid moderating growth in late 2019, India and Sri Lanka instituted measures to boost growth, including reductions in tax rates and pay rises for government employees. In September India lowered its corporate tax rate to 22 percent from 30 percent for companies that do not seek exemptions, and undertook other measures, including widening the program to boost rural incomes. Sri Lanka instituted a package of current expenditures to boost growth late in 2019, including a reduction in the VAT rate and an increase in the registration threshold. The rise in the pre-COVID fiscal deficit in Bangladesh was mostly due to significantly lower than expected revenue collection, which was 30 percent lower than targeted in the first half of FY20 (June–December). Faced with weak revenues, fiscal deficits have likely widened in most countries, leaving less space for a fiscal response to the COVID-19 crisis. India had invoked the ‘escape clause’ in the Fiscal Responsibility and Budget Management Act in the union budget in January, before COVID-19 hit.

High fiscal deficits in the region are adding to public debt, affecting fiscal sustainability. Public debt is already high in most countries except Bangladesh, Nepal and Afghanistan, where in addition external debt is largely on concessional terms (Figure 1.12). The pandemic is expected to slash growth and tax revenues, while fiscal stimulus to cope with the sharp fall in demand with the pandemic—such as the continuation of some subsidies in all countries—will add further to the debt. This creates particularly serious problems for Pakistan and Sri Lanka, already vulnerable countries that had embarked on IMF programs in the last years. In Sri Lanka, the enduring political leadership crisis already created setbacks for the IMF program. Given the modest exports, debt service is also high as a share of exports in Maldives and

Afghanistan. Although the public debt in Bhutan is over 100 percent of GDP, this is not a sustainability concern because most of it is contractually linked to hydropower project loans from India. Moreover, hydropower output should generate substantial export revenue soon. India’s debt is over 60 percent of GDP, but favorable debt dynamics with long-term maturities amid financial repression make the debt path sustainable—the statutory liquidity requirement creates a captive domestic market for debt which limits the interest cost of debt.

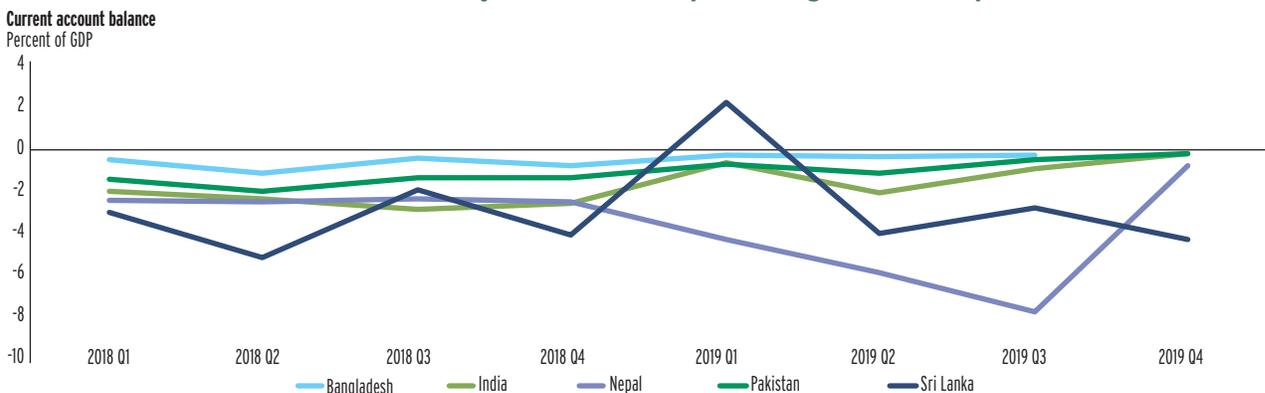
The improvement in current account balances in 2019 in several countries, as imports fell faster than exports, may make it easier to confront the COVID-19 crisis (Figures 1.13 and 1.14). That has enhanced these countries’ ability to deal with reduced remittances and capital outflows. Nevertheless, significant concerns remain regarding external sustainability. Pakistan and Sri Lanka have greater external sustainability issues compared to other countries, as shown by the low ratio of international reserves to months of imports of goods and services; for Sri Lanka it was hovering between 3.4 and 3.7 in January 2020. Maldives’ current account deficit is estimated at close to 20 percent of GDP, but a large share is financed by foreign investment. Still, in 2019 usable reserves (after netting out short-term foreign currency liabilities to domestic banks) amounted to only 1.4 months of goods imports. Although the current account deficit remains high in Bhutan, its deficit is largely financed by India’s investment of hydroelectric capacity which should turn into a net income once operational. Afghanistan’s deficit is mostly covered by grants for nation-building. Bangladesh has only a minor deficit. Nepal’s remittances are high, but the trade deficit is large as the country is quite import dependent. The latter three countries have benefited greatly from steadily rising remittances, although the COVID-19 pandemic could well reduce their remittance receipts (Box 1.3).

FIGURE 1.13: Import growth weakened earlier than export growth in Bangladesh, India, Pakistan and Sri Lanka.



Source: CEIC database and staff calculations.

FIGURE 1.14: Current account balances mostly increased with imports falling faster than exports.



Note: Quarterly GDP for Bangladesh, Pakistan and Nepal were derived from annual GDP and assumed to be constant for all four quarters.
Sources: Trading Economics, Haver Analytics and staff calculations.

The plunge in oil prices is providing support to external and fiscal balances. Since fuel and lubricants are an important net import for countries in the region (Figure 1.15, left panel), a drop in the price of oil along now-anticipated lines would improve the region’s terms of trade: all else equal, a fall of USD 1 in the price of petroleum improves the terms of trade by an estimated 0.45 percent of the region, bringing important gains to all countries (Figure 1.15, right panel). The gain would be particularly large to India, as it also imports substantial amounts of industrial metals, the prices of which seem to co-move with oil prices, and to Pakistan. Bhutan is a net electricity exporter, but its prices are set with India independently of oil prices. Therefore, it will also gain from lower prices on fuel imports.

The oil price drop also should lessen inflationary pressures. Of the countries with adequate data that have significant fuel subsidies, the share of fuel and related expenditures in the consumer basket ranges from 6.8 percent in

India to 29.4 percent in Pakistan (Figure 1.16, left panel). Falling fuel prices can also have an indirect effect on other prices, such as fertilizers (which uses petroleum as inputs) and transportation. There is a very strong relationship between food and fuel prices, and food comprises almost 50 percent of the South Asian consumer basket. (see SAEF Oct 2019, Box 1). Moreover, the low prices imply that expenditures on fuel subsidies by the general government will not kick in (most have a set threshold at which transfers are made), which would provide a slight respite for the budget. These subsidies are largest in Bangladesh as a share of government expenditures, but also are important in Pakistan and India (Figure 1.16, right panel). Sri Lanka has decided just recently to pass the benefit of low prices to consumers, and excise tax revenues will be low, so it is unlikely there will be fuel inflation. The pandemic is a good opportunity to eliminate the fuel subsidies and to replace them with more targeted cash subsidies for vulnerable households to pay for utilities and transportation (see Chapter 2). All in all, the fall in the oil price



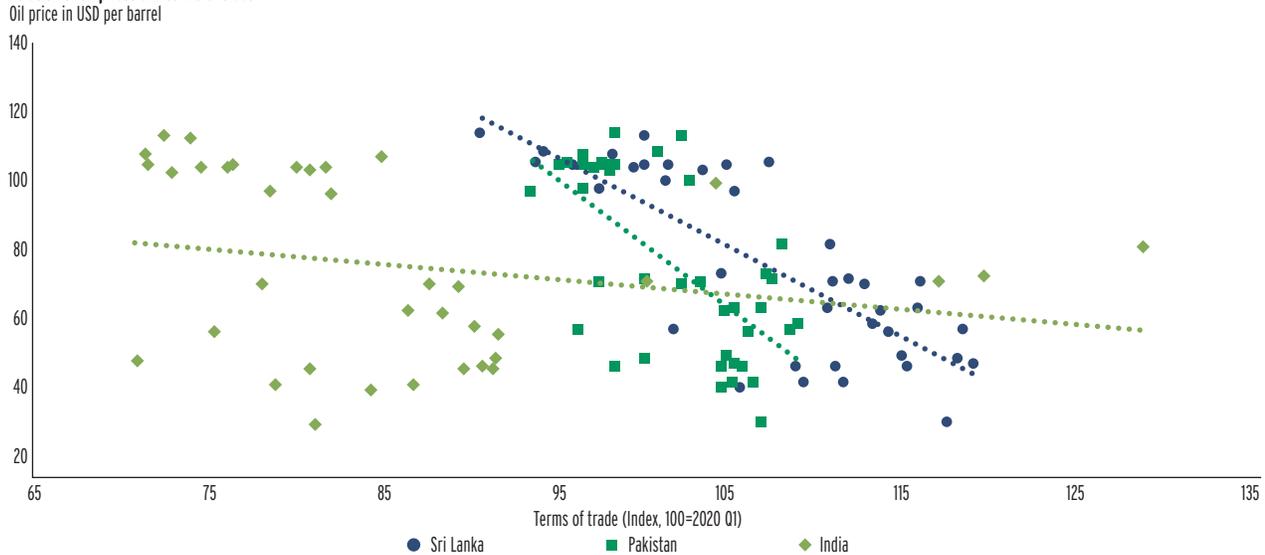
FIGURE 1.15: South Asian countries are net oil importers, which will help boost their terms of trade amid falling oil prices.

Imports and exports share of fuel and lubricants, and possible 2020 terms of trade



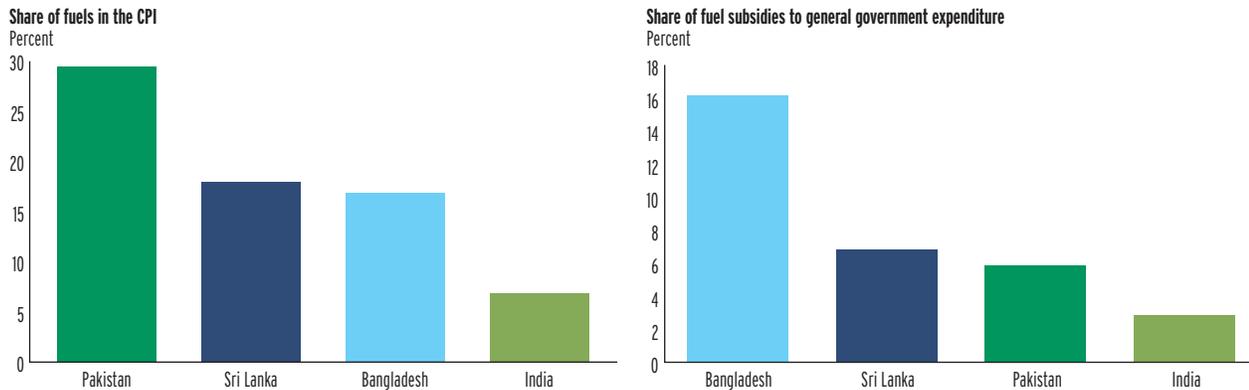
Notes: Exports and imports averages are from 2015 to 2018. Terms of trade change assuming average Brent crude price declines to USD 30/barrel (right scale). Sources: CEIC database, Haver Analytics and staff calculations.

Relation of oil prices and terms of trade



Note: The period covered is from 2010Q1 to the latest observation available. Source: UN Comtrade and staff calculations.

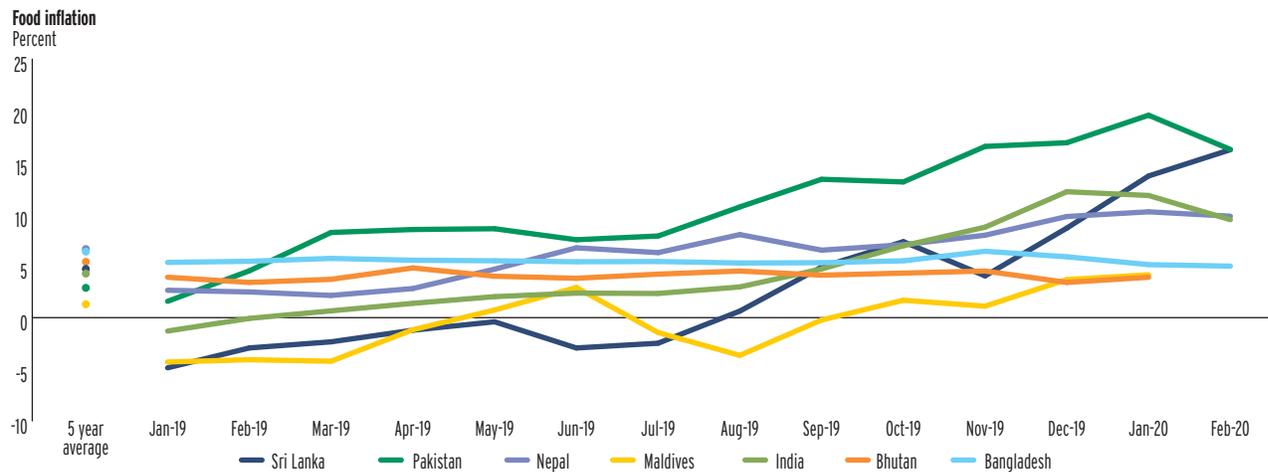
FIGURE 1.16: Falling oil prices are helping to keep consumer prices under control will lead to lower government expenditure on fuel subsidies.



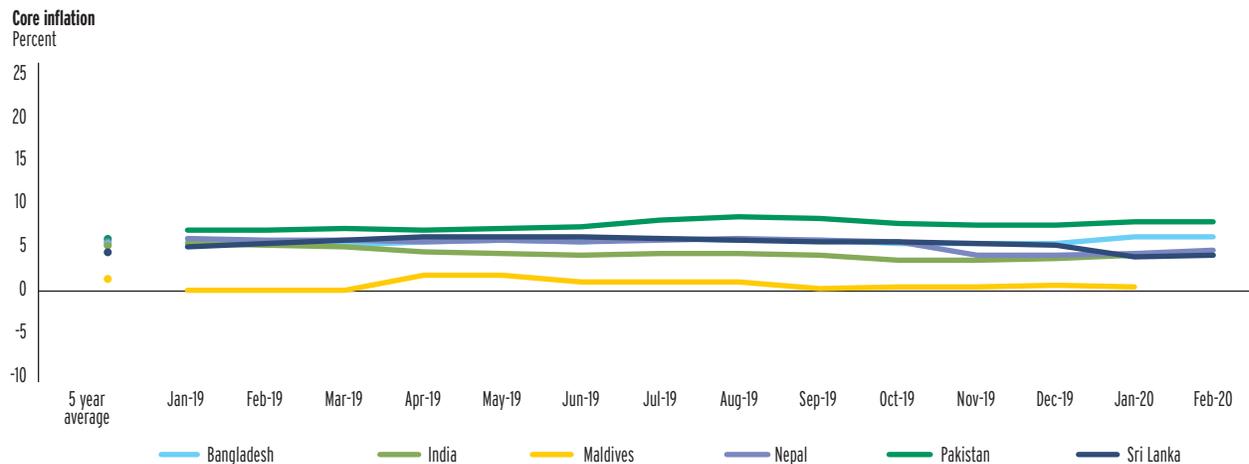
Notes: In Bangladesh the share represents the "Gross Rent, Fuel & Lighting" category. In India it represents the "Fuel and light" category. In Pakistan and Sri Lanka, the share represents "Housing, water, electricity, gas & other fuels" items. Source: CEIC database.

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

FIGURE 1.17: Food inflation picked up by early 2020 before COVID-19, but core inflation remained at single digits and broadly stable.



Sources: CEIC database, Trading Economics, national sources and staff calculations.



Notes: For Nepal, the CPI used was the "Non-Food & Services". For Bangladesh, the CPI used was the "Non-food". For Maldives, the CPI used was "Total excluding food & non-alcoholic beverages". Source: CEIC database and staff calculations.

should be considered a small silver lining for the region from this pandemic. However, if the volatility of crude oil prices stays at the levels seen in February 2020, even if the average oil price is low, this could have additional negative confidence effects for importers.

Another positive condition at the start of COVID-19 crisis was that core inflation was relatively low in most countries (Figure 1.17). That created space for central banks to lower interest rates and inject liquidity in the banking sector. Inflation remained low because of weak growth and terms of trade gains. In Pakistan, though, food inflation was high, although it had been declining prior to the COVID-19 crisis. As described above, there is a danger that food prices will spike under current circumstances. That would be extremely worrisome as it threatens food security for people at the lower end of the income distribution. However, across the board inflationary spirals are not currently among the many worries of policy makers.

Early economic policy responses

The challenges for policy makers in South Asia are daunting. Their highest priority is to increase resources for the health-care system, to prepare for a further spread of COVID-19. Simultaneously, they have to secure basic needs, especially for the most vulnerable in society, and secure vital economic functions like payment systems and banking operations. They must do this while facing fiscal limitations, existing vulnerabilities in financial sectors, and an external environment that is worse than after the Global Financial Crisis a bit more than a decade ago.

Policy makers in South Asia have been quick in addressing the many economic challenges. Immediate measures have already been taken to minimize the short-term



economic pain. For example, almost all countries eased restrictions on payments such as forbearance of taxes, rent and utility payments and deadlines for loan payments. India extended some short-term support for unemployed workers and raised the threshold of default for companies under the Insolvency and Bankruptcy Code. Countries have expanded their social safety nets for food consumption.

All central banks in the region have announced their intention to boost liquidity in the wake of the crisis, following appropriate monetary policy measures over the past few months (Table 1.3). Early steps to make as much liquidity available and to provide flexibility for debtors were intended to give a signal of support to the public, although these measures are unlikely to provide a stimulus effect until consumption and investment resumes. On March 26, the Reserve Bank of India presented a bold stimulus package on all fronts, including a reduction in the repo rate by 75 basis points to 4.4 percent, a complete moratorium on repayments of all term loans – retail and corporate – for the next three months across all financial institutions, and a deferment of interest on all working capital. It also cut reserve requirements for all banks. Pakistan, Sri Lanka and Bangladesh have also eased payment terms for borrowers and have indicated their intention to go further. India, Bangladesh and Sri Lanka had already loosened monetary policy since mid-2019 in an effort to stimulate weak demand (Table 1.3). In contrast, the State Bank of Pakistan had maintained a tight monetary in 2019 to defend the exchange rate but has since lowered rates in response to COVID-19. Bhutan and Nepal have been appropriately managing volatility, particularly the improvements in the interest-rate setting mechanism in Nepal.

TABLE 1.3: Over the last six months most countries loosened monetary policy rates.

Country	Change
Pakistan	-2.3
India	-0.8
Sri Lanka	-0.8
Bangladesh	-0.3
Nepal	0.0

Note: Change in policy rate since Oct-2019.
Sources: Haver Analytics and central banks.

Fiscal stimulus packages were also very quickly announced, with important components targeting those losing their jobs or those with loan payments (Table 1.4). India has set aside just over 1 percent of GDP for programs to increase health sector spending and compensate the unemployed, with the bulk of the money going towards cash transfers, free food and gas cylinders, and interest-free loans. All countries except Bhutan have put together fiscal spending packages, although Bhutan has indicated its intention to do so should the need arise.

The challenges will change as the course of the COVID-19 changes in nature, so policy options will need to cater to each country's situation and mode of impact. Economic experts in the region were mostly unanimous on their views about the negative impact of COVID-19 on growth (Box 1.5). Most of those surveyed believed that fiscal deficits and financial sector stress would rise.

The challenges will change as the course of the COVID-19 changes in nature, so policy options will need to cater to each country's situation and mode of impact.

TABLE 1.4: Monetary, financial and fiscal measures taken to contain COVID-19 economic costs.

Country	Monetary and financial sector responses	Fiscal responses
Afghanistan	Da Afghanistan Bank is in discussions with money-service providers to ensure uninterrupted services, including transactions in foreign currency, and to encourage enhancement of their remote services. The Financial Stability Committee is also meeting regularly to assess evolving risks to the financial and monetary stability.	The government allocated USD 15 million to respond to the potential outbreak in the country and an additional USD 10 million is allocated as reserve funds. The Afghanistan government also extended the deadline for filing 2019 annual income tax returns, business receipts tax, monthly withholding on salaries by two months from March 20 to May 20.
Bangladesh	Bangladesh Bank is working to ensure that there is adequate liquidity in the financial system to support the operations of financial institutions, and it has announced that it will buy treasury bonds and bills from banks. It has also issued circulars to delay non-performing loan classification, extend tenures of trade instruments, and ensure access to financial services. Effective March 24th, the repo rate has been lowered from 6 percent to 5.75 percent, while the CRR has been reduced to 4.5 percent from 5 percent on a daily-basis requirement, and from 5.5 percent to 5 percent for the bi-weekly requirement. The Bangladesh Bank also increased the size of the Export Development Fund (EDF), and reduced the interest rate on EDF borrowing, in line with the previously announced stimulus measures.	The Finance Division has allocated about USD 29 million to the Ministry of Health & Family Welfare to fund the COVID-19 preparedness and response plan. The Prime Minister announced a USD 588 million stimulus for export-oriented industries. Funds will reportedly be limited to salary support and utility payments will be deferred. In addition, the Prime Minister also announced four fiscal stimulus packages amounting to USD 8.6 billion (2.5 percent of GDP) to support economic recovery. The National Board of Revenue (NBR) withdrew all types of duty and taxes on imports of medical supplies related to COVID-19, such as protective equipment and test kits.

Sources: IMF, World Bank and central bank websites.

TABLE 1.4: Monetary, financial and fiscal measures taken to contain COVID-19 economic costs (continued).

Country	Monetary and financial sector responses	Fiscal responses
Bhutan	The Ministry of Economic Affairs authorized the provision of working capital at a 5 percent interest for wholesale distributors for a period of 3 months, extendable by 3 months, to enable them to procure adequate stocks and ensure uninterrupted supply of essential items at a reasonable price.	The Ministry of Finance extended tax filing and deferred tax payments until June 30 for the income year 2019.
India	The Monetary Policy Committee (MPC) cut the repo rate by 75 basis points to 4.4 percent at the end of March. Furthermore, the RBI announced a complete moratorium on repayments of all term loans – retail and corporate – for the next three months across all financial institutions, along with a deferment of interest on all working capital facilities for three months. It also cut reserve requirements for all banks from 4 percent to 3 percent for a year. The RBI will also conduct targeted long-term repos operations to increase liquidity in the market. The overnight borrowing limit for commercial banks under the marginal standing facility has been increased from 2 percent in the statutory liquidity ratio to 3 percent. The monetary policy rate corridor (that is, the difference between the repo and reverse repo rates) has been widened by 15 basis points to 40 basis points to discourage persistent excess liquidity. The additional liquidity injected amounts to about 3.4 percent of GDP. Further, in order to ease access to the domestic foreign exchange derivatives market, the RBI said it will merge facilities for residents and non-residents and allow users to hedge using any available instrument, effective June 1.	The Prime Minister announced an additional USD 2 billion (about 0.1 percent of GDP) will be devoted to health infrastructure, including for COVID-19 testing facilities, protective equipment, isolation beds, ICU beds and ventilators. Some stimulus measures have also been announced at the state level; the largest a USD 2.6 billion package in Kerala (2.5 percent of state GDP; 0.1 percent of country GDP), which includes some direct transfers to poor households. The Finance Minister has announced a series of income-support measures – cash transfers, free food grain and gas cylinders, interest-free loans – to buffer the shock for low-income households. Authorities estimate that the total benefit accruing to households from the first fiscal package – in cash and kind – would amount to about USD 23.3 billion (0.8 percent of GDP). The central government has also encouraged state governments to make direct transfers to unorganized construction workers from existing Labor Welfare Board funds. The Finance Ministry also stated that all pending income tax refunds up to USD 6,500 (INR 500,000) would be released immediately. Pending Goods and Services Tax (GST) and Customs refunds would also be released.
Maldives	The authorities announced measures that include: (i) reduction of the minimum required reserves up to 5 percent as and when required; (ii) making available a short-term credit facility to financial institutions as and when required; (iii) introducing regulatory measures to enable a moratorium of 6 months on loan repayments for those impacted by the current situation (this includes self-employed private individuals as well as freelancers). The Maldives Monetary Authority has obtained a foreign currency swap facility of USD 150 million under an existing currency swap agreement worth USD 400 million with the Reserve Bank of India.	To minimize the economic impact of the COVID-19 virus, the authorities announced on March 20 an Economic Recovery Plan of USD 162 million (2.9 percent of GDP). Under the plan, the Government of Maldives will (i) reduce expenditure by USD 64 million (1.1 percent of GDP); (ii) subsidize 40 percent of electricity bills and 30 percent of water bills for the months of April and May; and (iv) ensure through banks, availability of working capital to businesses. At the same time, the government intends to continue public sector investment program (PSIP) projects, but it remains unclear at what scale this will be done as financing these projects may now become difficult. The Government has waived import duties on protective masks, face shields, protective gloves, hand wash and disinfectant.
Nepal	The Nepal Rastra Bank announced its intention to provide interest subsidies through its refinancing facility and to allow banks to reschedule loan payments of businesses affected by COVID-19. The government advised all banks and financial institutions to halt the collection of principal and interest on loan disbursed in sectors hit by the spread of COVID-19. It also asked the Ministry of Finance to gradually boost pending disbursements.	The government decided to cut the electricity tariff by 20 percent for those households whose power consumption is up to 150 units a month.
Pakistan	The State Bank of Pakistan (SBP) has announced the following measures to cope with the impact of COVID-19: (i) a reduction in the capital conservation buffer for banks from 2.5 percent to 1.5 percent to increase the overall pool of loanable funds, (ii) the regulatory limit on extension of credit to SMEs has been increased from USD 750 thousand to USD 1 million, (iii) borrowing limits for individuals has been enhanced for one year. The debt burden ratio has been increased from 50 to 60 percent, (iv) banks and DFIs will defer the payment of principal on loans and advances by one year, (v) borrowers who reschedule / restructure their loans within 180 days from the date at which payment is due will not be treated as defaults, (vi) the margin call requirement of 30 percent vis a vis banks financing against listed shares has been reduced to 10 percent. The Pakistan Banks Association announced allowed commercial banks to sustain poor cash flows in the form of deferred payments for the next six months.	"A relief package worth USD 7 billion was announced on March 24. Key measures include: (i) an elimination of the import duties on imports of emergency health equipment; (ii) relief to daily wage workers (USD 1.2 billion), (iii) cash transfers to low-income families (USD 900 million), (iv) accelerated tax refunds to the export industry (USD 600 million), and (v) financial support to SMEs (USD 600 million). The economic package also earmarks resources for an accelerated procurement of wheat in the coming weeks (USD 1.6 billion), financial support to utility stores (USD 300 million), relief in fuel prices (USD 400 million), support for health and food supplies (USD 300 million), electricity bill payments relief (USD 660 million), an emergency fund provision (USD 600 million), and a transfer to the National Disaster Management Authority for the purchase of necessary equipment to deal with the pandemic (USD 151 million)."

Sources: IMF, World Bank and central bank websites.


TABLE 1.4: Monetary, financial and fiscal measures taken to contain COVID-19 economic costs (continued).

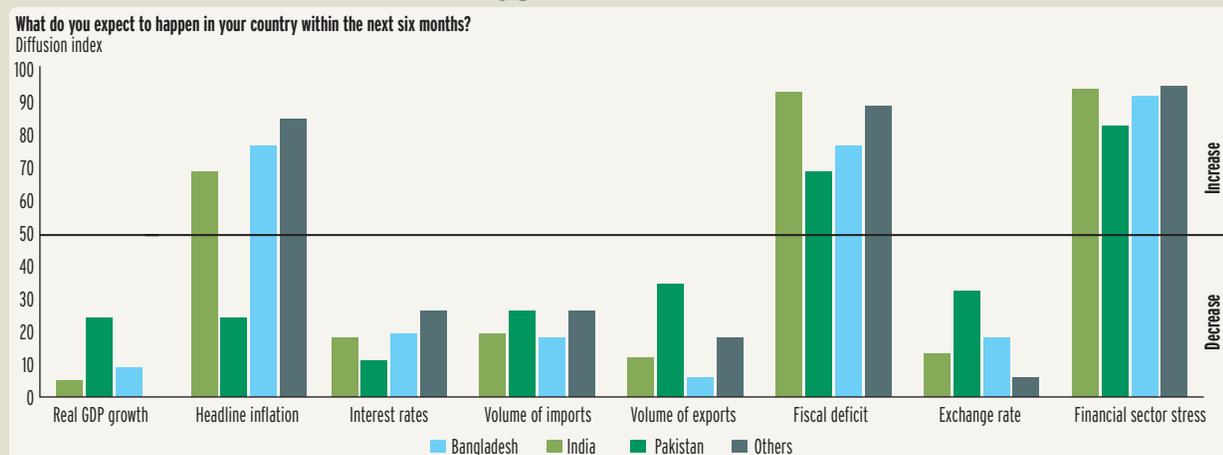
Country	Monetary and financial sector responses	Fiscal responses
Sri Lanka	The Central Bank of Sri Lanka (CBSL) reduced the monetary policy rate by 25 basis points on March 16 and lowered the required reserve ratio on domestic currency deposits of commercial banks by one percentage point to ease liquidity conditions. The President has also announced a wide-ranging debt repayment moratorium, which includes a 6-month moratorium on bank loans for the tourism, garment, plantation and IT sectors, related logistics providers, and SMEs, with reduced rate working capital loans for these sectors. There will also be a 6-month moratorium on leasing loans for three-wheelers, and a three-month moratorium on small-value personal banking and leasing loans. The interest rate on credit cards will be capped and the minimum monthly repayment reduced. The President has announced that state-owned financial institutions will invest in treasury bonds and bills to stabilize the money market interest rate at 7 percent.	A stimulus package to support growth has already been announced before the global spread of COVID-19. It includes a blanket moratorium for SMEs on capital repayments for one year, a reduction of VAT rate from 15 percent to 8 percent and other corporate and personal income tax concessions. The government also allocated up to 0.1 percent of GDP for quarantine and other containment measures, as well as USD 5 million (0.01 percent of GDP) to the SAARC COVID-19 Emergency Fund. The 2020 Q1 payment deadline for income tax, VAT and certain other taxes has been extended until the end of April. Other announced measures include tax exemptions for imported masks and disinfectant, price ceilings on essential food, as well as concessional loans and food allowances for low income consumers (beneficiaries of the Samurrdhi program). The President has also established a special fund for containment, mitigation and social welfare spending, inviting local and foreign tax-free donations.

Sources: IMF, World Bank and central bank websites.

BOX 1.5. Views from the South Asia Economic Policy Network

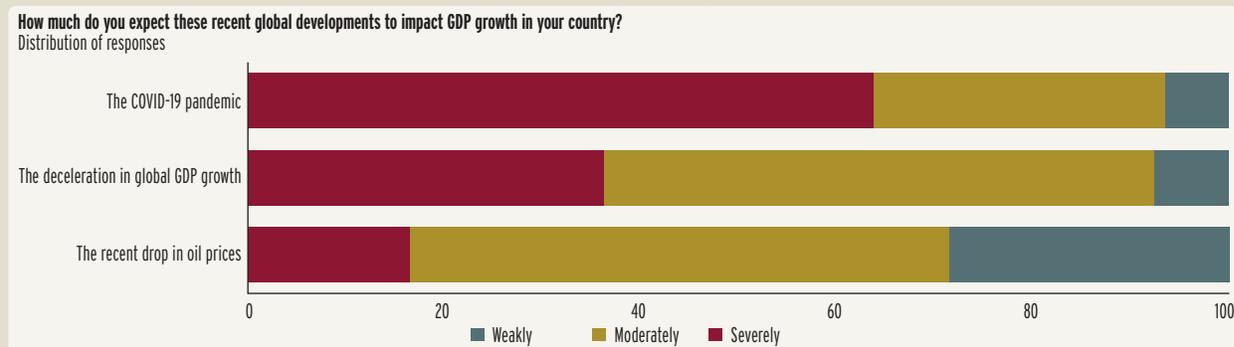
The South Asia Economic Policy Network represents an attempt to engage more strongly with thinkers and doers across South Asia, nurtures the exchange of ideas and fosters learning from colleagues and counterparts in the region. The nearly 500 Network members include researchers from seven South Asian countries, selected based on peer recognition, recent conference presentations, and research outputs. 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.

As for the last four editions of this report, a short opinion survey among the members was conducted. The objective was to take the pulse of informed and influential experts about economic developments in their countries. We also used the survey to gather their views on COVID-19 and on state ownership of banks. Responses regarding the economic situation and COVID-19 are summarized here. The views on public banks are reported throughout the third chapter.

FIGURE 1.18: Views on the outlook turned very grim.


Notes: The index is calculated as follows: $\text{Index} = (P1 \times 100) + (P2 \times 50) + (P3 \times 0)$, where, P1: Proportion of responses that report that the indicator will increase, P2: Proportion of responses that report that the indicator will stay the same, and P3: Proportion of responses that report that the indicator will decrease. Results are based on 95 responses collected between March 12 and April 5. Source: South Asia Economic Policy Network and staff calculations.

The economic outlook expressed by regional experts turned very grim amid the COVID-19 outbreak. Across all countries respondents strongly anticipate GDP growth to decline, very different from six months ago. Other expectations are in line with the anticipated economic deceleration: interest rates, imports and exports, and exchange rates (versus the USD) are expected to decrease, while fiscal deficits and financial sector stress are expected to increase. The uniformity of expectations for the next six months is much higher than in any survey conducted so far, suggesting rather strong changes in the respective directions. Pakistani respondents now expect higher fiscal deficits, compared to expectations of lower deficits six months ago, which could set back its macroeconomic adjustment.

BOX 1.5. Views from the South Asia Economic Policy Network (continued)
FIGURE 1.19: The COVID-19 pandemic is expected to drag down growth.


Source: South Asia Economic Policy Network.

More than nine out of ten respondents assert that the COVID-19 outbreak and the deceleration of global GDP growth will affect the GDP of their countries and more than seven out of ten express the same for recent oil price drops. However, there is some disagreement whether the impacts will be moderate or severe. Oil prices are mostly expected to have only a moderate impact. While nearly all agree that global growth matters for South Asia, more than a third even expects global factors to have a severe impact (see discussion about global factors in line with these views in Chapter 2). Somewhat surprisingly, a third of respondents only expects a moderate impact of the COVID-19 pandemic. Responses to this survey were collected between March 12 and April 5. Interestingly, the share of those expecting a severe impact of COVID-19 did not increase over time.

Around 60 percent of the respondents assume a large general impact on the economy, while around 30 percent anticipate a large impact on tourism with spill-overs into other sectors. Only 10 percent expect even less than that. Almost 40 percent of the experts expect the impact of COVID-19 will linger into 2021. Many respondents (48 percent) agree that the authorities in their country are taking appropriate measures. However nearly 40 percent believe there remain some gaps and that provided information is often piecemeal.

The survey offered room to express general views on the economy. Experts across all countries express severe concerns about the challenges associated with the COVID-19 outbreak. Experts across the board call for additional spending on health and social security, even if it leads to worsening deficits. Experts from Bangladesh seem particularly worried about the closure of industries and a rise in unemployment due to COVID-19. In Sri Lanka, some experts fear a reversal in economic reforms and a renewed worsening of the macroeconomic balance. In India, some economists doubt that the currently planned economic stimulus will be enough, but many are very optimistic about the benefits of the low oil prices. And Nepalese experts expressed concerns regarding large public investment projects coming to a standstill amidst the COVID-19 outbreak.

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CHAPTER 2 SOUTH ASIA ECONOMIC FOCUS

A dire outlook

The economic outlook for South Asia is dire. South Asia will likely experience the worst economic performance of the last 40 years. Because of the unparalleled uncertainty, this report presents a range forecast, estimating that regional growth will fall to a range between 1.8 and 2.8 percent in 2020, down from 6.3 percent projected six months ago. Hardest hit is Maldives where GDP is expected to decline by between 8.5 and 13 percent this year, as tourism has dried up. Also, for Afghanistan, Pakistan, and Sri Lanka, the full range of their forecast GDP growth for this fiscal year is in negative territory. In a worst-case scenario, the whole region would experience a contraction of GDP.

The dire forecast is based on the analysis of several adverse impacts. South Asia finds itself in a perfect storm. Tourism has dried up, supply chains have been disrupted, demand for garments has collapsed, consumer and investor sentiments have deteriorated, international capital is being withdrawn and inflows of remittances are being disrupted. On top of the deterioration of the international environment, the lockdown in most countries has frozen large parts of the domestic economy.

The crisis will reinforce inequality in South Asia. Even more worrisome than the grim macroeconomic outlook is the realization that the impact on the poorest in the population will be much harsher than the consequences for more affluent people. Analysis shows that poor people have a higher likelihood of having lost their work, and domestic migrant workers who had escaped rural poverty by finding work in cities are being forced back into rural poverty again. Many of the poorest face higher risk of food insecurity.

Policy makers are in uncharted territory and must consider innovative policies. In their immediate response, the focus has been rightly on mitigating the spread of COVID-19. While doing that, conditions should be created to jumpstart the economy, once countries emerge out of the immediate health crisis. A combination of temporary work programs and a moratorium on debt servicing and rent payments could help prepare for the restart of the economies. After tackling the immediate COVID-19 threat, South Asian countries must keep their sovereign debt sustainable through fiscal prudence and debt relief initiatives. In the longer run, South Asia would do well by diversifying its international connections, while there are great opportunities to expand digital technologies for payment systems and distant learning to unlock remote areas in South Asia.



As advanced economies enter one of the worst economic recessions in history, the short-term economic outlook for South Asia has rapidly worsened. South Asia finds itself in a perfect storm of adverse effects. Tourism has dried up, supply chains have been disrupted, demand for garments has collapsed and consumer and investor sentiments have deteriorated. On top of the deterioration of the international environment, the lockdown in most countries has frozen large parts of the domestic economy.

Although the outlook has worsened significantly, it is not easy to determine the magnitude of that deterioration. As South Asia is entering uncharted territory, history provides little guidance. The lockdown of economies around the world causes a much sharper decline in economic activity than in normal recessions, and the timing and pace of the subsequent rebound also will likely be different from normal cycles. Therefore, for the first time in the *South Asia Economic Focus*, we present a range forecast, rather than a point forecast. Moreover, it is prudent to prepare for a worst-case scenario, well below the range forecast, as a prolonged domestic lockdown would steepen the short-term contraction and jeopardize the subsequent rebound.

The crisis reinforces inequality in South Asia. Even more worrisome than the grim macroeconomic outlook is the realization that the impact on the poorest in the population is much harsher than the consequences for more affluent people. Poor people have less access to health care and find it more difficult to implement social distancing. They have a higher likelihood to lose their work and have no buffers to absorb a loss in income. Migrant workers who had escaped rural poverty by finding work in cities are forced back into rural poverty again.

The policy challenges are daunting. As the previous chapter described, all governments in the region have already started relief efforts and several central banks increased liquidity into the financial markets. It is a major challenge to provide safety nets and food security. As the crisis unfolds, the policy challenges will only become bigger as fiscal positions deteriorate and more support is needed to keep utility companies and banks solvent, in order to secure vital economic functions. Perhaps the biggest challenge is to keep SMEs afloat, so that they can play a crucial role in creating jobs during the rebound; as well as hiring temporary workers to help with the transition to normalcy. While governments are fighting the crisis and are creating conditions for a rebound, it would also be useful to focus on the longer-term consequences of this crisis. Will the character of tourism change? What are the long-term impacts on cross-border connectivity? What changes in the health-care system are needed? Are

there new opportunities to provide distant learning to remote areas?

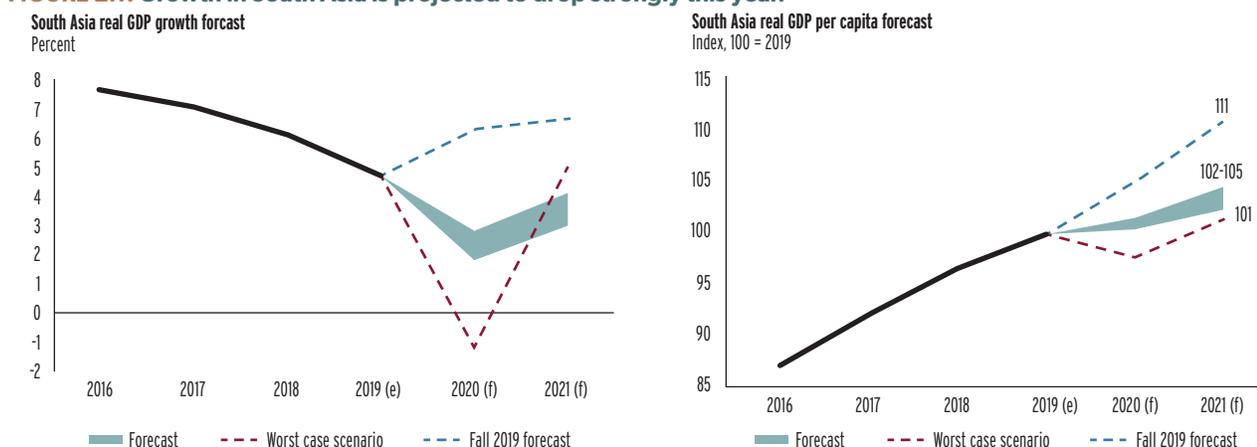
The remainder of this chapter is organized as follows. The first section presents the dire, but uncertain outlook. The second section describes the channels through which South Asia is affected by this crisis. Those channels are building blocks for the outlook but are also important inputs into the policy debates. The third section focuses on the distributional impacts of the crisis, while the final section summarizes the policy options.

A drastic downward revision of the outlook

The global nature and rapid spread of COVID-19 are so unprecedented that modern economic history provides few precedents. In 2003, the SARS virus outbreak was contained, with only short-term economic effects within East Asia, and no significant effect on South Asia's growth. Natural disasters tend to be confined to specific regions, in which case outside help can significantly cushion the impact and aid the recovery. In economic recessions, depressed demand can be stimulated to increase the utilization of production capacity. In normal cycles, investment is the most cyclical part of final demand, driving both the downturn and the rebound. The economic consequences of the current outbreak of COVID-19 are fundamentally different from these earlier examples (Reinhart 2020). The pandemic is a truly global disaster. Demand stimulus will not increase supply in the short run, because production facilities are closed to mitigate the spread of the virus. Services, normally the least cyclical part of an economy, are now leading the downturn.

Because of the unparalleled uncertainty, this report provides a range forecast. The upper bound and lower bound of that range are based on two possible global scenarios, which partly depend on the length of containment measures in major economies. Given the domestic and international channels of transmission, the upper- and lower-bound forecasts were calculated for all countries in South Asia, taking into account both domestic multipliers and the deteriorated external environment. In addition to this baseline range forecast, we consider a worst-case scenario, which assumes a large and prolonged lockdown of the economies in South Asia, for example, due to rapid community transmission of the virus.

The range of projections implies a sharp downward correction of South Asia's growth forecast. Real GDP


FIGURE 2.1: Growth in South Asia is projected to drop strongly this year.

TABLE 2.1: The contribution of private consumption to growth is expected to halve this year.

	GDP components growth (percent)			
	2018	2019 (e)	2020 (f)	2021 (f)
Private Consumption	6.7	4.5 to 4.6	1.4 to 2.0	2.8 to 3.4
Government Consumption	10.4	8.1	7.6 to 7.7	7.0 to 7.7
Gross fixed investment	8.7	1.6 to 1.8	-1.4 to 0.3	0.9 to 2.2
Exports	9.6	0.1 to 0.5	-6.8 to -3.9	1.0 to 2.4
Imports	11.3	-4.5 to -4.2	-7.3 to -6.2	0.2 to 0.5
Real GDP growth	6.2	4.7 to 4.8	1.8 to 2.8	3.0 to 4.1

Notes: (e)=estimate; (f)= forecast. Data are in calendar years.
Source: World Bank and staff calculations.

growth for the region is projected to be between 1.8 percent and 2.8 percent for calendar year 2020 (Figure 2.1), down from 6.3 percent projected six months ago (World Bank 2019), when there were early signs that the slowdown in recent years would be reversed. The 1.8 percent growth would be even lower than the region's worst performance since 1980. In 1991, South Asia's GDP also grew by a mere 1.9 percent. Even the upper bound of the range forecast would be more than 3 percentage points below average growth since 1980. There will still be lingering effects in 2021: real GDP growth in South Asia is now projected between 3.0 percent and 4.1 percent, down from 6.7 percent projected six months ago. In the following year, however, growth is expected to be back around 6 percent, close to its level in recent history.

Consumption is especially weak during this crisis. Normally, consumption is being smoothed over economic cycles, growing faster than GDP during downturns and slower than GDP during upturns. This time is likely different. Table 2.1 shows for the upper bound of the forecast that consumption growth is expected to fall short of GDP growth. The lower bound of the forecast range

shows a similar picture, with lower growth rates for all demand categories as restrictions on services directly affect private consumption. Government spending is expected to be countercyclical as expenditures increase 2.5 times faster than GDP. The contraction of imports and exports in 2020 and their weak growth in 2021 reflect the dire conditions in international markets. Investment is expected to remain weak over the forecast period.

All countries will feel the brunt of the coronavirus crisis (Table 2.2).

» Most affected is **the Maldives**, where tourism directly and indirectly contributes two-thirds of GDP, 80 percent of exports and 40 percent of revenues. A contraction of the economy between 8.5 and 13.0 percent is expected in 2020. With population growth of 1.8 percent in 2019, the per-capita income loss will be significant.

Other countries that report GDP numbers in calendar years are Afghanistan (December 20 to December 21) and Sri Lanka. Consequently, the impact in those countries is also largely reflected in their 2020 accounts.

TABLE 2.2: Growth expectations are revised downwards across the region.

Country	Fiscal year	Real GDP at market prices (percent)				Revision to forecasts from October 2019	
		2019 (e)	2020 (f)	2021 (f)	2022 (f)	2020 (f)	2021 (f)
Afghanistan	December to December	2.9	-5.9 to -3.8	3.3 to 3.9	5.2 to 6.2	-8.9 to -6.8	-0.2 to 0.4
Bangladesh	July to June	8.2	2.0 to 3.0	1.2 to 2.9	2.8 to 3.9	-5.2 to -4.2	-6.1 to -4.4
Bhutan	July to June	3.9	2.2 to 2.9	2.0 to 2.5	3.1 to 3.5	-5.2 to -4.5	-3.9 to -3.4
India	April to March	6.1	4.8 to 5.0	1.5 to 2.8	4.0 to 5.0	-1.2 to -1.0	-5.4 to -4.1
Maldives	January to December	5.2	-13.0 to -8.5	6.3 to 7.3	5.0 to 5.5	-18.5 to -14.0	0.7 to 1.7
Nepal	mid-July to mid-July	7.1	1.5 to 2.8	1.4 to 2.9	2.7 to 3.6	-4.9 to -3.6	-5.1 to -3.6
Pakistan	July to June	3.3	-2.2 to -1.3	0.3 to 0.9	3.2 to 3.3	-4.6 to -3.7	-2.7 to -2.1
Sri Lanka	January to December	2.6	-3.0 to -0.5	0.2 to 1.2	2.0 to 2.5	-6.3 to -3.8	-3.5 to -2.5

Notes: (e)=estimate; (f)= forecast. The 2020 and 2021 numbers represent the lower and upper bound of the forecast range. For India, 2020 refers to FY19/20.
Source: World Bank.

- » For **Afghanistan** a deep recession is expected this year, with a contraction between 3.8 and 5.9 percent. With population growth of 2.3 percent, this implies a dramatic drop in per capita income.
- » For **Sri Lanka** a recession is anticipated, with annual growth estimated between -3.0 and -0.5 percent.

Three countries— Bangladesh, Bhutan and Pakistan—report GDP in fiscal years that run from July 1 till June 30. Nepal reports GDP from mid-July to mid-July. For those countries, the short-term impact of the crisis is reflected over two fiscal years, FY20 and FY21. In all four countries, we have large downward revisions of the forecast in both years.

- » In **Bangladesh**, with a population growth of 1 percent per year, a limited increase in per-capita GDP is projected for two years. That would be an abrupt change from high growth rates in recent years. Given the variation within the country, it means that significant parts of the population would lose income during these two years.
- » In **Bhutan**, growth is still expected, but the downward revision from our Fall forecast is large in both years. Last Fall we anticipated a strong rebound linked to the hydropower sector, but that positive GDP outlook evaporated under the current crisis conditions.
- » **Nepal**, with population growth of 1.1 percent per year, would experience low per-capita growth for two years in a row.
- » **Pakistan**, which has already experienced low growth rates in recent years, could well fall into a recession. With 1.8 percent population growth, that would imply a painful decline in per-capita income.

In India, the fiscal year ends on March 31. The current fiscal year is over and most of the direct impact of the crisis will therefore show in FY21.

- » In **India**, GDP growth in the fiscal year that has just started is expected to range between 1.5 and 2.8 percent, implying per-capita GDP growth of between 0.5 and 1.8 percent. This would come after already disappointing growth rates in previous years. The green shoots of a rebound that were observable at the end of 2019 have been overtaken by the negative impacts of the global crisis.

Outcomes outside the forecast range are still possible.

Especially the timing and the magnitude of the rebound is uncertain. If globally, and in South Asia, the measures to contain the spread of COVID-19 are soon removed, there could be a very large base effect from people returning to work and getting back to their daily activities. That could push growth rates next year higher than is currently captured in the forecast range. However, if many SMEs do not survive the crisis and migrant workers cannot return to their original jobs, the recovery could take even longer.

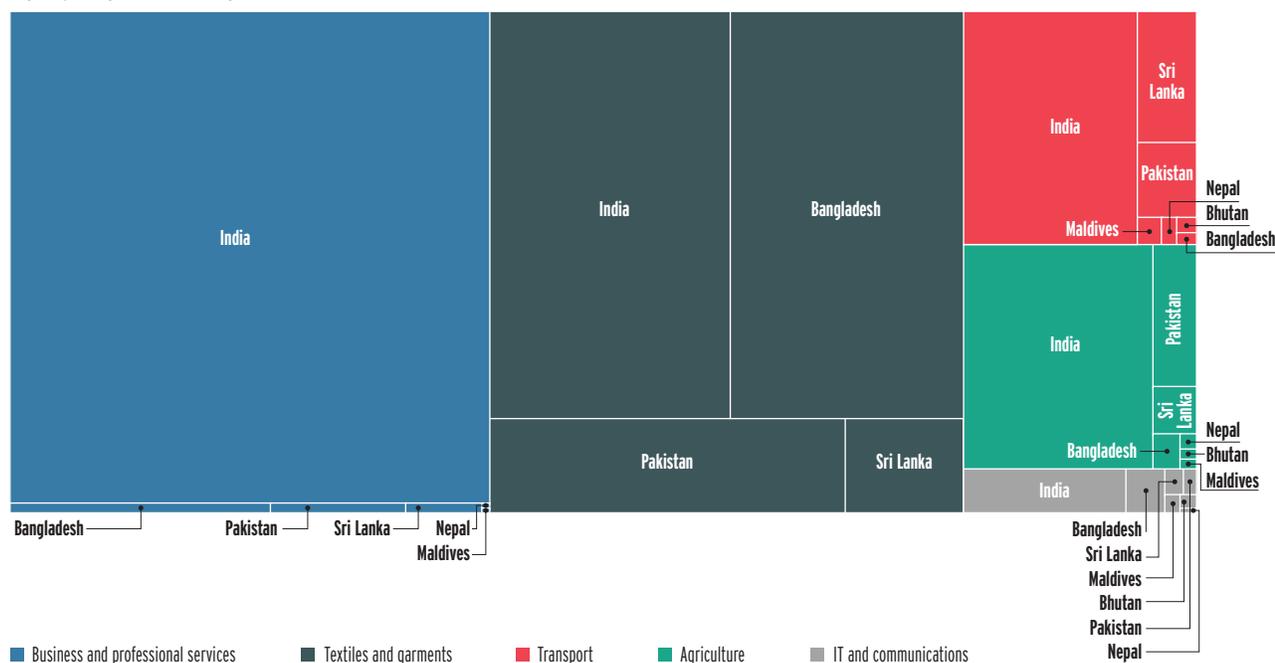
Therefore, it is prudent to anticipate a worst-case scenario.

If the current lockdowns were prolonged, the economic impact could be even worse than is captured in the forecasts above. A lockdown that is in effect for 2-4 months could cut manufacturing and services production in half during that time, as envisaged in the forecast range. However, production would quickly come online again. In contrast, in a worst-case scenario the recovery is assumed to be incomplete due to a second, smaller wave of COVID-19 contagion in the second half of 2020. We thus simulated a worst-case scenario in which, on top of the lower bound of the range forecast, there is a prolonged lockdown and an incomplete recovery, so that recuperation in 2021 is slower. The results are shown in Figure 2.1 with the red dotted line. The fall in GDP in 2020 would be more drastic, and regional growth could become negative. The recovery would thus be weaker as production would struggle to recover from the trough well into 2021.



FIGURE 2.2: Business services, textiles and garments and transport equipment dominate South Asian exports.

Major exports by sector and country, share of total



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

Source: ADB MRIOT, 2018.

South Asia is affected through multiple channels

The scenarios described above are based on different channels through which the crisis affects the economies of South Asia. The channels with the largest negative impacts can be conceptually divided into five: (i) a sharp drop in external demand; (ii) a shock to supply due to bottlenecks in global value chains; (iii) a domestic demand impact due to lockdowns, affecting employment particularly in services; (iv) the impact of stress in the financial sector on consumer and business sentiment; (v) price channels; and (vi) deepening inequality. We analyze each channel in turn below.

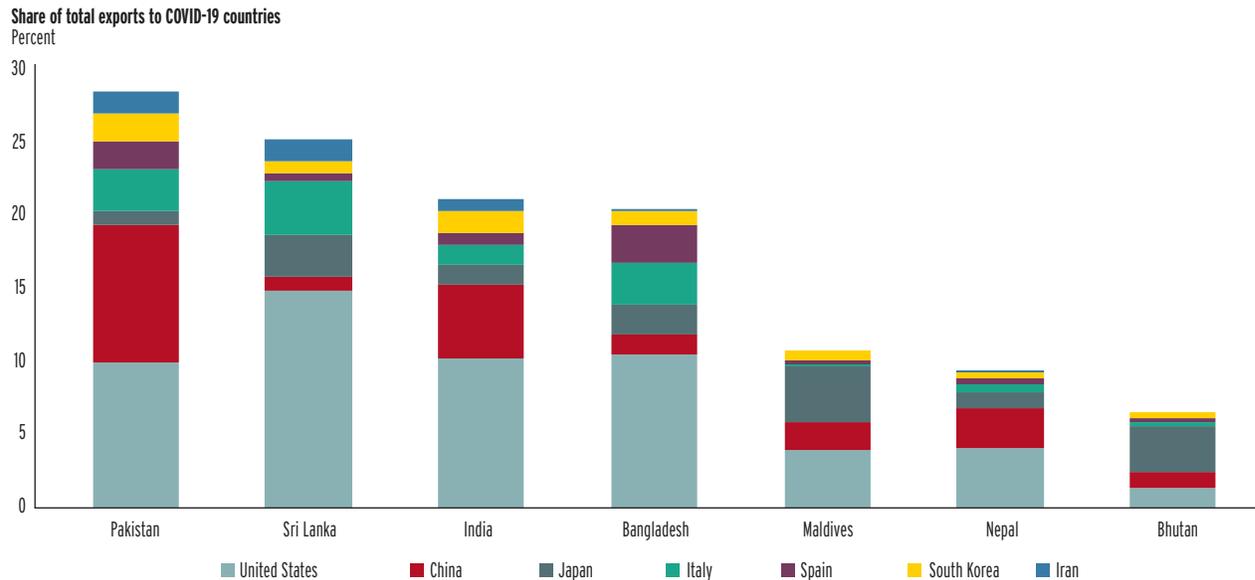
1. A sharp drop in external demand

South Asia's exports will suffer, as global production and imports contract sharply. With the exception of Maldives and Bhutan, South Asia's trade openness is comparatively low, but no country will escape the recession in international markets. This is especially true in the current crisis because cross-border services are directly impacted. One of India's (and South Asia's) largest exports is business and professional services, consisting of business process

outsourcing (BPO) such as technical support and call centers largely based in India (Figure 2.2). This sector is severely affected. Lockdown measures, both in origin and destination countries, have forced offices to close as their infrastructure is heavily geared towards in-office working. There is also a concern that external demand will drop precipitously even beyond the lockdown period, as clients cut costs (Parkin 2020). This situation will certainly mean fewer new projects, as well as the scaling back of existing ones.

Under the baseline forecast, demand for South Asian exports is likely to fall sharply but recover by end-2020 as growth of external partners resumes. While most of the world has gone on lockdown, some trading partners suffered more economic damage through March. These countries are: China, Spain, Italy, Japan, South Korea, United States, and Iran. China has been able to resume some economic activity, but few countries are demanding anything but non-essentials. The United States is a key partner, receiving between 10 and 15 percent of South Asian country exports in the past (Figure 2.3). In 2018, Pakistan, Sri Lanka, India and Bangladesh exported more than 20 percent of their exports to the COVID-19 affected countries listed above.

Reduced external demand for manufacturing exports will impact India, Bangladesh, and Pakistan, where more than half of exports are concentrated in the manufacturing sector. For instance, in India 52 percent of manufacturing

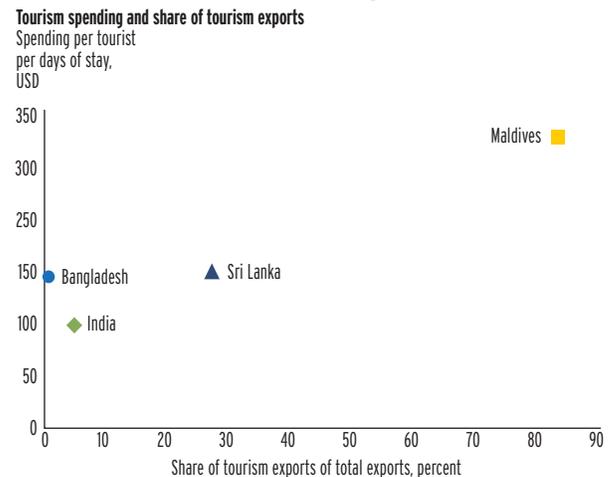
FIGURE 2.3: COVID-19 has affected demand for South Asian exports from major trading partners.


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

exports are concentrated in a diversified variety of sub-sectors, whereas in Bangladesh, 81 percent of total exports came from the textile and garments sector. In the case of Pakistan, 54 percent of manufacturing exports are related to the textile and food, beverages, and tobacco sub-sectors. Bangladesh and Pakistan, the main exporters, will suffer disproportionately, in part because the countries that suffered the largest outbreaks are also the largest buyers of garments from these two countries. Almost 40 percent of Sri Lankan goods' exports are concentrated in a few manufacturing activities, with textiles and garments having the largest share. In Bhutan, 37 percent of total exports consist of hydroelectricity sold to India, so the severity of the lockdown in India could affect Bhutan's electricity export growth indirectly.

Some services are not directly traded but can contribute to the value added of goods. IT and business services in India are strongly tied to global manufacturing, even if these services are not all directly exported. In India, business and IT are not only exported as part of Business Process Outsourcing (BPOs), but also the domestic value added as a share of the country's total exports is 18 percent. Sri Lanka's domestic value added in transport as a share of total exports is equal to 12 percent. In the other countries, by contrast, the contribution of services value added to total exports is negligible.

Tourism receipts are important for all economies but constitute a critical share of total exports for Maldives and Nepal, and to a lesser extent Bhutan and Sri Lanka. Tourism is one of the fastest-growing sectors globally, and South Asia has become an attractive destination. Even in India and Bangladesh where it constitutes a small part of total exports,

FIGURE 2.4: Spending per tourist and total tourism revenues as a share of GDP are high in Maldives.


Note: Data is for 2018.
Sources: IMF and CEIC database.

spending per traveler is significant (Figure 2.4). The closure of airports, hotels and non-essential travel globally will remove an important source of export receipts and put additional pressure on the balance of payments of these countries. During January–February, some began to lose tourism revenue from East Asia, but after the travel restrictions, receipts from all tourism sending countries have come to a screeching halt.

For small tourism-based economies, livelihoods will be severely impacted by COVID-19. This is particularly true for Maldives. Unlike previous shocks, when tourism was mostly confined to high-end resort islands, the fall-out from COVID-19 will disproportionately affect the incomes of guesthouse owners and their employees on

**TABLE 2.3: Economic Contribution of Tourism and Travel (T&T) in South Asia.**

	Share of GDP (%)	Number of jobs in T&T (000's)	Share in total employment, most recent year (%)	Growth (2018 or latest year)
Bangladesh	4.4	2,414	3.9	11.6
India	9.2	42,673	8.1	6.7
Maldives	66.4	69	32.4	7.9
Nepal	7.9	1,051	6.7	3.6
Pakistan	7.1	3,850	6.3	7.4
Sri Lanka	12.5	1,000	12.1	12.4

Notes: To assess the contribution of travel & tourism to national economic activity, the WTTC/Oxford Economics has developed a methodology that includes not only the direct impacts of travel & tourism activities but also the indirect and induced impacts. This methodology complements the UN Statistics Division-approved TSA methodology (TSA: RMF 2008) that only quantifies the direct contribution of travel & tourism. WTTC recognizes that travel & tourism's total contribution is wider and aims to capture its indirect and induced impacts. The WTTC/Oxford Economics methodology uses the input-output methodology to trace with fair precision the employment generated by the travel & tourism expenditures that take place each year.

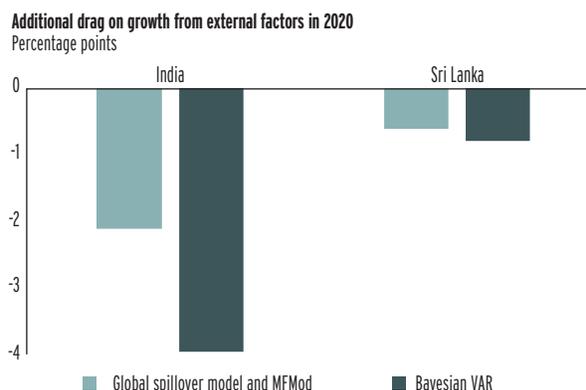
Source: WTTC based on Oxford Economics 2019 Travel & Tourism Economic Impact Research methodology, March 2019.

local islands, as most of the growth in visitor arrivals has occurred in this segment of the tourist market in recent years. More importantly, a large segment of the labor force in Maldives and Nepal is directly or indirectly engaged in the tourism industry, affecting more livelihoods than just those directly employed in tourism.

The tourism industry is generally much broader and affects a large variety of sectors and livelihoods not always captured in the tourism receipts. In recent years many agencies have attempted to measure the extent of tourism's reach through a combination of tourism satellite accounts as well as input-output tables. Using these definitions, the World Tourism and Travel Council has been able to account for a broader definition of the tourism industry, including informal workers that cater to tourists. Doing so shows that the overall impact on the economy can be many times larger than focusing just on expenditure per tourist (Table 2.3). Travel and tourism is important even for large countries such as India (9.2 percent of GDP) and Sri Lanka (12.5 percent of GDP). For Maldives, tourism and travel accounts for two-thirds of GDP, but only a third of total employment, reflecting the fact that the high-end tourism sector is less labor-intensive compared to other countries.

The region will not only be affected by reduced import demand from the rest of the world, but also by reduced intra-regional trade. Spillovers from India have become more important for the region. We investigate the intra-regional spillovers in Box 2.1. India comprises 78 percent of the region's gross national income and has important links with other countries in the region through remittances, supply chains and trade. The importance of India as a driver of per-capita growth in other South Asian economies is increasing, which suggests that any policies that India conducts to revive demand after COVID-19 will also have an important positive effect for the region as a whole.

Taking all the above trade and financial factors into account allows us to produce forecasts of the specific

FIGURE 2.5: External factors will drag down growth in South Asia in 2020.

Notes: The figure shows the impact of external spillovers on GDP in India and Sri Lanka using a macro and a VAR model (percent). The model and estimation follow closely Almansour *et al.* (2015). The contribution of external factors in calendar year 2020 is based on an out-of-sample forecast conditional on two scenarios of external variables. More details are provided in Appendix A2.1. Sources: World Bank, Haver Analytics, CEIC Database, Federal Reserve Bank of St. Louis, and staff calculations.

contribution of external factors to the economic impact of COVID-19. The baseline forecast range presented above was informed by a macroeconomic model for countries in South Asia that analyzes the impact of adverse shocks in the external environment, but additionally, incorporates a shock to the domestic services sectors (Burns *et al.* 2019). To get a qualitative sense of how large the external components of these shocks may be, we isolate the external contribution from this exercise and compare it to the one from a Bayesian vector autoregression model quantifying the impact of an expected deterioration of trade, financial linkages, and investment sentiments (Almansour *et al.* 2015). The latter model was earlier used to decompose India's deviation from average growth in 2019 into external and domestic factors (World Bank 2019). We use quarterly data applied to India and Sri Lanka for the lower bound of the forecast range in order to get a sense of how large the external component of the shock may be for these two economies (Figure 2.5). The results show a larger external

BOX 2.1. What are the spillover effects from India to the rest of South Asia?

Studies have indicated that when a major emerging market economy coexists alongside other smaller economies, the spillover effects of the major economy's growth are often high (Huidrom et al. 2017). India comprises 78 percent of the region's gross national income and has important linkages with the other South Asian economies through foreign direct investment, remittances, supply chains, tourism and trade channels. Therefore, higher growth in India would help support higher growth in other countries in the region. It is thus important to understand: (i) whether spillovers from India's growth have a statistically significant impact on that of the other South Asian economies, and (ii) whether GDP co-movements have increased, perhaps because they depend on each other through trade and financial links or they respond to common global shocks.

To answer the first question, we use a panel regression to estimate the impact of India's growth on the growth in South Asian countries other than India. The analysis follows the specification in Arora and Vamvakidis (2004, 2005, and 2010). Ding and Masha (2012) also apply the same methodology to South Asia up until the global financial crisis (GFC) in 2007. We extend this analysis up to 2018 as well as compare the before- and after-GFC scenarios. The model is specified as:

$$(Growth\ of\ real\ GDP\ per\ capita)_{it} = \beta_0 + \beta_1 X_{it} + \beta_2 S_{it} + u_{it} \quad \text{for country } i = 1, \dots, n \text{ over time } t$$

where the independent variables X_{it} include the standard variables in growth regressions: convergence (lagged average GDP per capita), demographics (age dependence ratio), physical capital (investment to GDP), human capital (secondary school enrollment), trade openness (trade as a percent of GDP), size of government (government expenditure as a percent of GDP), and macroeconomic stability (inflation). To determine whether spillovers from India have an additional effect, we include real GDP per capita growth in India, as well as the growth in other trading partners (weighted by share of trade) for all South Asian economies (represented by S_{it}). The regression is estimated using 3-year averages; data are from the World Development Indicators, IMF's Direction of Trade database, and staff estimates.

The main results for the variables of interest are presented in Table 2.4, and show additional external spillover effects, particularly from India. The coefficients of the control variables have signs largely consistent with the growth literature for the full sample, except for convergence (a lag of the dependent variable, suggests persistence) and the age dependence ratio.

TABLE 2.4: India's spillovers and partner countries' growth matter strongly for South Asia's per-capita GDP growth.

	All years (1992-2018)	All years (1992-2018)	Pre GFC (1992-2007)	Post GFC (2010-2018)
India GDP per capita growth	-0.37 (0.57)	0.49* (0.19)	2.09* (0.74)	10.74* (3.31)
Trade (percent of GDP)	0.03 (0.04)	0.07* (0.02)	0.16* (0.06)	0.43 (0.22)
Other trading partners GDP per capita growth	0.04* (0.01)	0.05** (0.01)	-0.05 (0.09)	-0.02 (0.05)
(India GDP per capita growth)*(Share of trade with India)		-0.02*** (0.00)	-0.03*** (0.00)	0.05 (0.02)
R-squared	0.28	0.57	0.89	0.96
Observations	38	38	20	18
Constant	YES	YES	YES	YES

Notes: ***, **, * denote significance at the 1, 5, and 10 percent levels respectively. The table contains the fixed effects panel regression for South Asia growth (1992-2018). Standard errors are in parentheses. Other indicators capturing business sentiments and human capital linkages included in the regressions are- convergence (lagged average GDP per capita), macroeconomic stability (inflation), demographics (age dependence ratio), physical capital (investment to GDP), human capital (secondary school enrollment), and size of government (government expenditure as a percent of GDP). We also include a dummy for the 2007-2009 average capturing the global financial crisis years when running the full sample.

Sources: International Monetary Fund, World Bank, and staff calculations.

As India's economy has become more integrated with the rest of the world over the years, the spillovers from India have become increasingly important for the rest of the region. This can be seen in the post global financial crisis (GFC) period in the regression results once we control for the other growth determinants. A 1 percentage point increase in India's per-capita GDP growth is associated with a .49 percentage point increase in the rest of South Asia. This not only reconfirms the results in Ding and Masha (2012), but also indicates that the relationship has gotten stronger in recent years. However, spillovers from trading partners (other than India) are also important, as can be seen in the coefficients for the indicator in columns 1 and 2 of the results table. The elasticity is low, but highly significant (reflected in the coefficients which are 0.04 and 0.05).

To test whether the conventional trade channel explains India's spillover impact, we also include an interaction term of growth in India with India's share of trade in each of the South Asian economy's total trade. For the full sample and before the financial crisis this variable is highly significant but negative, indicating that the spillover was possibly occurring through other linkages like financial flows, non-traded services, or remittances. The negative coefficient of the interaction term also indicates that the spillovers from India are smaller if the countries have more trade with India and less trade with other countries.



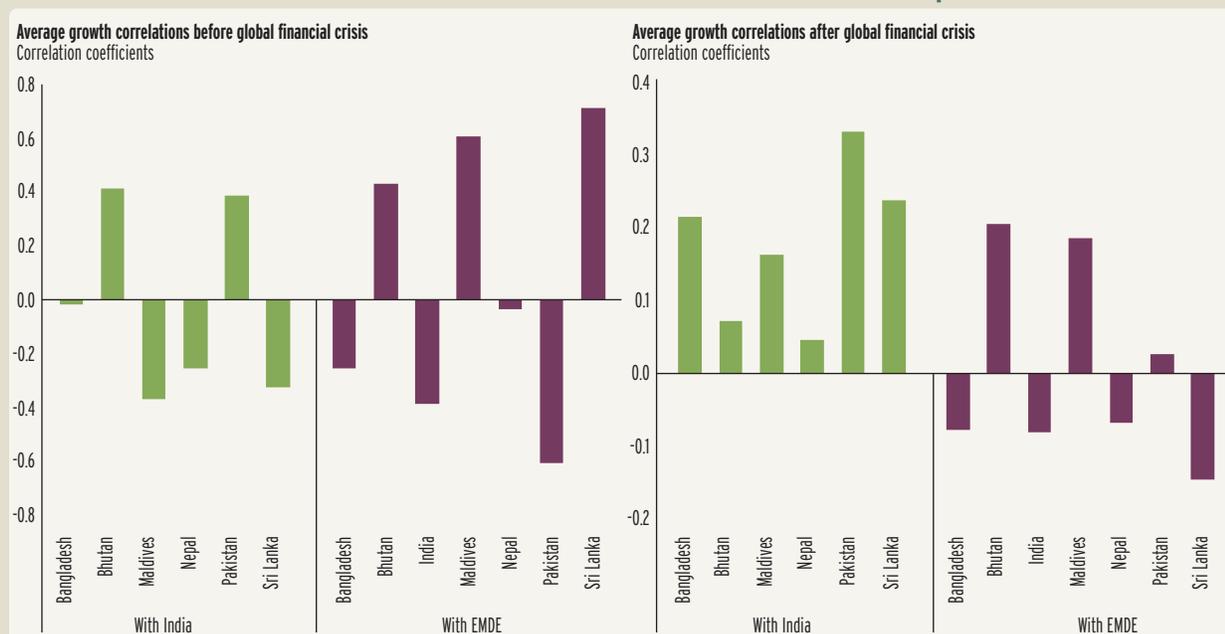
BOX 2.1. What are the spillover effects from India to the rest of South Asia? (continued)

To answer the second question, we measure co-movements between the South Asian economies and India, as well as South Asian economies and emerging market and developing economies (EMDEs). IMF (2013) examines co-movements of GDP at the global level and finds that the correlation and co-movements soar during times of crisis. If this is also true for South Asian countries, then recessions in other EMDEs will make it that much harder for South Asian countries to recover from the COVID-19 crisis. We estimate GDP growth correlation estimates by applying a bootstrapping technique to account for scarce data.

The results show that co-movements between India and the other South Asian economies (except Bhutan and Bangladesh) were not very large before the GFC (Figure 2.6). However, since the GFC all South Asian countries' GDP show positive co-movements with India. Still, the correlation is not very strong, with the highest (for Pakistan) only 0.3.

GDP growth co-movements between EMDEs and South Asian countries were somewhat large and positive for Bhutan, Maldives, and Sri Lanka before the financial crisis. After the GFC, however, co-movements remained strong for Bhutan and Maldives only, and had a negative correlation for other countries.

FIGURE 2.6: GDP co-movements between India and other South Asian economies are positive.



Notes: Each country is treated as a variable, and the results are based on 10,000 replications for sample sizes of 12 pre-global financial crisis and 38 post-global financial crisis. For Afghanistan, one or more parameters could not be estimated in 530 bootstrap replicates, so we exclude it from our analysis.

Source: World Bank and staff calculations.

The analysis thus suggests that alongside other external factors that will weigh in heavily on the small economies, the policies that India decides to pursue to both control the health crisis and revive the macroeconomy post-COVID-19 will be crucial for the rest of the region.

component for India than for Sri Lanka in both models. In Sri Lanka, the external contribution is very similar across the two models, but in India, the latter suggests a somewhat larger contribution compared to what is generated by the overall macro model (MFM_{od}).

II. Supply falls amid bottlenecks in global value chains

Another important channel of growth interruption is through reduced supplies from abroad. Domestic production will be interrupted by the stoppage of economic

activity by foreign suppliers, and if local suppliers are unable to engage in domestic economic activity during lockdowns, except for wholesale trade and deliveries of essentials. In China factories have already gone back to work, implying only a temporary interruption. However, factory closures will be prolonged even if activity in South Asia goes back to normal, because so many global value chains have been interrupted by lockdown in major hubs such as US and Germany.

It is important to understand how production has so far been affected by supply chain interruptions from COVID-19. Input-output fixed supply effects can be

used to estimate the impact on all sectors of the economy of a supply shock in sectors that provide inputs, whether domestic or imported. To do this we use a Ghosh matrix derived from the ADB Multi-Regional Input-Output Table (MRIOT) in 2018 (see appendix A2.2). The elements of the Ghosh matrix can be used to assess the direct and indirect impact on South Asia's production from a USD 1 reduction in the supply of goods or services from other domestic or external country-sectors. This analysis is useful to understand international and national production links, but it cannot incorporate the effects of relative price adjustments. However, given the artificially depressed supply in a COVID-19 world, capturing relative price movements will not be as informative as in normal times because price signals are also suppressed. We conducted an exercise assuming an interruption in both domestic and external production. We also ran a scenario assuming production interruptions originated only from the countries with the most serious outbreaks of COVID-19 as of early April (as shown in Figure 2.3) but found very similar results.

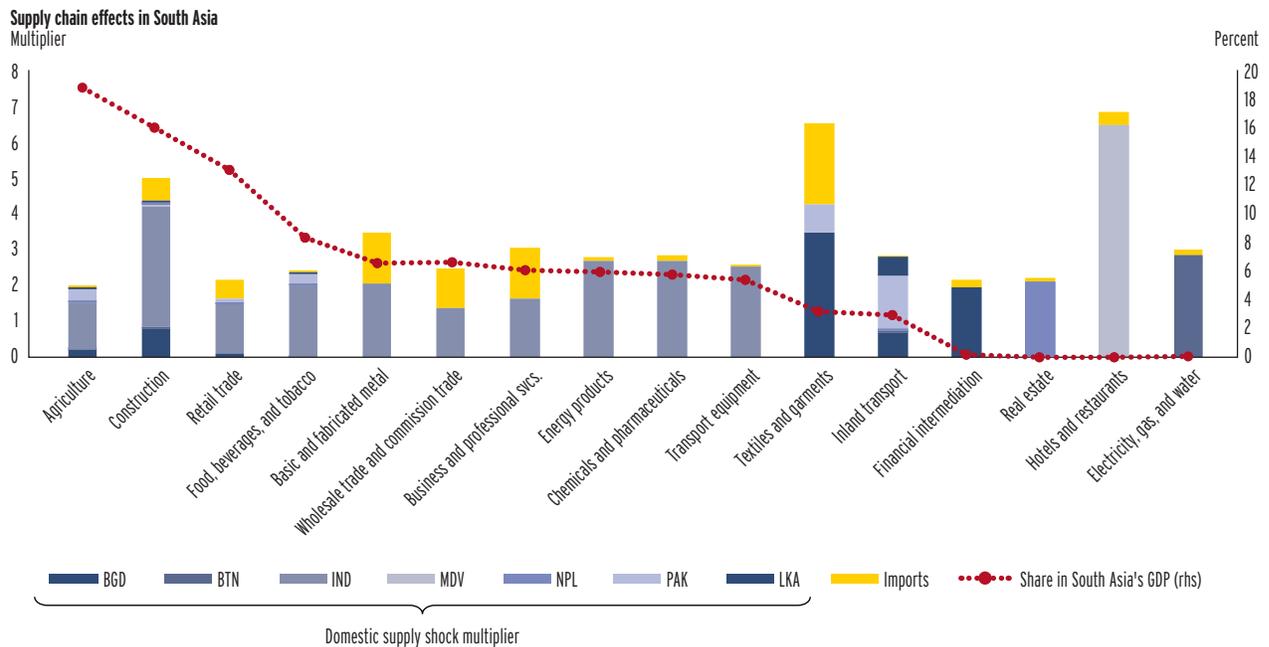
Figure 2.7 shows that the largest share of the multiplier effect for most sectors is due to domestic sources, except for Indian manufacturing sector and textiles and garments. For example, a USD 1 supply disruption in the sector of basic and fabricated metals will reduce output in South Asia by USD 3.53. About 40 percent of that supply

disruption originates abroad—through disrupted imports—and 60 percent originates from India which is also a producer. Output in basic and fabricated metals necessarily contracts by USD 1, but since it supplies intermediate inputs to other downstream sectors in India and elsewhere in South Asia (for example, steel for automobiles), other sectors in South Asia will experience contractions as well. As they themselves supply inputs to manufacturing, further contractions in manufacturing will occur. This cycle continues infinitely but at a diminishing rate; summing it all up, the total impact of the initial shock to each sector will be USD 3.53. Indeed, interruptions of energy products, chemicals and pharmaceuticals, and transport equipment mostly originate from India and have the effect of reducing output in the whole South Asian economy by between USD 2 and USD 3.

The results show that—with some exceptions—supply interruptions in the major sectors in South Asia are mostly of domestic origin.

» **Most intermediate production links are between sectors within each country.** There are some notable exceptions. About a third of intermediate supplies of textiles and garments are imported, affecting the large producers Bangladesh and Pakistan. Also, about half of the inputs for business and professional services in South Asia come from abroad, with significantly

FIGURE 2.7: Ghosh supply multiplier effects in South Asia and regional sector value added.



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



negative consequences for a prolonged interruption in orders and supplies. Still, the results are consistent with data showing that South Asia is not well integrated into global value chains.

- » **South Asian countries' production chains are not well integrated with each other either.** A supply shock from one South Asian country has an insignificant effect on production of another country in the region (either directly through a reduction in intermediate inputs, or indirectly through other supply effects down the value chain). The exceptions are Nepal's construction sector and Bhutan's electricity sector, which are affected by neighboring countries' output, particularly India's output.
- » **Most of the strong supply multiplier effects and production links are domestic, and for some sectors the impact is high (Figure 2.7).** Construction, one of the largest sectors in terms of regional GDP, is also the sector with the largest supply multiplier in the region, particularly in Bangladesh and India. Production of textiles and garments in Bangladesh, and to some extent in Pakistan, have a large supply multiplier effect, while a USD 1 interruption in the activities of hotels and restaurants in Maldives can signify an almost USD 6 loss of output according to the supply multiplier.
- » **The largest overall supply effects for South Asia are in agriculture, construction and retail trade.** They are the largest sectors in South Asia in terms of value added, accounting for almost 50 percent of the region's GDP (Figure 2.7). But the supply multipliers for agriculture and retail trade are not as high as that of construction.

Effects both on the supply side and through external spillovers could lead to a large impact on overall GDP in the coming months. On the one hand, if China and East Asia were to open up production earlier than South Asia, the benefits may be limited for South Asia, the region with the lowest level of GVC participation in the world: the share of foreign value added in exports in South Asia is only 13 percent (World Bank 2019). In other words, a recovery of manufacturing supply chains elsewhere is not going to necessarily boost production in South Asia quickly through supply-demand links. On the other hand, textile and garments exports and BPO exports from India are vulnerable: in a worst-case scenario in which lockdowns drag on, they could lose international clients from competitors in other regions. In terms of supply chains, factories in Bangladesh are suffering the consequences of both national and foreign lockdowns. This effect is compounded by lower demand in a post-pandemic world, given that fast-fashion retailers in Spain and UK, among others, have been severely affected by the crisis (Eley and Thomas 2020).

III. Domestic demand effects hit the vulnerable population

A drastic slowdown in domestic consumption as a result of the necessary lockdowns is by far the greatest threat to the livelihoods of many South Asians who work in labor-intensive services sectors. Significant long-term effects are possible if the lockdown is extended for more than a month. We identify a group of service sectors, mostly urban, that will bear the brunt of the economic cost of the lockdown. These are: (i) retail trade; (ii) land transportation; (iii) entertainment and other personal services, (iv) accommodations and restaurants; (v) travel agency, tour operator and other reservation service activities; (vi) water transport; and (vii) air transport. These sectors employed 88.4 million people, comprised 18 percent of total employment in South Asia and contributed about 22.5 percent of the region's GDP in 2018. Although sectors involved in food and beverage production and delivery, wholesale trade and health services were significantly affected by bottlenecks and health emergencies at the beginning, they are experiencing significant demand spurts during the lockdown.

Workers in the sectors that will be hit hardest have similar characteristics to the overall employed labor force, but there is heterogeneity within these affected sectors. Table 2.5 summarizes key characteristics of the labor force in those sectors based on the most recent labor force surveys (when available). The first point to note is that these sectors are not homogeneous. The largest four subsectors (retail trade, land transportation, personal services, and accommodations and restaurants) are the most labor-intensive. Moreover, workers in these labor-intensive sub-sectors have lower daily earnings, fewer years of schooling and are more likely to be self-employed or unpaid compared to workers in tourism, air transport and water transport (the latter earn, on average, twice the average earnings of South Asian workers as a whole). Retail trade alone employs 102 people per million dollars of output—compared to 81 for the region as a whole. The labor productivity of the affected service sectors in 2018 was many times lower than that of manufacturing, but almost three times that of agriculture.

To get a sense of the overall size of the impact on households, we conduct an input-output analysis to estimate the size of the employment multiplier effect from a USD 1 million reduction in demand for these services. The multiplier effect has three components: (i) a direct effect from the number of workers rendered unemployed because there is no demand for their output; (ii) an indirect effect from the fact that industries that supply to that sector will have idle capacity and thus create more unemployment

TABLE 2.5: Workers in service sectors most affected by COVID-19 are not homogeneous.

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

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

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

(for example, workers who made flower arrangements for a catering service that closed may lose their jobs); and (iii) a final consumption effect, reflecting a second round of job losses because consumption demand from idle workers falls. Appendix A2.2 describes the methodology. Then we apply the employment multiplier to calculate how many people could potentially lose their jobs for a given decline in consumption demand under the baseline scenario in which lockdowns last anywhere between 2 and 4 months.

Figure 2.8 summarizes the extent of the employment losses for each country. If the lockdown were to last 2 months, employment would fall in all countries but more severely--by double-digits--if the lockdown were prolonged for 4 months. For example, for every USD 1 million in foregone demand for these affected services in Sri Lanka there will be 170 fewer people employed (due to the total multiplier effect). This means that if consumption were to drop to the levels envisaged under the baseline scenario range (anywhere between 2 to 4 months), overall employment will decline by between 2.4 percent and 9 percent of total employment in those sectors of Sri Lanka. For Nepal

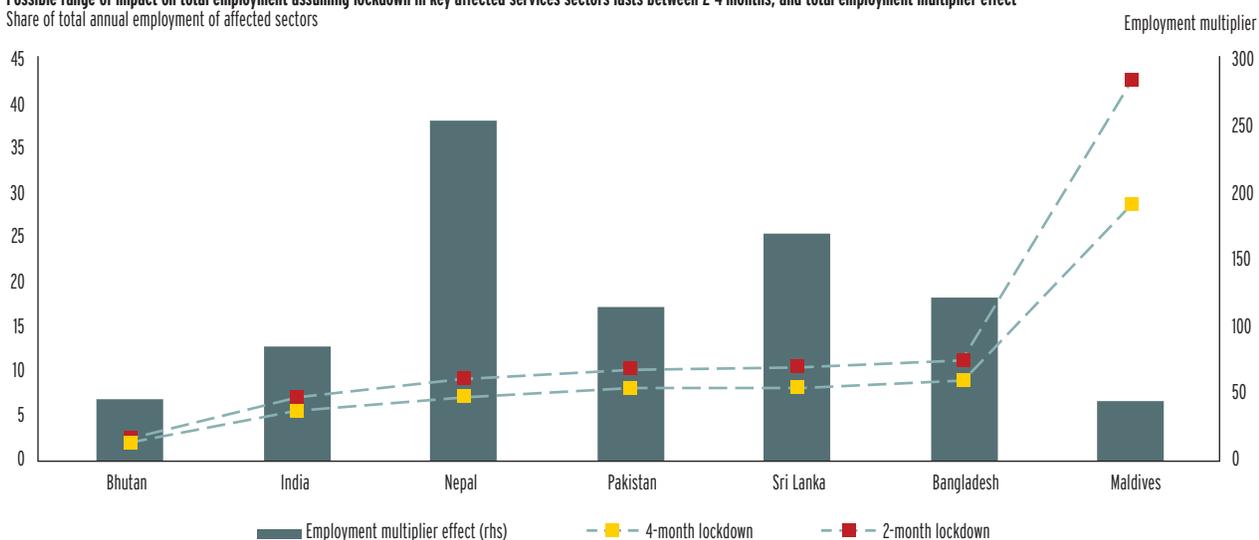
the employment multiplier is high, at 250 workers per USD 1 million. The simulation shows that the Maldives would have the largest employment losses (as a share of total employment) if the lockdown drags on, not through the multiplier effect but due to the high share of tourism in employment, almost 70 percent (Table 2.3).

The results do not capture the extent of the losses or all of the individuals affected. The analysis only looks at the employed population in the most affected services sectors, most of whom report wages or declare themselves as unpaid workers, but they are not necessarily the most vulnerable population in South Asia. Still, if a lockdown were to impact all non-agricultural sectors uniformly for 2 to 4 months, using the same methodology, employment losses in South Asia would range between 13 to 25 percent, respectively, of total 2018 employment. Even including agriculture, the labor force surveys on which these estimates are based only capture 550 million workers—from a population of 1.81 billion—and exclude large and important segments of the population such as children, students, the elderly. The dependency ratio is also high: about 53 percent



FIGURE 2.8: Employment multipliers vary by country. If lockdowns last between 2-4 months, 5 to 15 percent of jobs in those sectors could be affected.

Possible range of impact on total employment assuming lockdown in key affected services sectors lasts between 2-4 months; and total employment multiplier effect
Share of total annual employment of affected sectors



Notes: The employment multiplier shows the drop in employment in each country as a result of a USD 1 million decline in domestic demand in affected service sectors, taking direct and indirect sector effects into account. The analysis excludes Afghanistan; daily earnings for Maldives and Nepal are estimates.
Sources: ADB Key indicators, MRIOT 2019, labor force surveys and staff calculations.

of those employed in South Asia are heads of household and the size of an average household is 5.2 persons.

Capital intensive manufacturing and business tied to high-tech services will find it easier to go back to work with minimal losses to the physical capital stock, but the human capital losses in services may be irreplaceable and many establishments may simply not survive and lockdown period. But a significant share of the demand for entertainment, dining out and personal services that is lost during the crisis may never return: services are also different from goods in that they cannot be stored and require interaction among people to be consumed. Goods can be stored so there is generally no 'foregone' demand lost, as production can be ramped up to original levels faster. Many workers, and day laborers, in those affected service sectors could lose their jobs permanently.

IV. Declines in consumer and business activity impact the financial sector

Financial markets in South Asia are not prepared for the repercussions of the global COVID-19 pandemic. Many banks in the region have high shares of non-performing loans and low capital buffers. Banks in India and Bangladesh have particularly large stocks of non-performing loans. In India, the non-bank financial institutions are an additional source of vulnerability, as they play an important role in the wider financial market, and a further deterioration in their credit quality may affect their solvency. Private corporate credit as a share of GDP

is relatively high in India, Nepal, and Bhutan, but modest levels of household debt and manageable levels of sovereign debt in these countries mitigate the risks somewhat. In India, balance sheet vulnerabilities of listed corporates and their refinancing needs in 2020 were already high before the crisis. Pakistan and Bhutan are in a similar situation and in addition face heightened bank-sovereign nexus risks. Insurance companies in Bhutan have recently ventured into retail lending and now face challenges. Many non-bank finance companies and specialized banks in Sri Lanka have already been under strain over the past couple of years, with the new crisis worsening the outlook. Capital markets seem less vulnerable for the time being, but declines in capital flows may impact India and Pakistan. In Sri Lanka, the Colombo Bourse fell to an 8-year low in March amid heavy selling, and foreign holding of domestic government securities are less than 1 percent of the total outstanding. Financing is thus already very tight. Institutional investor bases are small across South Asia, which exacerbates the fallout in the event of foreign investors leaving the market.

The pandemic will amplify South Asia's financial sector vulnerabilities, and the peak impact and second-round effects are still to come. Mounting liquidity pressures and asset quality deterioration can adversely interact and lead to solvency problems. In addition, potentially large capital outflows could trigger exchange rate depreciations, which could further stress corporate and bank balance sheets. And in some countries where governments have borrowed heavily from domestic banks, the nexus between the sovereign and the state banks has already tightened,



and may tighten further (see Chapter 3). In other words, it will continue to be difficult to establish an arm's length relationship between the sovereign and the state banks. Strong legal and institutional frameworks are needed to deal with viable but insolvent firms, but the challenge is that insolvency systems across South Asia – and in Bangladesh and Bhutan in particular – are weak, which could amplify the stress.

State-owned banks will have to contribute their part.

With central banks providing much-needed room to extend credit, state-owned banks may be the best vehicle to on-lend funds. For example, governments could create COVID-19 bonds to lend to affected companies and step up through state-owned banks. These banks have played a stabilizing role in South Asia in the past. In India, for example, credit by private banks dropped during the global financial crisis, while public credit continued to grow, so that districts with a higher share of public banks were less affected by the shock (Chapter 3). And state-owned banks in India are again playing a crucial role now. Across South Asia, state-owned banks are now part of the solution, as they can engage in countercyclical lending and can reach out to vulnerable groups. However, the strong presence of the state in the financial sector in many countries in the region is also causing structural issues (Chapter 3) and raises systemic and fiscal risks. Many of the state-owned banks are heavily exposed to sovereign risks (including through investment into securities and direct lending). With concentrated loan portfolios, the level of non-performing loans is likely to increase significantly.

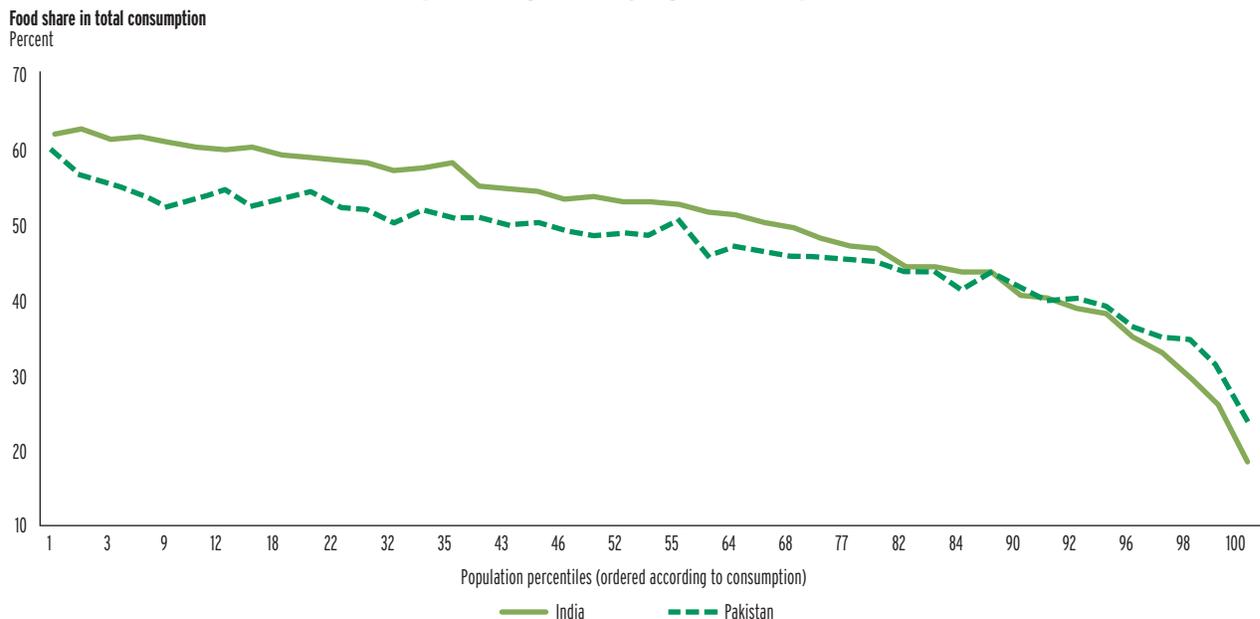
V. The price channels

One of the implications of widespread lockdowns to curb the spread of COVID-19 is the disruption of food supply chains. Even without a shortage of food stocks, the breakdown in transport links between farmers and traders means that the produce available in markets is a fraction of pre-COVID volumes. This has two regressive impacts. First, consumers face higher prices, and this affects the poor because the share of consumption allocated to food is higher for poorer households (as evident in Figure 2.9). An increase in food prices will, thus, impact the lower end of the income distribution more adversely. Second, agricultural producers, many of whom are poor, may see a decline in incomes as the breakdown in distribution systems forces them to accumulate inventories. This illustrates how vital the role of public distributions systems will be in the coming weeks.

For the remainder of 2020, prices are forecasted to fall.

Under the baseline scenario, oil prices are expected to remain low, while lower overall demand, due to income declines, will also help to limit price increases. In countries already heavily affected by COVID-19, such as the US and China, inflation rose in the early weeks, as prices of food and other essential items (such as medical supplies and household items) increased reflecting scarcity. However, falling prices of most other durable manufacturing goods and fuel more than offset food inflation after the first few weeks. This inflation pattern is also expected to materialize in South Asia, although the weight of food in the total consumer basket for the region (54 percent) is much larger than in the US (17.4 percent of total) and

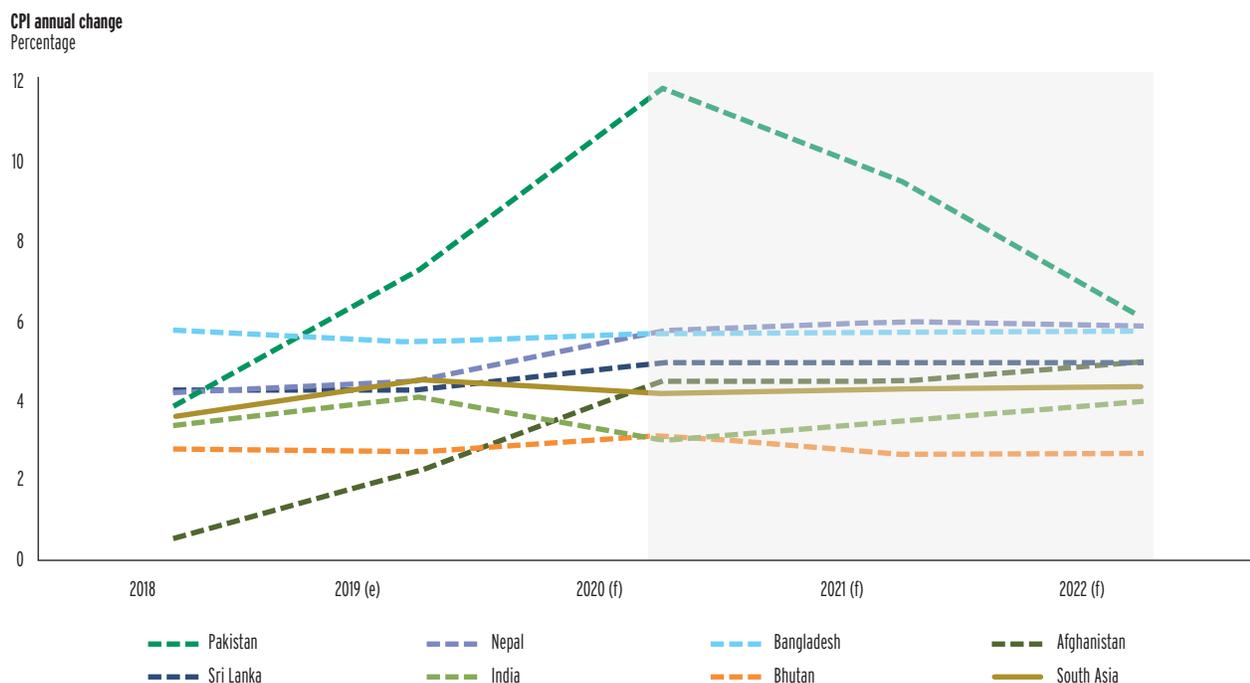
FIGURE 2.9: Food share in total consumption is significantly higher for the poorest consumers.



Sources: NSS 2011 Schedule 1.0 for India and Pakistan Social, Living Standards Measurement Survey (2013), and staff calculations.



FIGURE 2.10: Inflation is expected to remain stable in most of South Asia.



Notes: (e)=estimate; (f)=forecast. South Asia is an average.
Source: CEIC and staff calculations.

China (about 20 percent), so that the overall inflation deceleration will not be as dramatic. Food shortages from bottlenecks are also likely to be more persistent than in the US and China, as distribution systems are less efficient in South Asia, exacerbating vulnerabilities for the poor. Even if food inflation rises further in the short term there will be ample room for monetary policy to react. Inflation is expected to move back to more normal levels in 2021 as the South Asian economy recovers.

Lower fuel prices will mean an improvement in the terms of trade. A USD 30/barrel fall in Brent oil prices, all else equal, leads to an 8 percent improvement in the terms of trade of South Asia (see Figure 1.15). As discussed in chapter 1, this would certainly be a good opportunity for countries to rethink some fuel subsidies and reallocate resources toward programs to revive the economy or health expenditures. Countless studies show how fuel subsidies are regressive (Coady *et al.* 2015), encourage fuel over-consumption which impacts climate change, and raise the cost of food (Coady *et al.* 2019).

Deepening inequality

The macroeconomic forecasts and scenarios tell only part of the story, as they only show average impacts. The crisis will affect different socio-economic groups with different

severity. Some groups are experiencing losses in their labor income. Sources of income, such as transfers from governments and from domestic and international migrant workers, may also be affected and exacerbate the losses from reduced labor earnings. Finally, intra-household transfers can be a vital safety net to mitigate a fall in income.

The poor will be more affected by the crisis. First, they are more likely to become infected by the virus and get ill, as it is more difficult for them to exercise social distancing; they also have more limited access to health care (see Box 1.2 in Chapter 1). Second, the loss of work is sudden and large scale. As a result, many migrant workers who have lost their job in cities have no opportunity to stay there in the hope of finding other employment. The majority thus risks falling back into rural poverty. Third, the job losses are not concentrated in the manufacturing companies that produce for export but are widespread in the domestic service sectors, where jobs tend to be paid less and require lower skill levels (Artuc *et al.* 2019).

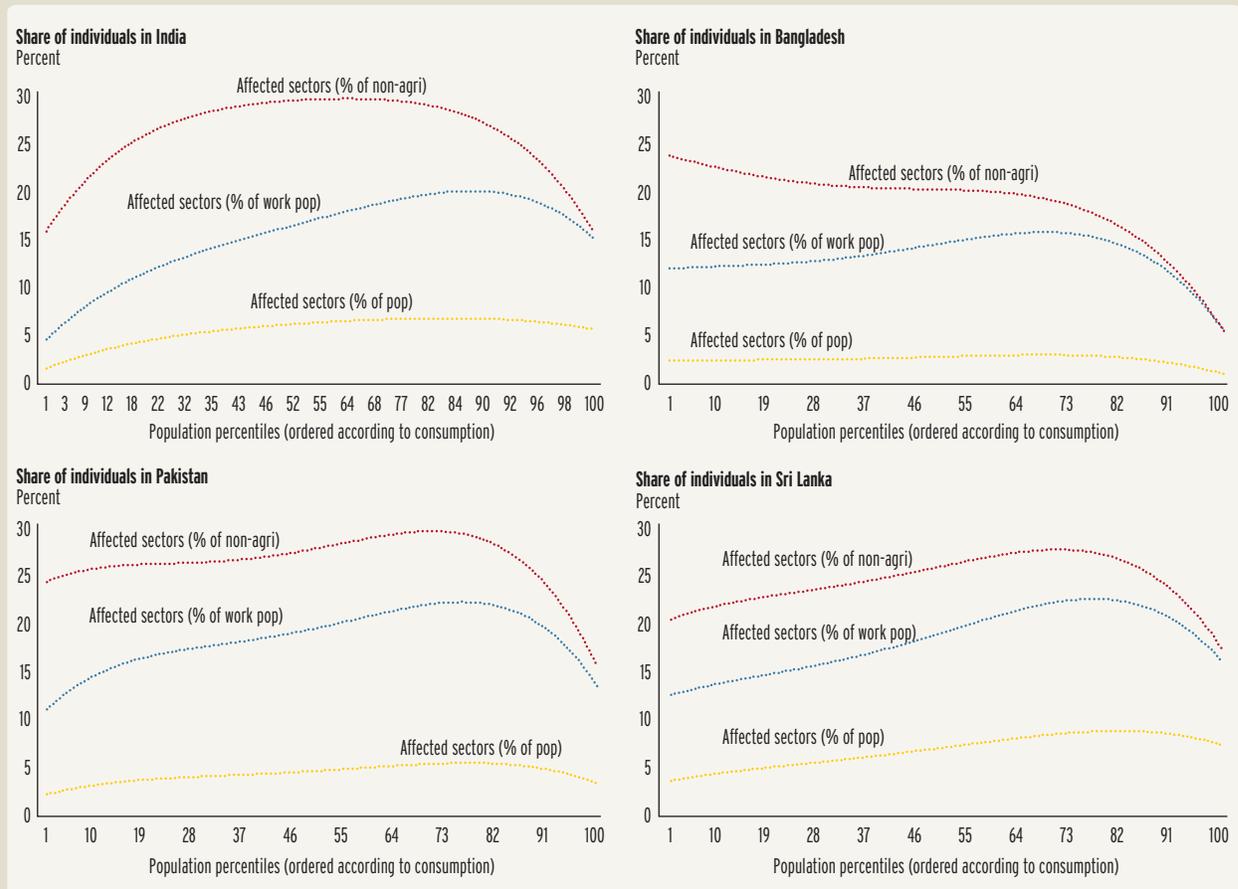
More information is needed to identify the most vulnerable. The World Bank will soon start a rapid-response survey in South Asia to collect more information. Box 2.2 tries to find some indirect evidence of who is hit hardest by this crisis by looking at the characteristics of people that work in the most affected service sectors. The conclusion is that there is a lot of variation within this group of people. They can be found in households with low consumption per person, in households with high consumption

BOX 2.2. Identifying the people working in sectors most affected by the COVID-19 crisis

This box focuses on workers in service sectors that are directly affected by the lockdown measures. In countries of South Asia, this is a large group, ranging from 13 to 20 percent of the working age population. It is also a heterogeneous group since it comprises people working in retail, hospitality, air transport and other services with very different earnings. Workers in these affected sectors are being laid off, yet some may be able to cope because members of their households are employed in different sectors, or because they have large savings. However, others may not have assets to buffer the shock or may live in households with undifferentiated sources of income. While unpacking all the different coping strategies may not be possible with the current data, we can still assess whether affected workers reside in households at the bottom, middle, or upper part of the consumption distribution.

According to the latest available household survey data for India, Bangladesh, Pakistan and Sri Lanka, workers in the affected sectors are found all along the distribution of household consumption per capita. Workers in the affected service sectors are not concentrated among the poorest in South Asia, who tend to live in rural areas and engage in agriculture. Figure 2.11 shows the proportion of workers in the affected sectors along the consumption distribution. All individuals are ranked in percentiles from the poorest 1 percent to the richest 1 percent. And for each of these percentiles, the figure shows the proportion of workers who are in the affected sector as a ratio of (i) the whole population, (ii) the working age population, and (iii) the working age population in non-agriculture. Workers in the affected sectors represent, on average, about 5 percent of the total population in these countries, about 17 percent of the working age population, and about 25 percent of the non-agricultural working population. There is clearly variation along the distribution, but these workers do not seem to be concentrated at the top or bottom of the distribution. And this pattern is remarkably similar across the four countries.

FIGURE 2.11: Individuals in affected sectors by percentiles of consumption per capita.



Note: Lines are polynomial of degree 4 approximation of the actual shares.
Sources: India PFLS (2017-18), Bangladesh Household Income and Expenditure Survey (2016), Pakistan Social and Living Standards Measurement Survey (2015), Sri Lanka Household Income and Expenditure Survey (2016) and staff calculations.

However, the poorer among these affected services workers – the young, those with less experience and less education – are at higher risk of being the first to be laid off. This means that the crisis, and the lockdown measures, may have an uneven impact and affect more severely some of the poorer workers of the service sectors.



BOX 2.2. Identifying the people working in sectors most affected by the COVID-19 crisis (continued)

A closer look at the data suggests that, as in other sectors, those at higher risks of unemployment tend to be young people and people with less education. Using the survey data, we estimated a Probit regression model to assess the likelihood of being in an employment or unemployment status given a set of household and individual characteristics. The results of the estimation are shown in Table 2.6. The sign and magnitudes of the coefficients are as expected: males in urban households are more likely to be employed vis-à-vis females or those in rural households; similarly, individuals who are not married are less likely to be employed than married individuals are. In terms of education and experience, the results show clearly that years of schooling and age also matter.

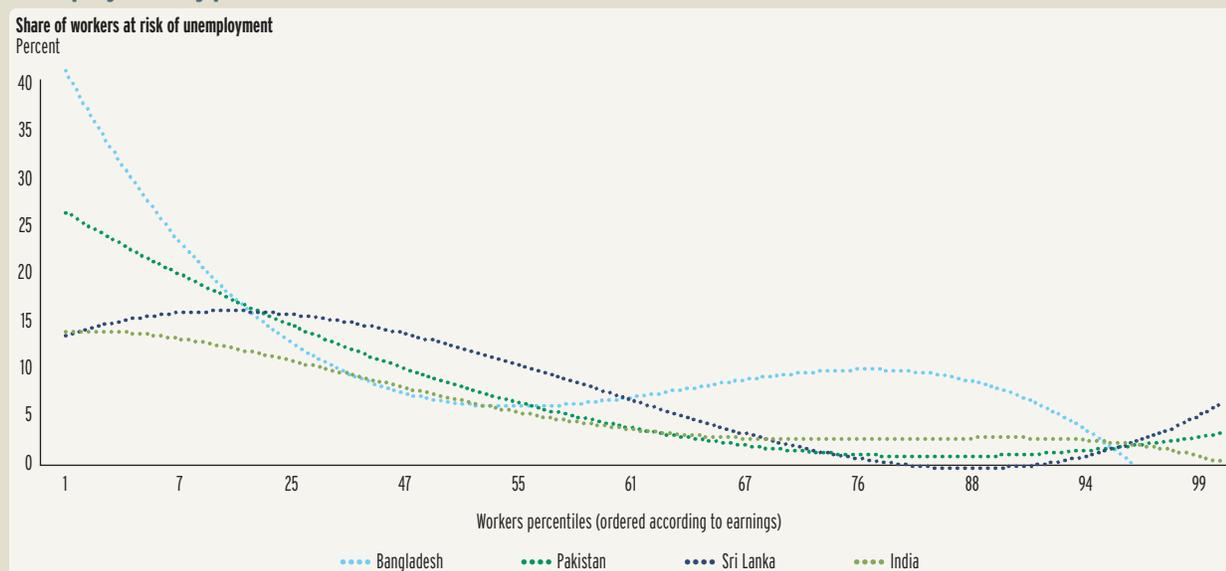
TABLE 2.6: Probit estimation of the likelihood of being employed.

Dependent variable: Employed						
	Coef.	Robust Std. Err	Z	P>z	[95% Conf. Interval]	
Urban	0.08	0.02	4.78	0.00	0.05	0.11
Female	-0.13	0.02	-6.42	0.00	-0.17	-0.09
<i>Marital status</i>						
Married	0.73	0.02	31.42	0.00	0.68	0.78
Widowed	0.54	0.06	9.07	0.00	0.42	0.65
Divorced	0.47	0.09	5.32	0.00	0.30	0.64
<i>Individual characteristics</i>						
Age	0.08	0.00	20.68	0.00	0.07	0.09
Age ²	0.00	0.00	-17.32	0.00	0.00	0.00
Education	0.17	0.02	8.18	0.00	0.13	0.21
Education ²	-0.03	0.00	-12.46	0.00	-0.03	-0.03
Household size	-0.01	0.00	-2.73	0.01	-0.02	0.00
Constant	-0.81	0.09	-8.82	0.00	-1.00	-0.63

Notes: Number of observations 157,950; and the pseudo R² is 0.1871; results (not reported) for other countries have a similar pattern.
Source: India PLFS (2017-18) and staff calculations.

Using these results is possible to rank individuals currently employed in the affected sectors by their likelihood of losing their jobs. These are younger, less educated, not married, female, and rural workers and, as shown in Figure 2.12, they are also, even before losing their jobs, at the bottom of the distribution.

FIGURE 2.12: India, Bangladesh, Pakistan, and Sri Lanka, individuals in affected sectors at higher risk of unemployment by percentiles.



Note: Lines are polynomial of degree 4 approximation of the actual share.

Sources: India PLFS (2017-18), Bangladesh Household Income and Expenditure Survey (2016), Pakistan Social and Living Standards Measurement Survey (2015), Sri Lanka Household Income and Expenditure Survey (2016) and staff calculations.



per person, and everything in between. While there is no evidence that workers in affected sectors reside predominantly in poorer households, the analysis also shows that those in poorer households are more likely to lose their employment.

Complicated policy challenges

Policy makers are in uncharted territory and must consider innovative policies. In their immediate response, the focus has been rightly on mitigating the spread of COVID-19. While doing that, conditions should be created to jumpstart the economy, once countries emerge out of the immediate health crisis. A complication is that fiscal and monetary policy must be recast under the realization that in a COVID world, neither demand nor supply work properly: broad-based expansionary macroeconomic policy cannot do much to increase production and employment during periods when workers are obliged to stay at home because of social distancing requirements. After the immediate response, expansionary policies may be needed to prevent a further spiraling down of economic activities, but the focus should also shift toward long-term fiscal sustainability. We discuss below first the immediate policy options and then potential policy measures once the health threat eases.

I. Policies for immediate action

Early measures to mitigate the spread of COVID-19 are paramount. The forecasts and scenarios presented earlier differ in one important way: the assumed duration of the lockdown measures. The earlier measures are taken, preferably before community transmission, the faster economic activity can begin to get back on track. Strengthening disease surveillance and health interventions in the region is also a high priority. With limited fiscal space, governments should actively seek concessional financing along with technical assistance from development partners to help cope with the health emergency.

Cost-effective (virtual) awareness-raising is part of an effective first response. By teaming up with satellite or phone companies, information on contagion can be made available at the local level and tracking systems can be developed. Cell phone operators in India were asked to run coronavirus awareness messages in place of the regular caller tunes, and Pakistan's government launched a

public web portal that provides the summary of domestic coronavirus cases along with information on prevention and testing.

Digital technologies can also be used to monitor the spread of COVID-19. Such initiatives, largely voluntary, have been successful in helping combat the pandemic in East Asia. Incentives also can be provided to those who report symptoms. India recently launched an app, Aarogya Setu, that uses location data from persons' smartphones to tell users if they have been near someone who tested positive for COVID-19. Privacy concerns can be dealt with by legislating sunset clauses on tracking systems. The region houses many poor and uneducated households that are nevertheless tech-savvy, and the innovative solutions technology brings could greatly help educate and track contagion across the populations at large.

Promoting solidarity can help mitigate the spread of COVID-19. Governments should be stern about clamping down on stigmatizing campaigns against those who have the virus or brought it, as this creates incentives for under-reporting symptoms, which only helps spread it. Daily positive messaging by national and local leaders can help shift behavior. In Bhutan there has been a show of solidarity for quarantined persons as well as Bhutanese stranded abroad.

Lockdown policies should not endanger the most vulnerable and poorest people. Temporary public work programs (for example, producing protective gear, sanitizing public spaces, delivering food to elderly) could provide migrant workers, many of whom need to travel or may not have a place to go if they lose their jobs, with food or cash. Digital technology can be used to identify the poor and vulnerable and organize food and cash distributions for them. Organized food distribution and even temporary price controls on food and basics should be a key area of focus. An optimal combination of logistics management, use of the strategic reserve, and inter-regional arrangements to speed up customs clearance of essential goods should be planned under the framework of public and private partnerships, given that the private sector can contribute to efficiency. Bhutan and Nepal took specific actions to speed up the importation of food amid some bottlenecks at the border. Profit pursuing reselling activities, hoarding and price fixing should be penalized.

Mobile and online banking platforms can be used for quick delivery of emergency funds to the neediest firms and individuals. Many unbanked populations in South Asia already have a mobile phone and/or internet access. To increase the number of new users, subsidies could be provided to enterprises that offer mobile and online cash



transfer services, as well as temporary exemptions on account opening fees and other transaction costs.

Firms and governments should find creative ways to quickly change their business models to survive through the crisis. Failure to do so can lead to long-term disruptions in production capacity and a prolonged economic slump. For example:

- » **Resources can be shifted to activities made more important by the crisis.** Construction workers can be mobilized to build health facilities. Restaurants can enhance food-delivery options. Online shopping, already growing very quickly in South Asia, can be expanded to micro-businesses. In Malaysia, digital free-trade zones established by the government create a one-stop shop for small e-commerce businesses to obtain resources.
- » **Manufacturing firms in South Asia are already contributing to reduce health costs.** In India, the Tata group is looking into producing ventilators. The Bangladesh Military Institute of Science and Technology has designed a ventilator which may be produced by Walton, a major Bangladeshi appliance manufacturing firm. Garment factories in Bangladesh are also beginning to produce face masks (India is already an important producer).
- » **The government can create temporary jobs which could help mitigate both health and economic costs.** Social media or media outlets can be used to recruit people who can provide public services that are in high demand, such as food delivery, cleaning of public buildings and buses, setting up temporary hospitals, call-center clerks who check up on quarantined people, etc.
- » **Large companies can also find ways to ‘spread out’ the cost by not laying off employees, but by reducing hours worked.** For example, Sri Lankan Airlines is implementing mandatory salary reductions for a period of three months to ensure the survival of the airline. While it does not solve the loss of income, it’s an important signal to workers that firms have an interest in retaining them.
- » **Debt-service moratoriums can be a tool to help firms and individuals to economically survive the crisis.** When income suddenly drops, the failure to service debt, to make mortgage payments or to pay rents can lead to bankruptcies or delinquencies, which could jeopardize the jumpstart of the economy. Grace periods and extension of debt maturities can help firms and individuals to bridge the crisis period. Careful monitoring of loan delinquency and recapitalization needs of banking sectors is essential to avoid a COVID-induced financial crisis.

Lack of liquidity could jeopardize the proper functioning of payment systems and could destabilize the banking sector. High levels of uncertainty have reduced investors’ willingness to allocate money for the riskier investments available in emerging and frontier markets. Timely actions by central banks, both within the region and globally, are recommended for coordinated liquidity supply and interest rate cuts to mitigate the tight financial conditions. So far, a series of monetary measures have been taken (see Table 1.4). For instance, India has announced anti-virus monetary policy measures, injecting new cash to financial systems by long-term repo operations with the aim of increasing bank lending and stabilizing the financial markets. Pakistan and Sri Lanka reduced policy rates, and Sri Lanka also reduced the statutory reserve ratio.

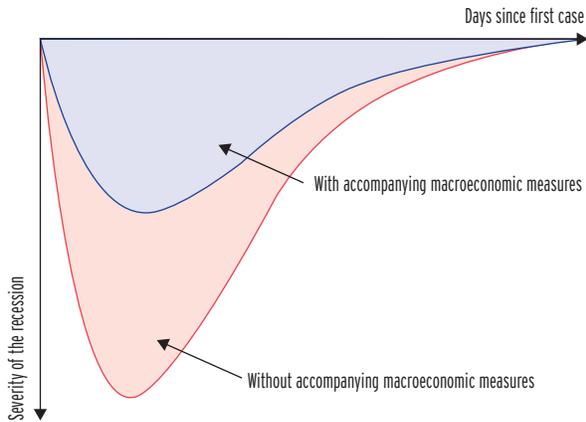
II. Policies for the aftermath of the health emergency

Once countries come out of the immediate health crisis, expansionary macroeconomic policies could aim to flatten the recession curve (Figure 2.13). Well-targeted fiscal support, a mix of tax exemptions and suspensions to the neediest segments of the population, and frontloading expenditures are tools to stimulate the economy when lockdown measures are suspended. Targeted fiscal measures are crucial for countries that have limited fiscal space, particularly those that are already heavily indebted. Therefore, it is important to make tax amnesties or forbearance temporary, by specifying a sunset clause. The crisis may also provide an opportunity to eliminate expensive and poorly targeted programs such as fuel subsidies in Bangladesh.

Increased infrastructure expenditure can accelerate the revival of economic activity. Construction and infrastructure spending could be ramped up, given construction’s large employment multiplier effect (Figure 2.7). Governments can work with the private sector to quickly identify those left unemployed by the lockdown. In some cases, it will mean restarting interrupted infrastructure projects; for example, in Nepal and Bangladesh some construction and infrastructure projects stopped because equipment could not be imported, and technical staff could not travel. Once some activities related to air and land transport take off, economic activity may return to normal levels. Satellite imagery already shows the extent of low economic activity in India—less so in Bangladesh where some manufacturing activity was open in March. A silver lining from the COVID-19 crisis will be the improvement in air quality, also evident from satellite images (Figure 2.14)

Fiscal sustainability will be at risk. Fiscal deficits are bound to increase as a result of lower tax revenue and

FIGURE 2.13: Macroeconomics policies should aim to flatten the recession curve to prevent the temporary COVID-19 shock from having permanent effects.



Source: Following Gourinchas (2020).

countercyclical spending. Maldives’ deficit is projected to double to 12.9 percent of GDP in 2020, the largest increase, while India, Bangladesh Pakistan and Sri Lanka are expected to see deficits rise to between 7 and 10 percent of GDP in the baseline. Bhutan is forecasted to move from a surplus to a deficit (Figure 2.15). Even without any fiscal stimulus, the fiscal deficit was expected to increase in several countries. Meaningful stimulus will lead to wider deficits. However, lower oil prices will provide some respite for the budget. A USD 30/barrel drop in the price of Brent crude, for example, can mean USD 42 billion of annual savings for India, which is nearly 1.4 percent of GDP.

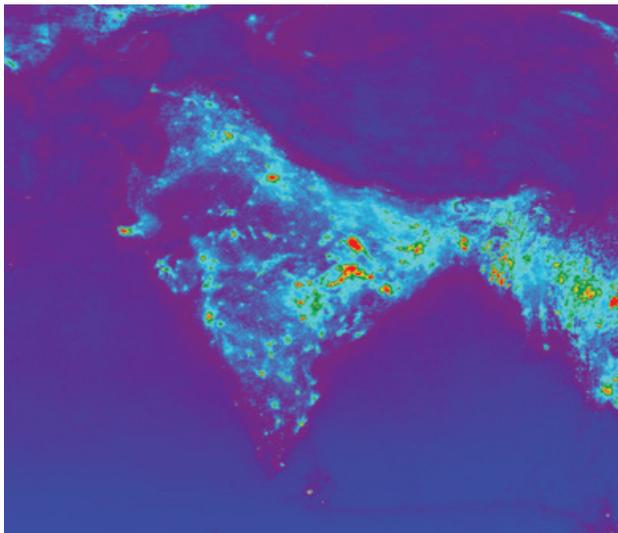
With the worsening fiscal deficit, debt will become an issue once countries emerge from the crisis and normal activity resumes (Figure 2.15). Several countries may want to consider public debt service restructuring programs to avoid bunching up of maturities further down the line that could increase financing costs. For example, in the Maldives, the authorities must prepare for certain rollover risks from sovereign debt, notably for the massive debt service due in 2022 (although some of it is mitigated by the Sovereign Development Fund). Medium-term fiscal prudence should be secured along with close policy dialogues with donors to seek a sensible arrangement on sovereign debt repayments, in order not to lose investor confidence. If restructuring of public balance sheets becomes necessary, it may provide India and Pakistan an opportunity to face the difficult challenge of reducing contingent liabilities.

While the baseline scenario does not project a sudden stop in external financial flows, these fiscal deficits can exacerbate the transmission of external financial shocks to the region. In 2020 all countries are expected to suffer a contraction of export and imports, in line with weak foreign and domestic demand. By 2021, some countries may see a mild improvement, while others will not see changes in the balance. In 2020 the current account deficit in India is expected to improve from 1.0 to 0.3 percent of GDP.

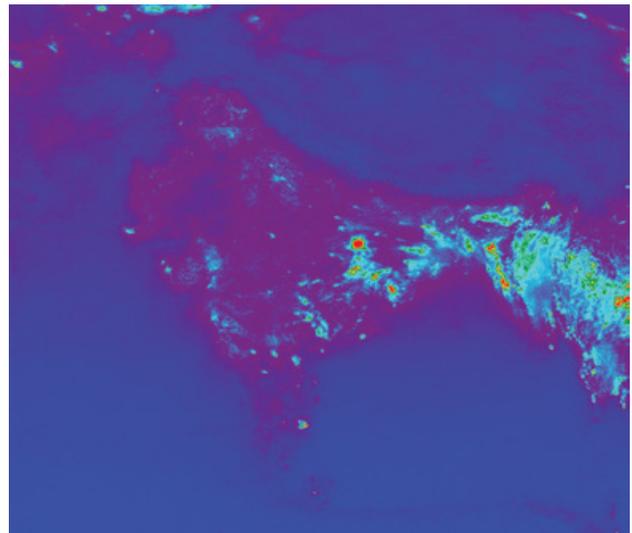
The crisis has likely changed long-term challenges and opportunities. While policy makers are addressing immediate problems, they cannot ignore the longer-term impacts of this crisis. The pandemic might reinforce the backlash against globalization that was already visible in

FIGURE 2.14: Environmental effects of the COVID-19 crisis.

2019: Mar 25 - Apr 3 (average)



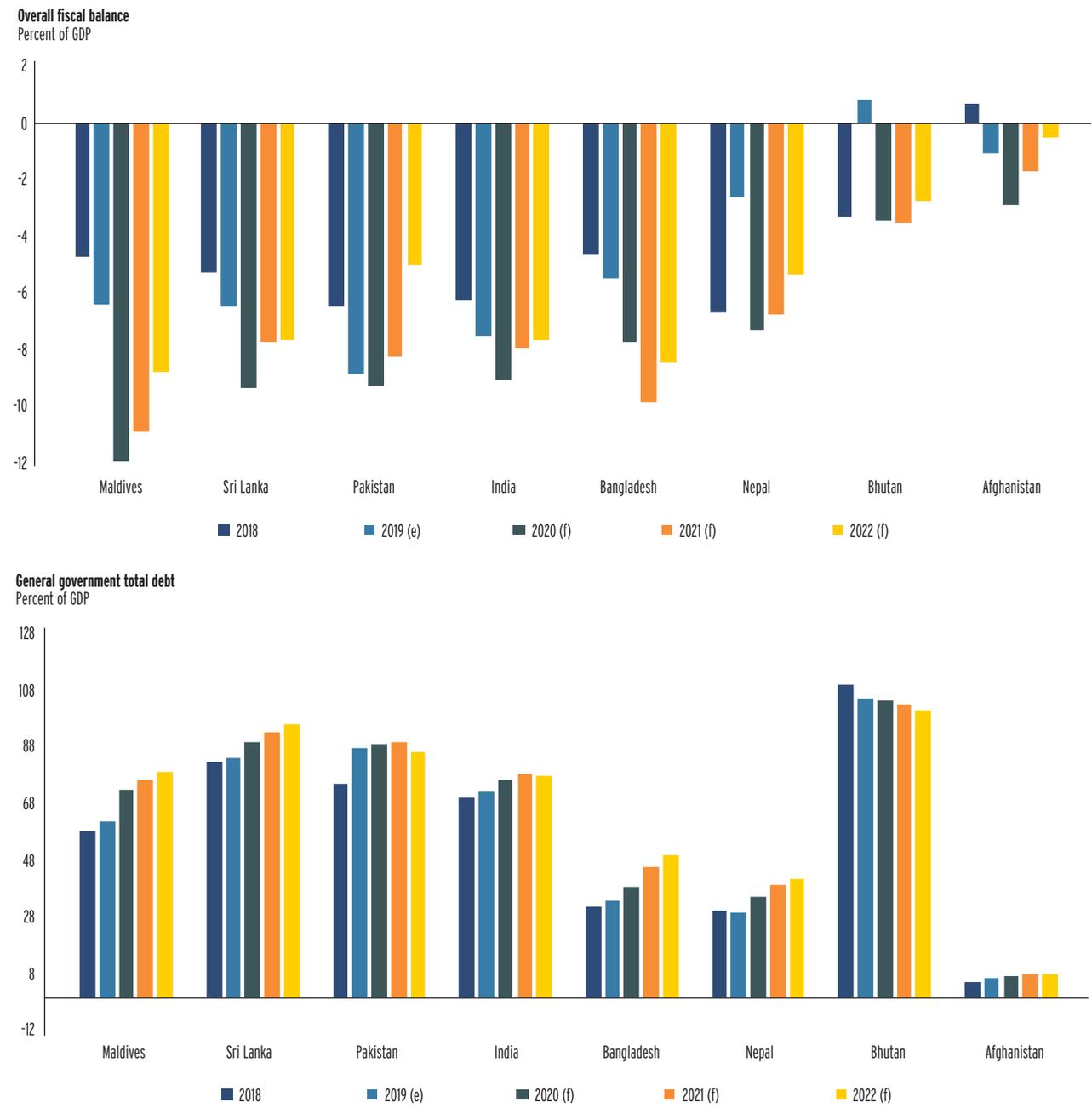
2020: Mar 25 - Apr 3 (average)



Notes: Picture shows satellite imagery of Nitrogen Dioxide (NO₂) concentration. NO₂ is closely related to anthropogenic activities and has been used as a proxy of economic activity and social distancing.
Source: Based on Sentinel-5P NRTI NO2: Near Real-Time Nitrogen Dioxide satellite data (<https://sentinel.esa.int/web/sentinel/user-guides/sentinel-5p-tropomi>) and processed with Google Earth Engine.



FIGURE 2.15: Indicators of fiscal sustainability are worsening.



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

recent years. When global value chains are disrupted, it is understandable that countries look for production methods that are less dependent on foreign producers. However, economic security is better served by diversification than by autarky. For South Asia, it is impossible to return to a sustainable high growth path without further integrating into global markets. The crisis has also laid

bare the harsh reality of inequality in South Asia. Reducing inequality is paramount to reach just and socially sustainable growth. Finally, the crisis highlighted digital opportunities for payment systems, communications, and distant learning. These opportunities will be valuable far beyond the current pandemic, especially in the development of remote areas in South Asia.

BOX 2.3. Fiscal policy should turn countercyclical during this crisis.

In the past, fiscal policy in South Asia has been procyclical. The cyclicity of government spending is typically defined in terms of how spending moves relative to the output gap (the difference between actual and potential output). If government spending decreases with a positive output gap, i.e. when output is above its potential, it is countercyclical. If it increases instead, it is procyclical. Tax revenues are naturally procyclical, with the strength of the relationship depending on the buoyancy of taxes.

The cyclicity of government expenditure and tax revenue can be estimated in a straightforward way. Beyer and Milivojevic (2019) estimate a panel error correction model to understand the extent of procyclicality in South Asia and find that both revenues and expenditures are highly procyclical. The model is of the following form:

$$\Delta(\ln(X_{it})) = \mu_i + \theta \times \Delta(\ln(GDP_{it})) + \gamma \times (\ln(X_{i,t-1}) - \beta \times \ln(GDP_{i,t-1})) + \varepsilon_{it}$$

where X_i = {government expenditure, tax revenues} stacked for all $i=1...6$ South Asian countries (Afghanistan and Maldives are excluded due to missing data). The constant term μ_i is country-specific or can be pooled. The second and third terms refer to the adjustment to trend growth, where β is the long-term coefficient and γ denotes the speed of adjustment, expected to be negative and less than 1. If the coefficient θ is positive for government expenditures, then there is procyclicality.

TABLE 2.7: Government expenditure and tax revenue in South Asia are pro-cyclical.

Dependent variable	μ	Θ	γ	β	Observations
Government expenditure	-0.011	1.25**	-0.14	0.94	168
Tax revenue	0.012	1.07***	-0.04	0.91	162

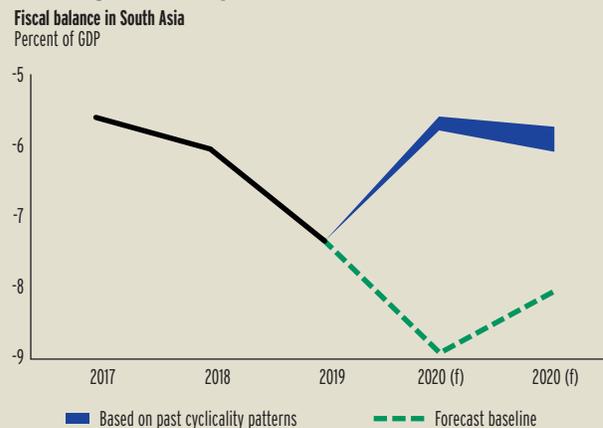
Notes: ***, **, * denote significance at the 1, 5 and 10 percent levels respectively. The estimation period is from 1990 to 2018. Sources: As explained in Beyer and Milivojevic (2019), World Bank, and staff calculations.

In South Asia, tax revenue increases less with GDP than public spending does. The table presents the results of updating the estimations of Beyer and Milivojevic (2019) to 2018. The coefficient of interest, θ , is highly significant. In the past, a 1 percent change in GDP growth translated into a 1.07 percent change in tax revenue, i.e. the tax buoyancy was around one. For each percentage point change in GDP growth, government expenditure changed by 1.25 percentage points. Since public spending changes more than proportional with GDP, there is a so-called voracity effect (Tornell and Lane 1999). In the past, governments did not carve out fiscal space during good times, so that they were unable to support the economy in bad times. Reduced public spending during growth decelerations amplified the economic downturns. The effect has been reinforced by the expenditure cuts targeting investment. In South Asia, capital expenditure – which is easier to reduce politically than current spending – has been more procyclical and has had a larger impact on GDP (Beyer and Milivojevic 2019). Procyclical fiscal policy is common among emerging markets and developing economies (Ilzetzki and Végh 2008, Frankel *et al.* 2013) and arguably a reflection of an inability to access external finance timely as well as of weak institutions unable to contain overspending when growth is high.

Contrary to past cyclicity patterns, fiscal deficits are forecasted to turn counter-cyclical. The above estimations were used to conduct an out-of-sample forecast of revenues and expenditures, based on the GDP forecasts presented in this chapter. The resulting deficit of the region provides a counterfactual of how fiscal deficits would move if GDP forecasts materialized and governments behaved as in the past, i.e. if they took no corrective fiscal policies to stem the COVID-19 crisis. The figure shows the resulting fiscal deficit for South Asia assuming the baseline range of GDP growth projections and compares it to the forecasted fiscal deficit in 2020 and 2021. All else being equal, if the same pro-cyclical trends were maintained as in the past, the fiscal deficits would be much smaller than forecasted. The difference between the two reflects the large additional expenditure (or on-purpose forgone revenue such as tax forbearance) the governments are expected to make to contain the COVID-19 crisis and to support the economy.

This crisis calls for countercyclical spending, but financing can be an issue – especially in countries with high debt. In the past, expenditures would have declined when GDP growth declines, particularly capital expenditures. In this crisis, however, countries across the region are attempting to support the economy with large relief packages (see Table 1.3) and in doing so increase spending and relinquish tax revenue. Experts across the region are also expecting large fiscal deficits (Box 1.5). These measures are needed, but the limited fiscal space in some countries raises concerns about fiscal sustainability. Outside aid may help to buffer the additional financing needs, but only slightly. For some countries, debt sustainability will be at risk and debt relief may be needed.

FIGURE 2.16: Fiscal policy is expected to turn strongly countercyclical in response to COVID-19 in 2020 and 2021.



Note: Out-of-sample forecast based on estimation above and forecasts presented in Figure 2.1. Sources: As explained in Beyer and Milivojevic (2019), World Bank, and staff calculations.



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Technical Appendix

Appendix A2.1

The simulation of the two external scenarios for India and Sri Lanka are based on the model and estimation strategy of Almansour *et al.* (2015), who propose a Bayesian vector autoregression model with financial and real variables to quantify the contribution of external conditions on growth in emerging markets. The model features an external and internal block and assumes that global economic conditions are exogenous to the growth of emerging markets on impact. It has also been employed for the World Economic Outlook, April 2014, Chapter 4 (*On the Receiving End? External Conditions and Emerging Market Growth*). For the simulations, real GDP growth in China and international oil prices (which matter for India) are added to the model. In addition, the US shadow federal funds rate (Wu and Xia 2016) replaces the 10-year US Treasury bond rate (to simulate unconventional monetary policy in advanced countries).

The model is estimated from 1998Q1 to 2019Q4 and then employed for two different conditional out-of-sample forecasts. Both scenarios are identical for 2020Q1 with real GDP growth for 2020Q1 (for the US, the Euro Area and China) based on nowcasts, and the JP Morgan EMDE EMBI yield, the US federal funds rate and inflation, and the oil price for 2020Q1 being averages from the beginning of the year to the latest observation (March 25). The terms of trade for India and Sri Lanka are assumed to be 5 percent higher than in the quarter before. For the remaining quarters of 2020, the conditioning real GDP growth rates and oil prices match the World Bank scenarios described in the chapter and the remaining variables are assumed to be in line with these scenarios.

Appendix A2.2

Calculating supply and demand multiplier effects.

The main data source used for supply and demand multipliers by sector and country is the multi-regional input-output table (MRIOT) produced by the Asian Development Bank (see ADB, 2019). The methodology is described in ADB (2015). This data has been updated to 2018 and is available in millions of current US dollars for 62 countries and the rest of world, including all South Asian countries except Afghanistan. Production is disaggregated into 35 economic sectors. The difference between the MRIOT and regular input-output tables of an individual economy is that all countries are stacked and linked, which means that each element of the matrix refers to supply and use of one country-sector to another country-sector. The sum of all elements of the column corresponding to sector i in country j ($i=1..35; j=1..7$) represents the amount of intermediate input (in millions of USD) that sector i of country j demands from all countries and all sectors in the South Asia sub-system ($35 \times 7 = 245$ country-sectors). If an additional row of sectorial value added is included in \mathbf{Z} , as well as final demand column to the right of matrix \mathbf{Z} , then we have a social accounting matrix \mathbf{S} of size $(35+1) \times (1+35)$.

Given an input-output table (either single- or multi-country), then from the Intermediate Use Matrix \mathbf{Z} , one can derive the Technical Coefficients matrix, \mathbf{A} . The entries of \mathbf{A} , a_{ij} , specify the amount of input needed from each sector i to produce a unit of output in sector j . They describe production technology in each sector, which is assumed fixed. In matrix notation, one can express relationships embedded in input-output tables via the Leontief equation:

$$\mathbf{x} = \mathbf{A}\mathbf{x} + \mathbf{f}$$

where: \mathbf{A} = technical coefficients matrix; \mathbf{x} = (1x245) gross output vector; and \mathbf{f} = final demand vector.

Deriving supply shock effects.

Using the same type of transformation, Ghosh (1958) derived a matrix, \mathbf{G} which looks at the issue from the supply side. The rows of \mathbf{G} give the impact on all sectors of a supply shock in a sector. For example, the row i_j shows the impact to all sectors given a unit change in primary inputs of sector j in country i .



Denote v = value added vector. Then:

$X'B + v' = x'$, where $B = \hat{x}^{-1}Z$ derived from $A = Z\hat{x}^{-1}$ is the technical coefficients matrix.

Thus, $x' = v'G$, where $G = (I - B)^{-1}$ is the Ghosh inverse matrix (Ghosh 1958). G would be a square matrix of size $nm \times nm$. This type of supply analysis, though, cannot be used as a behavioral model but as an accounting exercise in the short-term, since it allocates output in response to changes in value-added in a given sector without those changes in output translating into further changes in value-added (Guerra and Ferran, 2011).

Deriving employment multipliers.

Denote by e the $[35 \times 1]$ vector of employment coefficients for each of the sectors, which is obtained by dividing sector employment by the corresponding sector output. Denote by A the direct requirements matrix of output multipliers. Then based on McLennan (2012):

The vector $V_{FR} = e * A$ denotes the (1×35) vector of first round employment effects;

$V_{IE} = e * L = e * (I - A)^{-1}$ denotes the (1×35) vector describing the simple employment multiplier, which accounts for industrial support effects through demand from sectors that provide inputs. The Leontief inverse: $L = (I - A)^{-1}$ gives us the output multipliers. The entries in L , l_{ij} , show by how much output in sector j will change in response to a change in final demand for sector i .

Finally, define the vector: $V_{TM} = e * S'$, where S' is a $(mn+1)$ by $(nm+1)$ matrix which includes one additional row: the factor incomes per sector, and includes one additional column: the consumption of households. S therefore includes additional indirect effects on employment of an increase in USD 1 million in demand. V_{TM} provides an estimate for the set of countries or region of the total employment multiplier effect. Assuming no change in relative prices, the mix of inputs in production or the marginal propensity to consume over income, it can be interpreted as the change in employment from a USD 1 change in the demand for output from sector i .

CHAPTER 3

Public banks: a cursed blessing

Public sector banks are more prevalent in South Asia than elsewhere. Over 40 percent of South Asia's banking assets are owned by the public sector, the largest share among global regions and more than twice the level of East Asia (excluding China). The share of bank assets owned by public banks is highest in India (62 percent) and Bhutan (56 percent), followed by Sri Lanka and the Maldives (somewhat over 40 percent).

Public banks play both a positive and negative role in economic development. On the positive side, their lending can be counter-cyclical, and they are more likely than private banks to provide services to people in remote areas and poor people. That is an opportunity in the current crisis. On the negative side, they suffer from inefficiency and are likely to reduce competition and thus slow innovation, while they face severe agency problems, leading to political interventions that result in an inappropriate use of public money. These negative characteristics were at the root of the rise in non-performing assets in recent years.

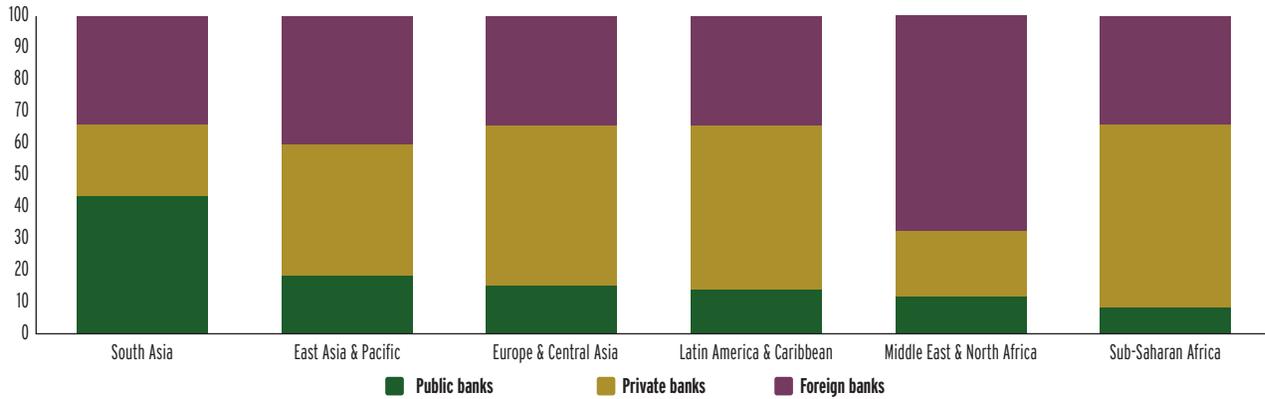
To reap the benefits and mitigate the problems of public banks, they should be reformed according to best practices. They need much better-defined objectives and missions, in order to separate social mandates from profit-maximizing objectives. They need to be more transparent in their financial results, including in the amounts of implicit government subsidies and in contingent liabilities assumed by governments. Stronger governance and accountability could improve the performance of public banks. Finally, creditor rights must be strengthened, in order to recover parts of non-performing assets.

Aadhaar Seeding For
Jeevan Pramaan



FIGURE 3.1: In South Asia, state-owned banks are much more common than elsewhere...

Share of bank assets by type of ownership in different regions
Percent



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

Public sector banks are important in South Asia

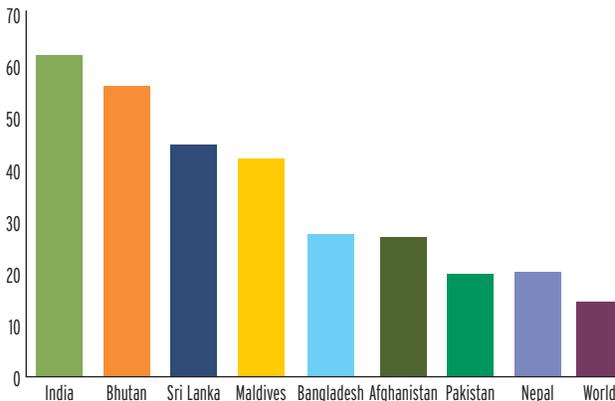
Public sector banks are more prevalent in South Asia than elsewhere. The contribution of public sector banks—banks in which a state, a municipality, or another public actor controls at least 51 percent of the shares—to growth and development has long been a subject of great controversy. A review of their role in South Asia is particularly important at this time, for two reasons. First, banks continue to dominate regional financial systems, and over 40 percent of South Asia’s banking assets are owned by the public sector, the largest share among global regions and more than twice the level of East Asia (excluding China), which has the second largest share (Figure 3.1). The share of bank assets owned by public banks is highest in India (62 percent) and Bhutan (56 percent), followed by

Sri Lanka and the Maldives (somewhat over 40 percent). In Afghanistan and Bangladesh, the share is around 25 percent and with only around 20 percent it is the lowest in Pakistan and Nepal (Figure 3.2). Looking at the shares of public bank branches instead of assets increases the public footprint in India and Bangladesh and lowers it in Nepal.

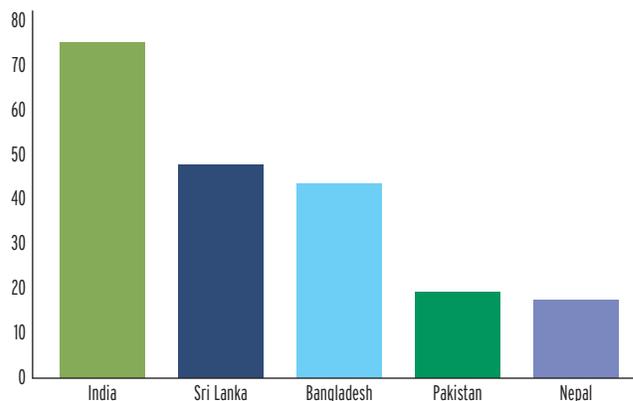
Second, public banks are both a cause and a potential balm for the severe stress financial markets now face. The sharp increase in non-performing loans in Bangladesh and India over the last years was initially concentrated in public banks (Figure 3.3), and non-performing loans have started rising in all other countries as well. This, plus weak investment demand following the 2019 global slowdown, has led to a strong deceleration of credit growth in several countries. In India, for example, credit to service companies grew over 20 percent (y-o-y) at the beginning of last year but contracted at the end of it. In Sri Lanka, service credit growth more than halved

FIGURE 3.2: ... but there is considerable variation across countries.

Share of assets owned by public banks
Percent



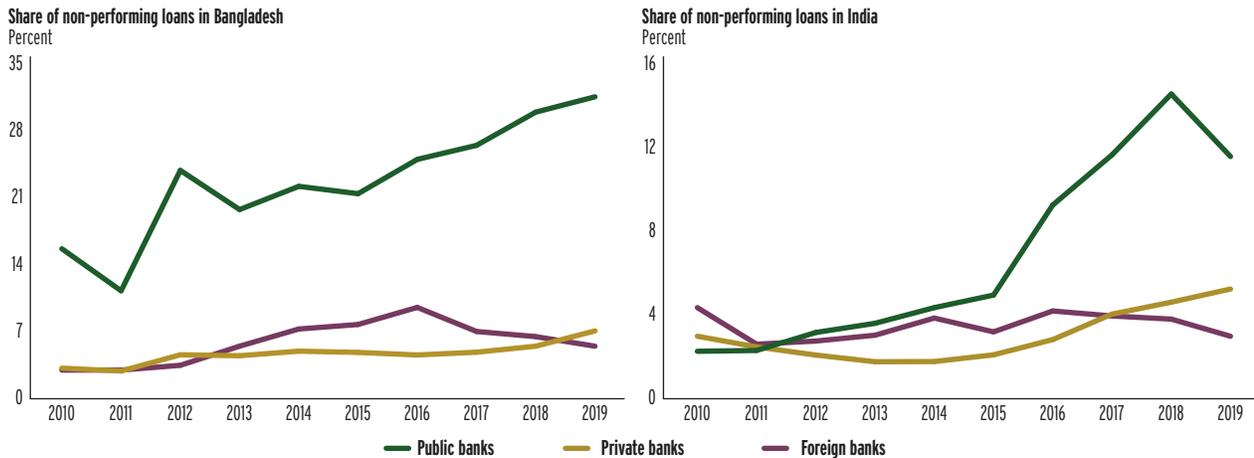
Share of public bank branches
Percent



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



FIGURE 3.3: Non-performing loans grew strongly in recent years in Bangladesh and India.



Source: Central bank webpages.

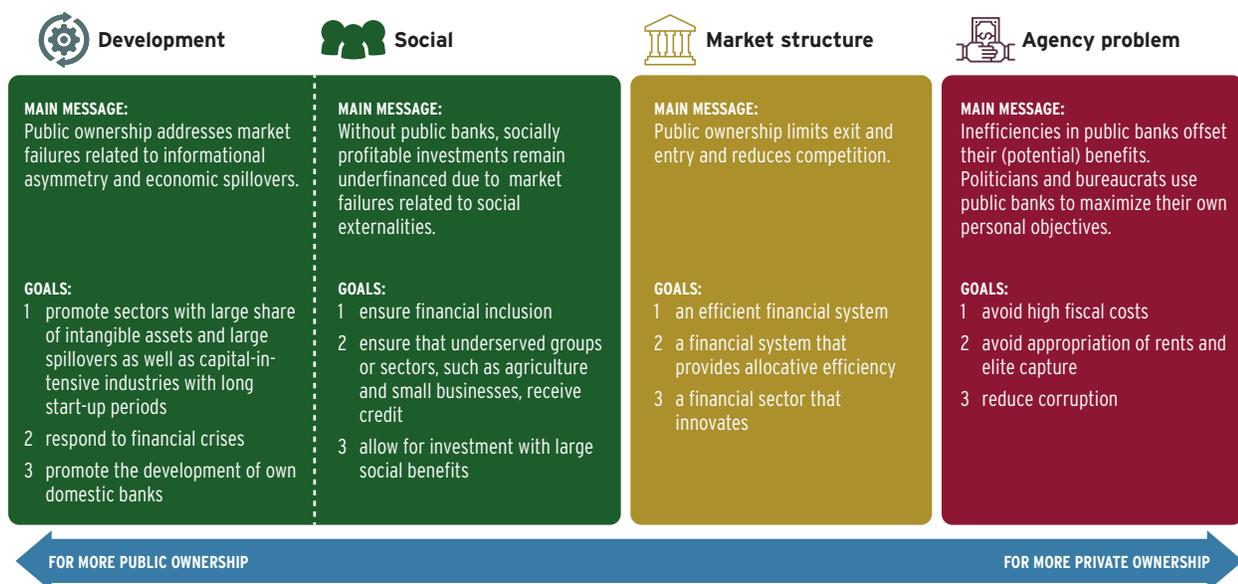
from 2018Q4 to 2019Q2. Recent growth slowdowns across the region (Chapter 1) place a further burden on corporate and bank balance sheets, and the impact of the COVID-19 pandemic has the potential to greatly magnify weaknesses in financial markets, in turn reinforcing sharp slowdowns in the real economy (Chapter 2). But as the financial markets are now hit by external shocks, public banks are becoming part of the solution also, as they can engage in countercyclical lending and can reach out to vulnerable groups.

This chapter proceeds in three steps. It first lays out a framework for considering how public banks may or may not contribute to growth and development. It then analyzes South Asia’s experience with public banks and concludes with a discussion of the policy options going forward.

There are good reasons for and against public banks

The theoretical literature discusses both positive and negative effects of public banks on growth and development (Figure 3.4). Public banks can contribute to inclusive growth by: a) avoiding market failures that exist in markets with only private banks, and b) playing a social function by providing services to people in remote areas and poor people, for example through a large and subsidized branch network. On the other hand, public banks also can: c) reduce competition and thus slow innovation and suffer from inefficiency, and d) face severe agency problems, leading to political interventions that result in an inappropriate use of public money.

FIGURE 3.4: There are good reasons for and against public ownership of banks.





a) Public banks may address market failures

Stiglitz (1993) identifies seven key manifestations of market failures in financial markets: (1) private agents collectively undersupply monitoring, which is a public good (2) private actors do not internalize positive externalities of monitoring, selection, and lending, (3) they also ignore negative externalities of financial disruption, (4) missing and incomplete markets prevent efficiency, (5) competition is imperfect, among other reasons because each bank has specialized information about its customer base, (6) other assumptions of Pareto efficient markets are not fulfilled either, and (7) investors are often uninformed.

Public banks offer a tool to address these market failures:

- » Public banks can contribute to the accumulation of capital in uncertain situations (Gerschenkron 1962) and promote sectors with a large share of intangible assets and large spillovers, as well as capital-intensive industries with long start-up periods. For example, public saving banks played a crucial role in Germany's economic development and continue to be important today (Guinnane 2002).
- » In many countries, public banks are used to promote strategically important industries, to jump start new ones and to create national champions (Gerschenkron 1962; Ferrari, Mare, and Skamnelos 2017). They may also help to overcome coordination failures (De la Torre, Gozzi, and Schmukler 2017). Moreover, it may be useful for developing countries to create their own large domestic banks in line with typical infant industry arguments. In 1964, for example, Qatar National Bank was founded as Qatar's first domestically-owned commercial bank by the government. One difficulty is to identify the appropriate industries and companies and to assess the viability of large investments.
- » Finally, public banks can contribute to economic stability. They can internalize individual contributions to systemic risk and provide countercyclical lending and a safe-haven in crises (Bertay, Demirgüç-Kunt, Huizinga 2015). Lending by public banks hence tends to be less correlated with the business cycle and to be less responsive to macroeconomic shocks than lending by private banks across the world (Micco and Panizza 2006). Public banks have been shown to have mitigated the negative impact of global financial crisis in Brazil (Coleman and Feler 2015).

b) Public banks may incorporate social externalities

Investments with high risks or low yields can still be worthwhile due to social externalities. Public banks can provide the financing for projects with high social returns

but a negative net present value (Levy-Yeyati, Micco, and Panizza 2004). For example, public banks play a crucial role in ensuring financial inclusion in many countries and help underserved groups or sectors – such as agriculture and small businesses – to receive credit. Public banks can ensure liquidity, payments and credit services in remote and otherwise unbanked areas (Hakenes and Schnabel, 2010). They may also finance infrastructure or higher education that would not be financed privately (Hainz and Hakenes 2012).

c) Public banks may reduce competition and be inefficient

Public ownership of banks can result in resource misallocation and inefficiencies. Public ownership usually creates a market structure in which exit and entry are limited and the playing field between public and private banks is not leveled, for example because public banks benefit from implicit government guarantees. Reduced competition can curtail innovation and limit efficiency increases, for example through delayed adoption of new technologies. However, a large share of public bank does not seem to hinder subsequent financial development (Box 3.1). Soft budget constraints weaken the incentives of managers in all state-owned enterprises, including in public banks (Megginson 2005), which can result in operational inefficiency. The latter may be further hampered by bureaucratic human resource management unsuitable for banks (Government of India 2018). Lower salaries than in private banks, for example, may incentivize the best employees to leave, and a promotion scheme based on seniority instead of merit may result in excessive risk aversion. Private ownership in a competitive market can contribute to an efficient financial system by providing a profit-maximizing credit allocation.

d) Public banks may facilitate misuse of public funds

There is a severe conflict between the development and social objectives of public banks and the private objectives of those running them (Banerjee 1997; Hart *et al.* 1997). These principal-agent problems are more severe in public banks compared to private ones. Since a public bank's objective is to finance developmental or social projects, it is especially difficult to measure the bank manager's performance. This implies that managers of public banks cannot easily be held accountable (Körner and Schnabel 2011). In addition, over-riding prudent risk management to support development and social goals increases the likelihood of banking sector distress across the world, especially because public sector banks are more prone to restructure and evergreen non-performing loans


BOX 3.1. Have public banks hindered subsequent financial development?
TABLE 3.1: A higher share of public banks is not associated with slower subsequent development.

	Credit growth			GDP growth
	(1)	(2)	(3)	(4)
GDP per capita	0.09 (0.16)	0.69 (0.71)	22.33*** (5.25)	-0.01*** (-6.14)
Private credit	-0.04*** (-2.90)	-0.05*** (-3.44)	0.83*** (29.56)	0.0001 (1.52)
Public share	-0.06*** (-2.91)	0.12 (0.80)	-0.004 (-0.09)	0.00 (0.29)
Public share x GDP per capita		-0.02 (-1.23)		
Country fixed effects	NO	NO	YES	NO
Observations	75	75	620	75
R-squared	0.11	0.14	0.99	0.40

Notes: * p < 0.10, * p < 0.05, *** p < 0.01. Robust t-statistics are in parentheses. The dependent variable is the average annual growth rate of private credit over GDP. The dependent variable is measured as the 1999-2016 average, all explanatory variables are values of the initial year. Column (3) is a panel regression from 1999 to 2016. More details in Appendix A3.1.
Source: World Bank and staff calculations.

A higher share of public banks has been argued to be associated with slower subsequent financial development and slower economic growth (La Porta, López-de-Silanes, and Shleifer 2002). In a broader set of 75 countries and using the same regression model, public ownership seems to have had a negative impact on subsequent private credit growth between 1999 and 2016 as well (Table 3.1, column 1). A ten percent higher share of public ownership was associated with 0.6 percent lower average annual credit growth as percent of GDP.

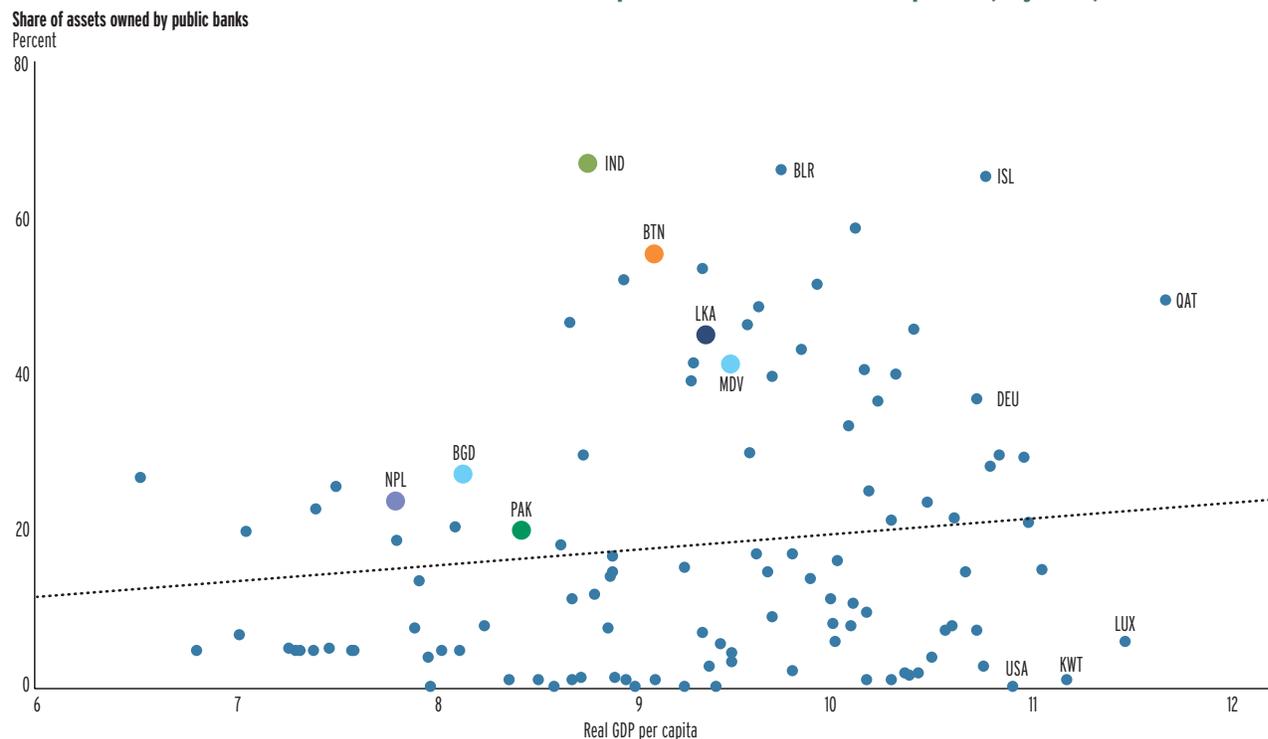
However, such a simple comparison of countries suffers from severe causality and omitted-variable problems. First, since public banks are likely to be more prevalent when private financial intermediation is hindered by institutional and other deficits, the negative relationship between private credit and state ownership could be due to reverse causality or the omission of institutional variables (Levy-Yeyati, Micco, and Panizza 2007). Second, this relationship does not hold for all countries: the negative effect of public ownership on subsequent credit growth has been shown to increase with lower financial development and low institutional quality (Andrianova *et al.* 2012; Körner and Schnabel 2011). Third, the negative effect of public ownership varies across time-periods (Levy-Yeyati, Micco, and Panizza 2007). And even when resulting in lower allocation of credit to the private sector, higher state-ownership may still lead to a more efficient banking sector and greater deposit mobilization in the poorest countries (Detragiache *et al.* 2005).

In fact, there is no evidence that state ownership of banks depresses subsequent financial development. First, between 1999 and 2016, there was no negative effect for poorer countries when controlling for the level of economic development (Table 3.1, column 2). Second, variations in public ownership over time within countries (rather than across them) do not show any significant relationship between ownership and credit growth either (Table 3.1, column 3). Including the possibility of a non-linear relationship between the share of public banks and credit growth does not change these results. And even when ignoring causality and omitted-variable problems, a higher share of public ownership – in contrast to La Porta, López-de-Silanes, and Shleifer (2002) – has not been associated with lower subsequent GDP growth between 1999 and 2016.

(D'Souza and Surti 2020). The non-recognition of bad assets can promote “zombie” lending, which refers to a situation in which insolvent borrowers are kept afloat solely by new bank credit. Such “zombie” lending reduces firm entry and investment (Caballero *et al.* 2008). Frequent financial stress in public banks results in many cases in a recapitalization of public banks. In addition to the fiscal costs of the capital infusions, banking crises can reduce growth for an extended period (Romer and Romer 2017, Wix 2017). Worse still for economic development, politicians and bureaucrats can (mis)use public banks to maximize their own personal objectives. For example, they may use them to increase their chances to be re-elected, for personal profit, or to provide beneficial financing for supporters (Shleifer and Vishny 1994; Shleifer 1998). In less

developed countries during election years, credit growth in public banks picks up significantly more than in private banks (Dinc 2005), indicating that private ownership can limit the appropriation of rents and elite capture and reduce corruption. The high costs related to agency problems and political interference may result in high costs of public ownership.

The extent of which these effects occur depends, among other things, on the actual operations of the public banks. The degree to which they are commercially oriented varies to a large degree: some are run like private banks, while others are just extensions of the treasury offices for channeling state subsidies and concessionary finance. Public banks can be classified

FIGURE 3.5: The share of state-owned banks does not depend on the level of development (anymore).


Notes: Data is last available observations, which is 2016 in most cases. Real GDP per capita is in PPP.
Source: World Bank.

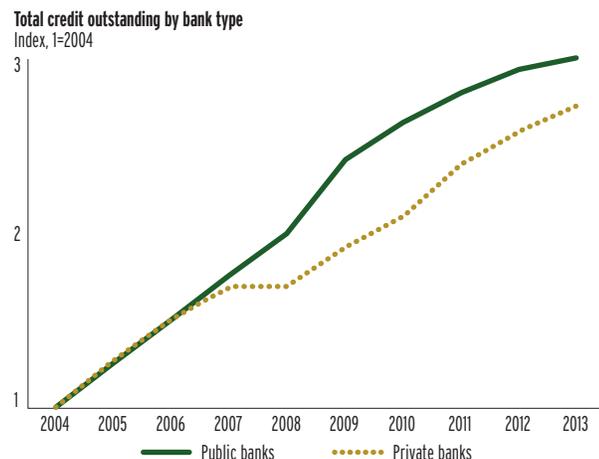
into three categories: public development banks, quasi-commercial banks, and commercial public banks. The first function as development finance institutions with the aim to support financial intermediation and often provide wholesale funding to other financial institutions. After the global financial crisis, these banks were supported in many countries by governments and International Financial Institutions to fuel the economy for a quicker rebound. These banks usually do not compete with commercial banks and their market distortions are usually limited. Quasi-commercial banks are hybrids between development banks and commercial banks and are very frequent across South Asia. These banks work directly with the end borrowers (including retail and corporate) and are commercial banks by nature, but with expanded mandates (explicit or implicit) determined by the governments. These additional tasks often conflict with the banks' commercial banking objectives and profitable operation. These banks often operate in the blurred regulatory framework with their governance in many cases not regulated by law and often politicized. Finally, public commercial banks are only different from their private peers by the ownership.

Different countries weigh the advantages and disadvantages of state ownership of banks differently, and judgments vary over time. Consequently, state-ownership of banks differs widely across time and countries. In

the 1960s and 1970s, public banks were more common in less developed countries (La Porta, López-de-Silanes, and Shleifer 2002). However, many of these countries undertook privatizations of public banks in the 1980s and 1990s, and by 2016 the correlation between the share of assets owned by state-owned banks and the level of development measured in real GDP per capita (PPP adjusted) was not significantly different from zero (Figure 3.5). If anything, state-ownership is now lower for the less developed countries. Among the less developed half, the average state-ownership is 15 percent, whereas it is 22 percent in the more developed half. State-owned banks can of course play a developmental role even in high-income countries. In Germany, for example, the transformation to green energy is largely financed by public banks. There is also no statistically significant relationship between state-ownership of banks and the structure of the economy. For example, different sectoral compositions of GDP, i.e. varying contributions of agriculture, manufacturing, and services, are not associated with different shares of state-owned banks. And neither is the amount of exports, the domestic savings rate, the level of government debt, or the amount of non-performing loans related to the share of public-ownership of banks. However, there is a relationship with the financial market structure. Economies with a lower share of public banks tend to have a higher market capitalization of listed domestic companies and tend to be financially more open.



FIGURE 3.6: Only public banks increased lending during the global financial crisis in India.



Public banks in South Asia have both supported and impeded development

The experience in South Asia supports many of the arguments concerning the impact of state ownership of banks. The following section reviews selected issues in each of the four aspects of public bank ownership: market failure, social objectives, competition and misuse of public funds.

a) Public banks can address market failures

Public banks in South Asia play a stabilizing role. Over the last fifteen years, credit growth of private banks was strongly correlated with GDP growth in India (0.51), but credit by public banks was not (0.05). Public banks in India also provided countercyclical lending during the global financial crisis. Credit by private banks dropped while credit by public banks continued to grow (Figure 3.6), and districts with a higher share of public and rural banks were less affected by the shock (Table 3.2). And there were real economic implications: during the crisis, a large share of public banks had a positive impact on a district's economic activity measured by nightlight intensity (Figure 3.7). Evidence from Indian firms provides some corroboration of this point: the export earnings of firms in India with no connections to a public bank dropped 8 percent during the global financial crisis, with all the drop explained by firms' sales to existing customers, while export earnings of firms connected to public banks were not affected (Chakraborty 2019). In times of crises, public banks benefit from deposits moving from private banks to them. During the global

TABLE 3.2: In Indian districts with many public and rural banks, credit increased during and after the global financial crisis...

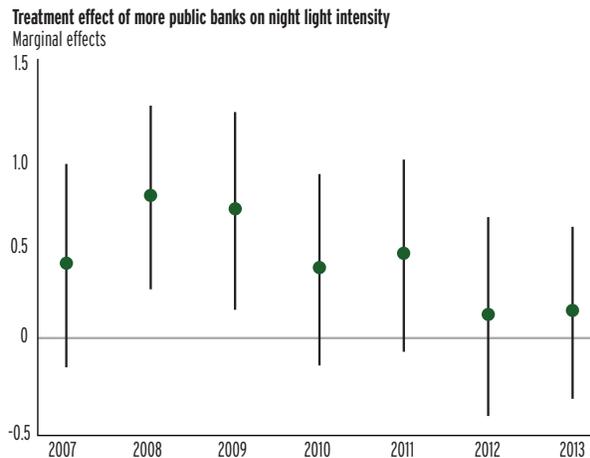
	Credit	
	(1)	(2)
Crisis x Share of public branches	0.65*** (0.10)	0.63*** (0.10)
Crisis x Share of rural branches	0.38*** (0.09)	0.38*** (0.09)
Post-crisis x Share of public branches	0.73*** (0.17)	0.60*** (0.16)
Post-crisis x Share of rural branches	0.22 (0.15)	0.23 (0.15)
After 2012 x Share of public branches	-0.18 (-0.14)	-0.16 (-0.14)
After 2012 x Share of rural branches	-0.10 (-0.16)	-0.18 (-0.14)
Controls	YES	YES
District fixed effects	YES	YES
Bank branch shares	2006	annual
Observations	7452	7452
R-squared	0.53	0.52

Notes: * p<0.1, ** p<0.05, *** p<0.01. Clustered standard errors in parenthesis. The estimation includes 628 districts for the period 2006 to 2017 and follows Coleman and Feler (2015), who estimated this model for Brazil. More details in Appendix A3.2.

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

financial crisis, vulnerable private sector bank branches in districts with greater exposure to state-owned banks experienced larger deposit withdrawals and shortening of deposit maturity, while nearby vulnerable state-owned bank branches grew their deposit base and increased loan advances (Acharya and Kulkarni 2019). But public banks extended more loans during the crisis also by borrowing much more from the central bank (Chakraborty 2020). Even when public banks are stressed, they do not reduce lending and, consequently, they can contribute to sustaining firm investment even in times of bank distress (Kibuka and Melecky 2020). In line, state-ownership of banks has been shown to help avoid large losses during financial crises in Asia (Hossain, Jain, and Mitra 2013).

Public banks are also more responsive to extreme weather events. Little is known about the possibility that private and public banks also respond differently to localized shocks. Many of the reasons explaining a differential response to global or nationalized shocks do not apply for localized shocks: since the latter do not stress balance sheets, overall lending is likely to remain stable. In general, public banks do not seem better equipped to cope with local shocks. However, one example of local shocks are weather conditions, which have a larger impact on lending by public banks compared to private banks in India. In years of extreme weather – defined by either much

FIGURE 3.7: ...with real implications: nightlight intensity was positively affected by more public banks.


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

more or much less precipitation than normal – lending in Indian districts increases, presumably to adjust to the adverse conditions. If a district experiences extreme weather, credit growth by public banks is 1.6 percentage points higher than in years with normal weather, while the credit growth of private banks does not respond to extreme weather (Table 3.3).

However, the stabilizing role of public banks also comes with costs. The loans extended by public banks during the global financial crisis, for example, have a poor ex-post performance, and access to stronger government guarantees during systemic crises allows even vulnerable state-owned banks to access and extend credit cheaply despite their under-performance (Acharya and Kulkarni 2019). Similarly, firms for which the productivity of capital is below the median level received more loans from public banks during the global financial crisis than more productive firms did, suggesting a possible re-enforcement of inefficiency due to a misallocation of credit (Chakraborty 2019). In India, public banks helped to sustain lending during the financial crisis, partly due to political pressure coupled with expectations that growth will soon revert sustainably to pre-crisis levels. However, this behavior accentuated the ‘twin balance sheet’ problem, and some public banks continued excessive lending for infrastructure and large industries. Subsequently, many had to reduce lending when their balance sheets got stressed with non-performing loans, and some were brought under the Prompt Corrective Action framework, which restricts fresh lending to a large extent. One lesson is that just like there is good debt and bad debt, there is also good credit and bad credit creating that debt.

TABLE 3.3: Only public bank lending responds to extreme weather.

	Credit		
	(1)	(2)	(3)
Extreme weather, t-1	0.001 (0.006)	0.009 (0.029)	0.005 (0.004)
Extreme weather	0.028*** (0.008)	0.003 (0.031)	0.016*** (0.005)
Extreme weather, t+1	0.001 (0.010)	0.015 (0.030)	-0.002 (0.006)
Controls	YES	YES	YES
District fixed effects	YES	YES	YES
Banks	All	Private	Public
Observations	7407	6000	7317
R-squared	0.053	0.097	0.087

Notes: * p<0.1, ** p<0.05, *** p<0.01. Clustered standard errors in parenthesis. The estimation is explained in detail in Appendix A3.2.
Sources: World Bank, Reserve Bank of India, South Asia Spatial Database, staff calculations.

In Asia, public banks increase credit allocation to the private sector. A ten percent higher share of public banks is associated with an additional 6.8 percent of GDP in credit to the private sector (Table 3.4). In this respect the impact of public banks in Asia is different from other parts in the world. In a large sample for 76 countries covering the whole world, there is no statistically significant positive relationship between public ownership and private credit between 1999 and 2016, even when institutional characteristics— the days it takes to enforce contracts and a corruption index – are considered (Table 3.4). The success of directed lending programs in India in funding increased production of severely credit constraint firms (Banerjee and Duflo 2014) suggests considerable real economic benefits from increasing credit. The overall success of the directed lending programs, however, is less clear, and loans for agriculture have been shown to move away from small, marginal, or medium farmers (towards

TABLE 3.4: In Asia, higher shares of public banks are associated with more credit to the private sector.

	Credit	
	(1)	(2)
Public bank share	0.03 (0.12)	-0.21 (-0.82)
Public bank share x Asia		0.68*** (2.49)
Log of GDP per capita	4.88 (1.61)	7.14*** (2.16)
Concentration	-0.31 (-1.44)	-0.18 (-0.76)
Institutional controls	YES	YES
Observations	76	76
R-squared	0.66	0.69

Notes: * p < 0.10, * p < 0.05, *** p < 0.01. Robust t-statistics are in parenthesis. The dependent variable is the average private credit over GDP from 1999 to 2016, all explanatory variables are averages from 1999 to 2016 as well. More details in Appendix A3.1.
Source: World Bank and staff calculations.



TABLE 3.5: Public banks are not better than private ones in supporting growth in manufacturing firms that rely more on external finance.

	Value added in manufacturing sectors			
	(1)	(2)	(3)	(4)
Private bank credit x external financing needs	-0.34 (-0.81)	-0.71 (-1.33)		
Public bank credit x external financing needs	-1.01 (-0.58)	-1.05 (-0.47)		
Private bank credit x intangible assets			0.59*** (4.08)	0.01 (0.06)
Public bank credit x intangible assets			-1.43** (-2.42)	0.24 (0.42)
Controls	YES	YES	YES	YES
Country and industry fixed effects	YES	YES	YES	YES
Sample	All	Asia	All	Asia
Countries	87	13	87	13
Observations	1497	211	1434	202
R-squared	0.079	0.240	0.086	0.246

Notes: * p < 0.10, * p < 0.05, *** p < 0.01. Robust t-statistics are in parenthesis. Details in Appendix A3.3.
Sources: World Bank, UNIDO, and staff calculations.

large business interests) and away from the rural areas (Ramakumar and Chavan 2014).

There is no evidence that public banks are more efficient in targeting manufacturing industries in need of credit. If the provision of credit by private and public banks is equally efficient in stimulating manufacturing growth, greater amounts of credit (as percent of GDP) should have a similar and positive impact on the relative growth rate of industries that require external finance more and that have higher shares of intangible assets (Galindo and Micco 2004). However, for Asian countries, the effect of more credit provided by private and public banks is not statistically significant in either case (Table 3.5). These results suggest that public banks in Asia are neither helpful nor harmful in directing financial resources towards the sectors that demand them most. In a cross-country analysis covering over 80 countries around the world, the same result holds for manufacturing industries that rely more on external funding sources (Table 3.5). And the results for industries with a large share of intangible assets are contrary to the theoretical argument: only the development of a private banking industry appears to promote the growth rates of manufacturing industries that face tighter financial constraints due to reduced access to collateral (as in Galindo and Micco 2004).

b) Public banks can support the most vulnerable

Public banks are more prevalent in less developed areas and are driving financial inclusion across the region. In India, Nepal, and Bangladesh, both public commercial

banks and especially non-commercial banks are more prevalent in rural areas (Table 3.6). And the higher the share of agricultural employment in a district or province, the more does it depend on banking services provided by public banks. Public banks are also more common where the literacy rates are lower. This spatial distribution is partly a result of strong micro-management. In India, for example, public sector banks have to open a number of rural branches for each urban branch.

The presence of public banks in these areas provides opportunities to broaden financial inclusion. In India, for example, a financial inclusion program that led to 255 million new bank account openings was in large part implemented by public banks. The program led to new demand and supply for formal credit and increased borrowing and spending on health (Agarwal *et al.* 2017). And the nationalization of its large private banks in 1980 has been shown to have had a lasting effect on the sectoral allocation of credit, leading to increased lending to agriculture and rural areas, though it did not affect agricultural investment and increased the share of non-performing loans substantially (Cole 2009). In Bangladesh, where public banks have a better coverage across districts than private ones, bank branch growth has positively affected firms' output and productivity (Hossain, Yoshino, and Taghizadeh-Hesary 2018). In addition, access to banking services is strongly associated with poverty reduction in Bangladesh (Iqbal, Roy, and Alam 2018). However, despite public banks having a much larger branch network and deposit collection in rural areas in India than private banks do, the share of loans to agriculture and to micro, small, and medium enterprises (MSME) – two key targets for improving the incomes of poor and excluded groups – is not very different

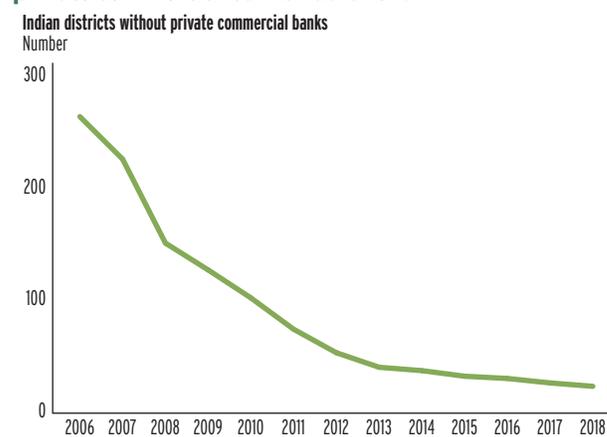
TABLE 3.6: Public banks are more common in rural areas with a lot of agriculture and low literacy.

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

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

from that of private banks (Kibuuka and Melecky 2020). One reason is that all banks, independent of their ownership, are mandated to lend a certain share to agriculture and MSMEs. Public banks in India do account for the majority of lending to micro-enterprises, which underlines their developmental role. In Bangladesh, state commercial banks also have similar lending portfolios to private ones (Box 3.2)

Public banks also support economic development of remote areas. In India, districts with many banks grew faster over the last decade than others (measured in terms of night-light intensity). 10 percent more commercial bank branches in 2006 was associated with over 2.1 percent higher growth between 2007 and 2017 (after controlling for state fixed effects and district level controls). In districts with both private and public bank branches in 2006, more private bank branches had a larger benefit than more public bank branches. However, comparing all districts, a higher number of public bank branches has been associated with considerably higher growth. In 2006, the average district in India had only 50 public bank branches per million citizens. A district with 75 branches instead of 50, grew 1.2 percent faster each year

FIGURE 3.8: The number of Indian districts without private commercial banks has fallen.


between 2007 and 2017 (Table 3.7). This indicates that public banks are especially important for areas with few or no private banks. But while only around half of the districts had a private bank branch in 2006, private banks are now present in nearly all districts (Figure 3.8). The rationale for a large share of public ownership has hence weakened over time.

TABLE 3.7: Banks are important drivers of long-term growth.

	Growth rate of nightlight intensity from 2007 to 2017				
	(1)	(2)	(3)	(4)	(5)
Initial nightlight intensity	-0.61*** (0.04)	-0.58*** (0.05)	-0.69*** (0.07)	-0.43*** (0.04)	-0.69*** (0.07)
Initial commercial bank branches	-0.04 (0.08)	0.25*** (0.08)	0.21*** (0.07)		
Initial public bank branches				0.02 (0.13)	0.15** (0.07)
Initial private bank branches				0.07* (0.03)	0.01 (0.01)
State fixed effects	NO	YES	YES	YES	YES
District-level controls	NO	NO	YES	YES	YES
Observations	619	619	619	358	619
R-squared	0.82	0.90	0.92	0.85	0.92

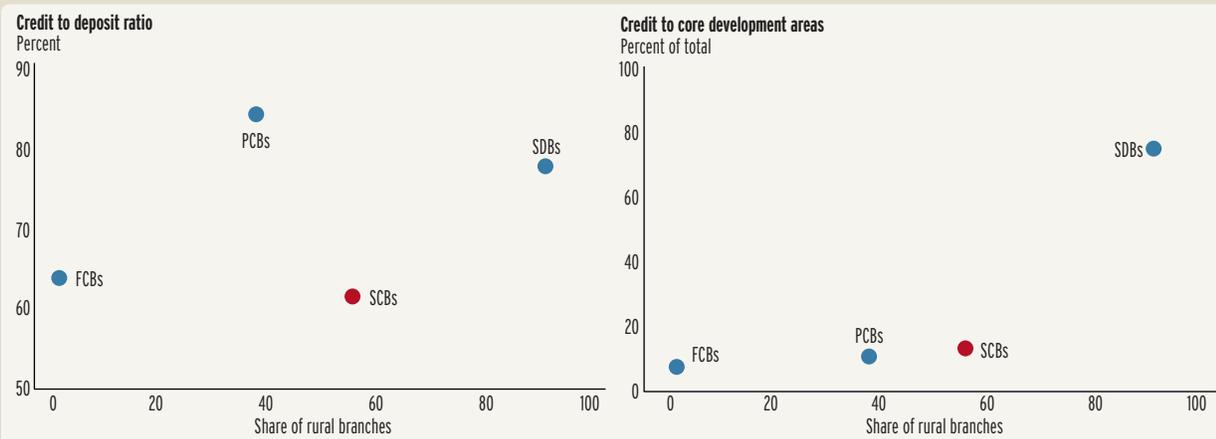
Notes: * p < 0.10, ** p < 0.05, *** p < 0.01. Standard errors are in parenthesis. More details about this estimation are in Appendix A3.4. Sources: DMSP, VIIRS, Reserve Bank of India, South Asia Spatial Database, and staff calculations.



BOX 3.2. Does the broad public branch network translate into more credit for development targets in Bangladesh?

The public banks of Bangladesh have a strong branch presence in rural areas. Public ownership includes state commercial banks (SCBs) and state development banks (SDBs) – about 23 and 2 percent of the banking sector’s assets, respectively. The banking sector’s branches are almost equally distributed between urban and rural areas. SCBs and SDBs represent nearly 65 percent of all rural branches, being responsible for ‘social safety net’ payments and other government services (but with limited compensation). SCBs and SDBs have 53 and 88 percent of all their branches in rural areas, respectively, while private commercial banks (PCBs) have just 35 percent, and foreign commercial banks (FCBs) have none (Figure 3.8).

FIGURE 3.9: Despite a significant rural branch network, public banks contribute little to sectors associated with market failures and to overall financial intermediation.



Note: Core development areas are defined as credit to (i) Agriculture, Fishing and Forestry; (ii) SMEs; (iii) Cottage and micro industries.
Source: Bangladesh Bank.

Credit to agriculture and MSMEs is only a small part of the SCBs’ loan portfolios, suggesting a limited developmental impact. Credit to traditional key targets for improving the incomes of poor and excluded groups (agriculture, fishing, forestry, and MSMEs in industry) is low for SCBs at just 13 percent of their total portfolio – not that different from PCBs and FCBs at nine and six percent respectively (Figure 3.9). SDBs did target these market segments successfully (under clear developmental mandates, unlike SCBs), but their overall credit accounts for just three percent of the total sector’s amount, implying limited overall impact. SCBs’ loan portfolio is heavily skewed towards large loans, which, alongside the observation that their branch network in the urban areas largely overlaps that of the private sector, suggests limited additionality. Nevertheless, part of the credit could be for large infrastructure projects that contribute to development and private banks are less capable to finance.

Despite the benefit of significant rural and state deposits, SCBs fall short in their intermediation function. SCBs receive a large part of their deposits from the public sector (about 40 percent) as well as rural areas (about 35 percent, a benefit of rural branches and implicit government guarantees). Nevertheless, the credit to deposit ratio of SCBs is the lowest among all bank groups at just 60 percent, comparable to FCBs (that have no rural branches) but much lower than that of PCBs and SDBs at 84 and 77 percent, respectively (Figure 3.8). Combined with SCBs’ high non-performing loans and low profitability and capital adequacy, this suggests a need for policy makers to clearly articulate the value proposition of public ownership in the banking sector.

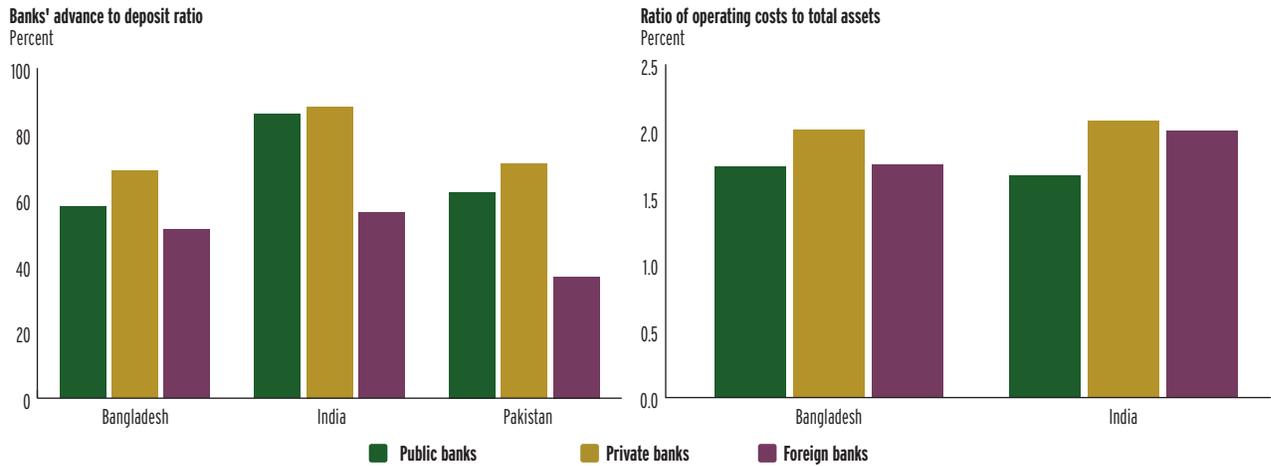
c) Public banks can stifle competition and innovation and are inefficient

Public banks in South Asia perform poorly in terms of returns on assets. Public banks in South Asia tend to underperform (Cull, Peria, and Verrier 2018). Across the region, public banks perform poorly compared to private banks, which are better capitalized, have better asset quality and are more profitable (Kibuuka and Melecky 2020). In Sri Lanka, public banks are undercapitalized and may need additional capital infusions to meet the Basel III capital and liquidity requirements. Public banks tend to rely more on cheap deposit funding and usually pay lower salaries than private banks. Consequently, they have lower

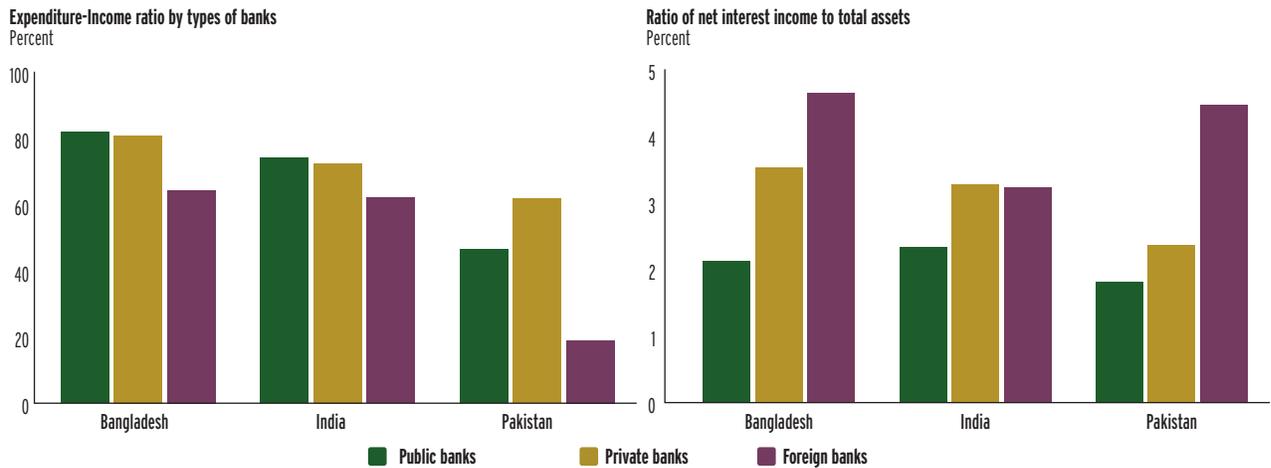
operating costs (Figure 3.10, a). Public banks in Asia seem to pass on the lower costs, and more public banks are associated with lower interest rate margins (Box 3). However, due to a much lower ratio of net interest income to total assets, public banks have a higher expenditure-income ratio than private ones (Figure 3.10, b). This translates into much lower returns on assets, especially in Bangladesh and India (Figure 3.10, c). In line, the stocks of listed public banks in India perform very poorly compared to private ones (Government of India 2019). While a lower profitability is consistent with the developmental and social mandate, it is partly due to allocative inefficiencies. Public banks in many countries are loss making, and frequent capital infusions reveal the costs of public ownership.

FIGURE 3.10: Public banks in South Asia perform poorly as businesses.

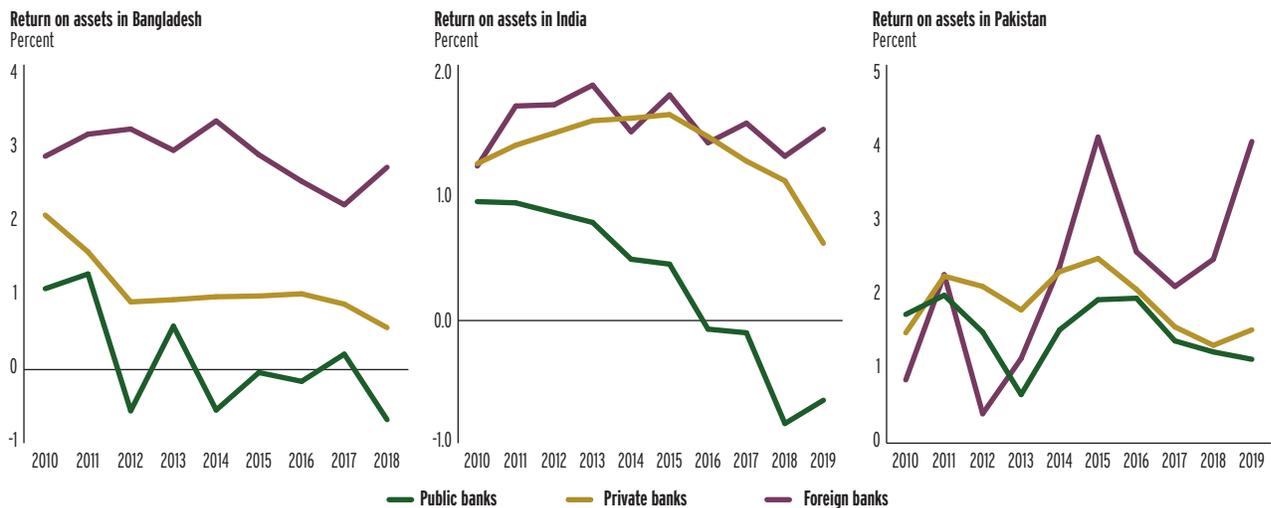
a) Public banks have lower operating costs...



b) ... but due to lower net interest incomes and higher expenditure-income ratios ...



c) ... they have lower returns on assets, especially in Bangladesh and India.



Notes: Data in a) and b) is for 2019 for India and Pakistan and 2017 for Bangladesh. All data is in fiscal years. Source: Central bank webpages.



BOX 3.3. In Asia, more public banks are associated with lower interest rate margins

The presence of public banks can have positive effects on the costs of borrowing. In a large sample of 76 countries, a higher share of public banks is not associated with either lower or higher overhead costs of banks between 1999 and 2016 (Table 3.8). However, in Asian countries a higher share of public ownership is associated with lower average overhead costs of banks. Similarly, in Asian countries a higher share of public ownership results in a lower interest rate margin, averaged across all banks. While the interest rate margins of public banks tend to be lower than that of private banks, the presence of public banks also affects the efficiency and competitive behavior of private banks. In low-income countries, a higher share of public banks has been shown to be associated with a higher efficiency of private banks, suggesting that in these countries public banks have positive spillovers. And the increase in efficiency is passed on to customers, as reflected in a negative effect of more public banks on the net interest margin of private banks (Levy-Yeyati, Micco, and Panizza 2007).

TABLE 3.8: In Asian countries with more public banks, operating costs and interest rate margins are lower.

	Operating costs		Net interest rate margin	
	(1)	(2)	(3)	(4)
Public share	0.01 (0.45)	0.04 (1.47)	-0.023* (-1.79)	-0.006 (-0.36)
Public share x Asia		-0.087*** (-3.55)		-0.049*** (-2.82)
GDP per capita	-0.38 (-1.10)	-0.679** (-2.11)	-0.943*** (-2.84)	-1.113*** (-3.11)
Concentration	0.004 (0.19)	-0.013 (-0.59)	0.019 (1.22)	0.009 (0.57)
Observations	76	76	76	76
R-squared	0.393	0.474	0.579	0.600

Notes: * p < 0.10, ** p < 0.05, *** p < 0.01. Robust t-statistics are in parenthesis. The dependent variable is the average overhead costs of banks and the average bank net interest margin. All dependent variables are measured as the 1999-2016 average. More details in Appendix A3.1.
Source: World Bank and staff calculations.

Public banks in South Asia come with high costs. As discussed, governments may prefer a delayed recognition of bad loans and loan losses which can result in evergreening and much higher subsequent losses. In addition, public banks suffer from frequent farm loan waivers and unsound letters of guarantee. Against the backdrop of the global financial crisis, for example, India enacted a large unconditional debt relief for rural households amounting to around 1 percent of GDP – with unclear benefits for the real economy (Giné and Kanz 2018). Bangladesh and India have infused capital into their public banks every year for many years. Between 2010/11 and 2017/18, India infused USD 27 billion and Bangladesh infused USD 1.9 billion, which is 1.2 percent and 1.1 percent of GDP, respectively. Fiscal costs are opportunity costs and governments may be allocating scarce resources to the financial sector that could be more efficient elsewhere. In India, state-owned banks are also more prone to distress than private banks (Kibuuka and Melecky 2020). In India, public banks also tend to invest more into government securities than private banks (Gupta, Kochhar, and Panth 2015), which can deprive the private sector of loans. However, independent of the share of public ownership, governments across South Asia consume substantial shares of national savings and crowd out private sector financing (Box 3.4).

d) Public banks can enable political favoritism

In a survey conducted for this report, three quarters of South Asian economists see public banks as a means for bureaucrats and politicians to fulfil personal objectives.

Despite the evidence presented above, only around a half of South Asian economists agree that public banks fulfill development or social objectives in their country, asserting widespread skepticism that public banks fulfil a development and social role (Figure 3.12). And only around a half agrees that they are part of a market structure that prevents competition and creates allocative inefficiencies, which indicates some concern about an uneven playing field which, however, does not seem a major concern for a vast majority. But three quarters of South Asian economists hold that public banks are used by politicians and bureaucrats to fulfil personal objectives. It is very worrying but not surprising that such a large share of them assert self-enrichment in public banks.

In fact, political lending as a result of agency problems is widespread in the region.

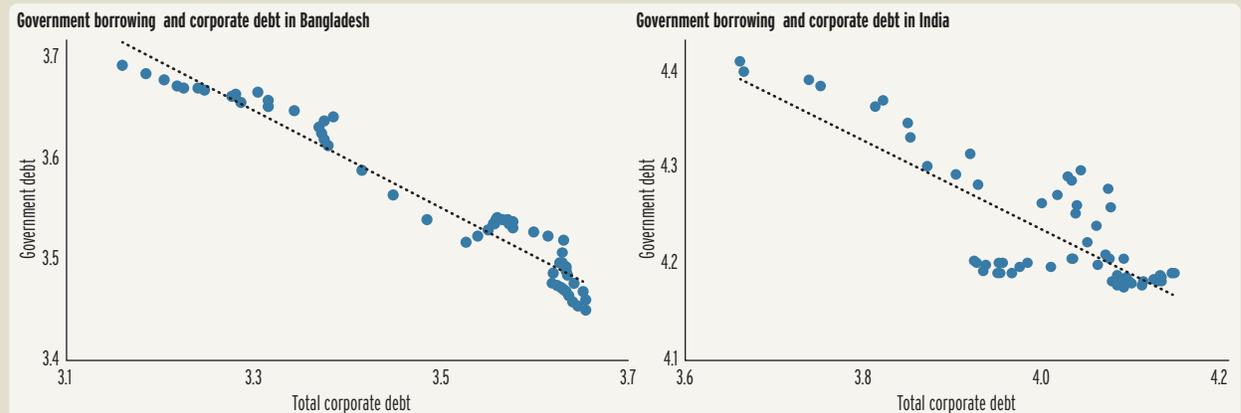
In India, public bank lending has been shown to track the electoral cycle between 1992 and 1999, with agricultural credit increasing when there is an election (Cole 2009). And lending by public banks continues to be higher in election years: between 2004 and 2019, public banks lent around 3.1 percent

BOX 3.4. Government borrowing crowds out the private sector across the region

Many governments in South Asia rely predominantly on domestic savings for funding their public debt. Domestic banks – both state-owned and private – finance the bulk of the governments’ needs. Governments also rely on direct retail borrowing from the population, for example in the form of national savings certificates in Pakistan and Bangladesh or as savings instruments of the India Post in India. Furthermore, the State Bank of Pakistan (SBP) has monetized a substantial amount of the government’s debt.

- » Bangladesh’s domestic public debt is comprised mostly of banking sector debt and National Savings Certificates (NSCs). In FY20, the high cost of the NSCs and a drop in foreign loan disbursements led the government to finance the fiscal deficit mostly through bank borrowing. Borrowing from Bangladesh Bank (BB) has been also rising gradually since FY18.
- » Domestic commercial banks in India hold a substantial part of public sector debt, to a large extent in compliance with the Statutory Liquidity Ratio. Government securities comprise over 80 percent of the banks’ total investments. However, over the past decade the share of banks in the total holdings of government securities has decreased as capital markets and institutional investors have grown.
- » Pakistan, despite having a relatively low share of public bank ownership, has by far the largest exposure of the financial sector to public debt. Commercial banks held about PKR 6.9 trillion (USD 45 billion) of government’s domestic debt in June 2019, equal to about a third of banking system assets and 90 percent of the investment portfolio. Overall, more than 60 percent of sources of funds in the formal economy are intermediated by the financial sector towards the government.

FIGURE 3.11: When government borrowing is higher, corporate debt tends to be lower.



Notes: The government debt includes both central and state government debt. The total corporate debt is a sum of the financial and non-financial corporate debt. Data are in natural logarithmic scale from 2005Q1 to 2019Q3.
Source: International Institute of Finance and staff calculations.

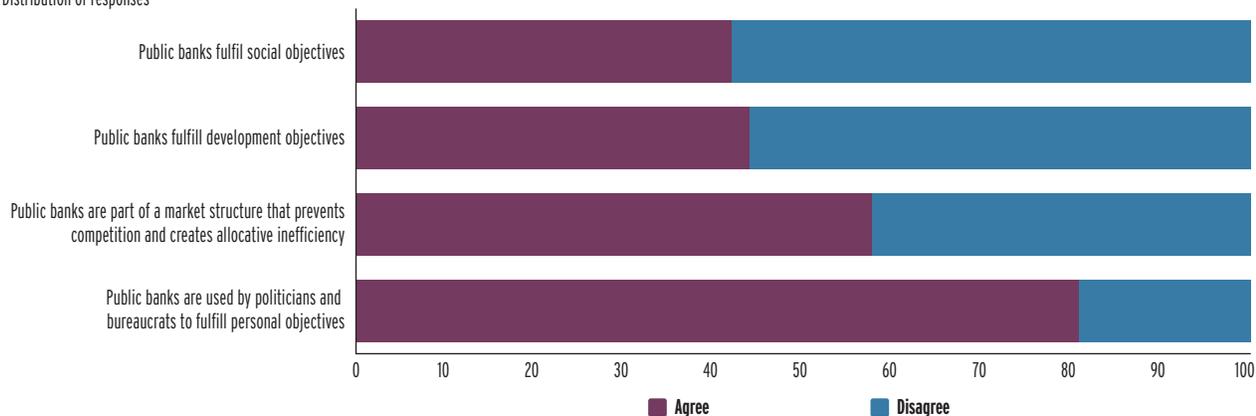
The governments’ substantial reliance on domestic savings has led to inadequate supply of funding for the private sector (Figure 3.11). Non-performing loans have also been detrimental during the past few years for the volumes of private sector credit in India and Bangladesh. As the governments remain large borrowers from the banking system, they tend to resort to various forms of financial repression in order to incentivize bank lending to the private sector. While India has maintained the Priority Sector Lending (directed lending) program for the past 40 years, financial repression has also been (re)introduced in Bangladesh, in the form of the lending interest rate cap, and to some extent in Pakistan, through “soft” sectoral lending targets for banks.

- » In Bangladesh, while the government borrowing from the banking sector surged in the first half of FY20, private sector credit growth declined to 9.2 percent (the lowest in 16 years) at the same time. The new cap on the lending rate imposed by BB is likely to further strengthen the banks’ appetite for sovereign exposures. Unavailability of a functional bond market and a poorly performing stock market further reduce the options available to the private sector.
- » In India, public sector investment growth has been robust since 2013, while private sector investment growth has been depressed since 2012. The public sector borrowing requirements grew above and beyond the increasing fiscal deficit (which may be explained by contingent liabilities or hidden deficits) and institutional investors owned by the state readily invest in government securities. Gross borrowing by government routinely exceeds net household financial savings.
- » In Pakistan, the combination of heavy government borrowings and adverse demand-side conditions have kept private sector credit sluggish for the past decade. Private sector credit has declined from a high of 29 percent of GDP in 2008 to 15 percent of GDP in 2019, compared to government debt which has increased from 30 percent in 2008 to 54 percent in 2019. Structural bottlenecks, weak external demand, and high real costs of borrowing constrained business activity and credit demand by the private sector.



FIGURE 3.12: Three quarters of South Asian economists agree that public banks are used for personal objectives.

Within your country, do you agree or disagree with the following statements?
Distribution of responses



Source: South Asia Economic Policy Network.

TABLE 3.9: Credit growth of public banks in India increases in elections years.

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

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

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

more in states holding an assembly election, and this increase is again driven by additional lending to agriculture (Table 3.9). Lending to other sectors and lending by private banks does not change in years of elections. Political bank lending to farmers before elections has been shown to crowd out lending to manufacturing firms, with real economic costs (Kumar 2019). Political lending of public banks occurs across the region. In Pakistan, for example, firms with political connections have been shown to borrow more and to have higher default rates; and this preferential treatment seems to occur in government banks (Khwaja and Mian 2005). In Bangladesh, where public banks have recently been troubled by a series of loan scams and high non-performing loans, the presence of politically linked directors on a bank's board has been shown to adversely affect efficiency (Robin, Salim, and Bloch 2018).

Striking the right balance going forward

To reap the benefits and mitigate the problems of public banks, they should be reformed according to best practices:

- » Like public banks in the rest of the world (Ferrari, Mare, and Skamnelos, 2017), public banks in South Asia need much better-defined objectives and missions. While specialized (or development) banks are set up specifically to promote the development of industry, agriculture, or foreign trade, many quasi-commercial banks across the region have very general development objectives. For many of them, the objectives of profit-maximizing and fulfilling a developmental and social mandate are blurred. For example, many are listed on a stock exchange but remain committed to serve the government for other purposes. There is often a valid case for the need of quasi-commercial banks as market

creators and contributors to social objectives. To improve their functioning, they need clearly defined objectives, in addition to maximizing profit. Otherwise there is no rationale for public ownership.

- » Public banks need to be more transparent in their financial results, including in the amounts of explicit (and implicit) government subsidies, and on contingent liabilities. Governments can be expected to prefer giving silent subsidies to hide the costs of public banks from tax payers. In addition, the proper delineation and actual pricing of the social and developmental services are very difficult. But while capital infusions, coupled with subpar stock market valuations, may serve as a proxy for these hidden costs, they prevent proper accountability. Despite the challenges, public banks should hence receive subsidies for their development and social objectives directly from the budget. That would make the costs of their beneficial activities much more transparent than irregular capital infusions, as is the practice in South Asia today. These funds would be fungible and could be used to both make up for bad loans related to the development and social objectives, as well as for general mismanagement and political lending. Public banks would hence need to justify the subsidies they receive based on demonstrated results.
- » Stronger governance and accountability could improve the performance of public banks, as there are many ways in which organizational design impacts banks' service delivery. For example, career concerns (Holmstrom 1999) and low within-firm transaction costs (Williamson 1984) imply higher efforts when monitoring is stronger. In line with this finding, lending by public banks in India is higher in districts in which monitoring (between lead and convener bank) is stronger (Gupta 2019). Recent initiatives to improve governance in Indian public banks include setting up an independent Banks Board Bureau (BBB) to appoint executives, the introduction of a performance and compensation framework, and leadership programs for executives. The governance of public banks across the region could be improved by strengthening their operational independence, including by ensuring a non-political board of directors. In Bangladesh, weak governance has contributed to the accumulation of non-performing loans, especially in development finance institutions and state-owned commercial banks (Khatun and Saadat 2020).
- » Finally, financial regulation needs to consider the incentives faced by public banks. Formal accountability of public bank officials can also be higher than that for private bank staff, since public banks are covered under the vigilance guidelines issued by governments. This in turn can lead to overly conservative lending by

public banks and on excessive reliance on external ratings, which is not helpful. And across the region, weak creditor rights hinder asset recovery. But even with strong creditor rights, under-capitalized banks may be unwilling to recognize losses to avoid provisioning costs. A strengthening of creditor rights hence needs to be accompanied by regulatory policies that reduce lender discretion in recognizing bad assets. This may be especially important for public banks, in which incentives are stronger to evergreen bad loans. In India, an overhaul of the bankruptcy code resulted in only a modest increase in the reporting of bad loans, while a regulatory intervention removing lender discretion in bad loan recognition had a sizable effect – but public banks were significantly less likely than private ones to report “zombies” even after these interventions (Kulkarni *et al.* 2019).

Reducing the government ownership of banks can have positive effects (Box 3.5), but if public banks in South Asia are privatized, it needs to be done right.

There is a large variation in the performance of public sector banks, and a one-size-fits-all approach to public ownership is inappropriate (Government of India 2015). Instead, there needs to be a selected approach and – in some cases – privatizations may be the best solution. If so, foreign investors should be allowed to participate, and ideally a single strategic investor should be prioritized for each bank. Small public commercial banks without a development and social mandate would likely be more efficiently run when merged with others and run under private ownership. Inefficient and redundant public banks could also be closed.

Sound public banks will have a role to play in the future, and especially in the near term.

In the current economic situation, public banks are needed to provide countercyclical lending – as they did during the global financial crisis. And in some cases, they may be needed to inject capital into weak private banks. In March, the government of India took control of the country's fourth-largest private lender through capital injections by its largest public bank. If financial markets start crumbling due to the economic consequences of COVID-19 (see Chapter 2), then public banks may provide a crucial policy tool to stabilize the banking system and prevent further economic turmoil. And they will need to support economic transition in the long-run. In many countries, public banks already play an important role in transforming economies to reduce carbon emissions and in making them more climate resilient by providing strategic financing for a successful energy transition. To fulfill these functions – in addition to strengthening their frameworks and operations – public banks across the region may require additional capital infusions to address their still weak balance sheets.


BOX 3.5. Reducing government ownership has had positive effects in other countries.
TABLE 3.10: Reducing government ownership tends to have some positive effects.

	Before	After	Difference
<i>Event</i>			
Share of bank assets owned by public banks	37	20	-17*
<i>Effect on structure of economy</i>			
Exports of goods and services	35	38	+3*
Gross domestic savings	18	18	0
<i>Effect on financial structure of economy</i>			
Domestic private credit	34	45	+11*
Market capitalization	23	31	+8*
Bank non-performing loans to total gross loans	6	6	0
Interest rate spread	12	7	-5*

Notes: A privatization event is defined as the biggest reduction of the public bank share in a country within a year if it was at least five percentage points. We identify 46 such events from 1999-2016. Stars mark differences that are statistically significantly different at the ten percent level. Missing country observations are linearly interpolated. The value for before/after is computed as the average of the three years before/after the year of the event.

Source: World Bank and staff calculations.

Reducing government ownership of banks has had positive effects in some countries. Identifying a “privatization event” as the largest drop in a country’s share of public ownership (if that drop was larger than 5 percentage points), results in 46 privatization events between 1999 and 2016. In the three years before the event, the average public ownership was nearly twice as high than in the three years after (Table 3.10). After reducing government ownership, credit to the private sector and market capitalization increased strongly, while the interest rate spread declined. More developed equity markets can serve as a cushion against crisis shocks (Levine, Lin, and Xie 2016) and a lower interest rate spread can reduce the costs of borrowing. This may provide a hopeful note for the region, as increased openings of private bank branches in new areas has occurred in tandem with a fall in the share of assets held by public banks, especially in India and Sri Lanka.

Finally, governments need to create an environment in which FinTech can drive financial innovation. Governments usually rely on bank ownership and subsidized credit programs to promote agriculture, small and medium enterprises, and rural development in general. But there have always been calls for governments to take another role: one of ensuring a favorable legal and policy environment for the development of rural financial markets and to address market failures by well-designed and self-sustaining interventions (Yaron, Benjamin, and Charitonenko 1998). This may be even more promising nowadays with fast technological progress in the financial industry. FinTech companies offer new solutions and will play a crucial development role in the future. Financial liberalization allows commercial banks to compete on a wider range of market segments. Across South Asia, banks with higher market power generate less income from non-traditional activities than smaller banks do, and activity restrictions hinder banks’ ability to earn non-interest income through revenue diversification strategies (Nguyen, Skully, and Perera 2012). This harms financial

innovation, and hence more competition and lower activity restrictions may be useful. The removal of restrictions on foreign banks would expose domestic banks to more competition. In a survey conducted for this report, only 1 out of 10 of South Asian economists saw public banks as the main drivers of financial innovation. However, public banks can still play a role in innovation. The State Bank of India, for example, launched a new mobile app offering a variety of services that it developed together with numerous private partners. Such efforts should be accompanied by those of new start-up companies, which would benefit from regulatory sandboxes. Public banks, for example, are now experimenting with co-origination of loans for micro, small and medium enterprises with FinTech companies. Many of the people who lack access to a local bank or other sources of formal financial services possess a mobile phone with internet access, so online banking offers new solutions for financial inclusion (Demirgüç-Kunt *et al.* 2018). It may also allow for increasing productivity of the informal sector in South Asia, which contains tremendous unleashed potential.

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Technical Appendix

Appendix A3.1 Cross-country analysis of public bank performance

The different cross-country regressions follow Levy-Yeyati, Micco, and Panizza (2007) and the papers cited therein.

(i) Public banks and development: an update and refinement of La Porta, López-de-Silanes, and Shleifer (2002)

We estimate the relationship between the public bank share and the average annual growth of private credit and real GDP using the following regression model:

$$\Delta x_{i,t,T} = a + \beta \text{ public bank share}_{i,t} + \gamma (\text{ public bank share}_{i,t} * \text{ GDP per capita}_{i,t}) + \theta \text{ GDP per capita}_{i,t} + \varphi \text{ private credit}_{i,t} + \varepsilon_{i,t},$$

where x is either credit growth, measured as the average annual growth rate of domestic credit to the private sector as a share of GDP for country i from 1999 to 2016, or the average annual growth rate of real GDP for country i from 1999 to 2016. We use data on the initial year (i.e. 1999) for all explanatory variables. We also include a panel estimation (not using the average) with country and year fixed effects. For the latter, we use the lagged explanatory variables.

Data on domestic credit to the private sector (percent of GDP), real GDP (constant 2010 USD), and real GDP per capita, PPP (constant 2011 international USD) come from World Development Indicators. The share of public bank assets is from the Bank Regulation and Supervision Survey. Missing country observations for public bank share are linearly interpolated (if there are at most two missing observations in a row and these are not in the first two years, otherwise countries are dropped). The data covers 75 countries.

(ii) Public banks and private credit: an update and refinement of Detragiache, Tressel, and Gupta (2005)

We estimate the relationship between the public bank share and the average private credit over GDP using the following regression model:

$$\text{ private credit over GDP}_{i,t,T} = a + \beta \text{ public bank share}_{i,t} + \gamma (\text{ public bank share}_{i,t} * \text{ Asia}) + \theta \text{ GDP per capita}_{i,t} + \varphi \text{ concentration}_{i,t} + \delta \text{ controls}_{i,t} + \varepsilon_{i,t},$$

where the dependent variable is the average domestic credit to the private sector, measured as a share of GDP from 1999 to 2016. All explanatory variables are averages from 1999 to 2016 as well, including the share of assets of government-owned banks in country i and time t . We control for inflation and institutional variables related to contract enforcement (data is for 2004), a measure of the cost to banks of obtaining credit information on borrowers (data is for 2005), and a corruption perceptions index (data is for 2005). We also add an interaction term of the public bank share and Asian countries in order to understand the relationship between the public bank share and private credit for Asian countries.

The data on bank concentration (the share of assets controlled by the three largest commercial banks) is from the Global Financial Development Database. Inflation is from the World Development Indicators. The data on contract enforcement (in days) and the measure of the cost to banks of obtaining credit information on borrowers are from the Doing Business Indicators. The corruption perceptions index is from Transparency International. All other data sources have been listed above. The data covers 76 countries, of which 12 are from Asia.

(iii) Bank ownership and efficiency: an update and refinement of Levy-Yeyati, Micco, and Panizza (2007)

We estimate the relationship between the share of public banks on overhead costs and on net interest margin using the following regression model:

$$x_{i,t,T} = a + \beta \text{ public bank share}_{i,t} + \gamma (\text{ public bank share}_{i,t} * \text{ Asia}) + \theta \text{ GDP per capita}_{i,t} + \varphi \text{ concentration}_{i,t} + \delta \text{ controls}_{i,t} + \varepsilon_{i,t},$$



where x is either the average bank overhead costs (measured as share of total assets) for country i from 1999 to 2016, or the average net interest rate margin (bank's net interest revenue as a share of its interest-bearing assets) for country i from 1999 to 2016. All explanatory variables are averages for 1999–2016 as well and we include the same controls as in (ii).

Data on bank overhead costs (measured as share of total assets), bank net interest margin and bank concentration (the share of assets controlled by the three largest commercial banks) are from Global Financial Development Database. All other data sources have been listed above.

Appendix A3.2 Adjustment to shocks in Indian districts

We follow Coleman and Feler (2015) to assess the effect of government ownership of banks on the adjustment of Indian districts to global shocks and estimate the following regression model:

$$\log(\text{credit})_{it} = \sum_m \alpha_m \text{period}_m \cdot \text{share}_{SOB_{it}} + \sum_m \beta_m \text{period}_m \cdot \text{share}_{rural_{it}} + \delta \text{controls}_{i,t} + \text{district FE} + \text{year FE} + \varepsilon_{i,t},$$

where the dependent variable is the logarithm of total outstanding credit in district i at calendar year t . Period_m is a set containing four (m) periods: pre-crisis (2006–2007), crisis (2008–2009), post-crisis (2010–2012), and normal times (2013–2017). Share_{SOB} is the share of state-owned bank branches and Share_{rural} is the share of rural bank branches in district i at year t . Control variables are the number of bank branches per one thousand people as well as a district's baseline characteristics interacted with year indicator variables. The model includes year and district fixed-effects that absorb any common shocks and time-invariant district-specific characteristics. This specification therefore estimates the difference in credit between districts with higher versus lower share of state-owned bank branches. Standard errors are clustered at the district level.

To assess the effect of government ownership of banks on night light intensity, the following model is estimated:

$$\log(\text{light intensity})_{it} = \sum_T \alpha_T \text{year}_T \cdot \text{share}_{SOB_{it}} + \sum_T \beta_T \text{year}_T \cdot \text{share}_{rural_{it}} + \delta \text{controls}_{i,t} + \text{district FE} + \text{year FE} + \varepsilon_{i,t},$$

where the dependent variable is the logarithm of nightlight intensity in district i at year t . In this model, the share of state-owned bank branches and the share of rural bank branches is interacted with year dummies. The other variables of the model are defined as in the specification above. We calculate marginal effects of an increase in the share of state-owned bank branches on night light intensity as follows:

$$\frac{\partial \log(\text{light intensity})_{it}}{\partial \text{share}_{SOB_{it}}} = \alpha_{2006} + \alpha_t \cdot \text{share}_{SOB_{it}},$$

To assess the effect of government ownership of banks on the adjustment of Indian districts to local weather shocks, we estimate the following regression model:

$$\log(\text{credit})_{it} = \alpha_1 \text{weather shock}_{it-1} + \alpha_2 \text{weather shock}_{it} + \alpha_3 \text{weather shock}_{it+1} + \delta \text{controls}_{i,t} + \text{District FE} + \text{Year FE} + \varepsilon_{i,t},$$

where the dependent variable is the logarithm of total outstanding credit in district i at calendar year t . In addition, we estimate the model using the logarithm of outstanding credit by state-owned and private banks as dependent variables. To identify weather shocks, we, first, calculate departures of the rainfall as a deviation of the rainfall from its long-term mean (1950–2018). We then define a weather shock as a dummy variable that equals one if the departures of the rainfall are at the upper or lower 10 percent of the distribution, and zero, otherwise. We augment the model with a one-year lag and lead of the weather shock. The other variables of the model are defined as in the specification above. Standard errors are clustered at the district level.

This analysis covers 628 Indian districts during calendar years 2006 to 2017. Data on nightlight intensity was obtained from NOAA and cleaned according to Beyer *et al.* (2018). Data on total outstanding credit and number of bank branches is from the Reserve Bank of India. State-owned banks are State Bank of India and its Associates, nationalized banks, and other public sector banks. Baseline district characteristics include the logarithm of administrative population, the share of urban population, the share of population with secondary education, share of population below the poverty line, share of people employed in agriculture in 2011, and the logarithm of the number of bank branches in 2006 (per 1,000 population). These variables are from the 2011 Census and were obtained from the South Asia Spatial Database (Li *et al.* 2015). Data on precipitation is processed from CRU TS Version 4.03 Google Earth Interface (Harris *et al.* 2014).

Appendix A3.3 Bank ownership and performance in manufacturing industries

We follow Galindo and Micco (2004) to test if government-owned banks promote growth by directing credit towards the industries that rely more on external finance and towards those industries where informational asymmetries are higher. We estimate the following empirical model using cross-industry-country data:

$$growth_{ij} = \beta_0 + \beta_1 share_{ij} + \beta_2 credit\ private_i \times x_j + \beta_3 credit\ gov_i \times x_j + \gamma_i + \gamma_j + \varepsilon_{ij},$$

where the dependent variable is the growth rate of value added of sector j in country i , $share_{ij}$ is the share of industry j in country i in the manufacturing sector, $credit\ private_i$ is the ratio of credit to the private sector to GDP provided by privately owned institutions in country i , $credit\ gov_i$ is the ratio of credit to the private sector to GDP provided by public financial institutions, and x_j is either the requirement of industry j for external funds or the share of intangible assets of industry j that is used to proxy difficulties in pledging collateral. We include country and industry fixed effects. Given that this data is available at different valuations depending on the country, we also include valuation fixed effects.

Data on value added comes from the United Nations Statistical Division, credit to the private sector, measured as percent of GDP, is from the World Development Indicators, and the public share of bank assets comes from the Bank Regulation and Supervision Survey. As in Galindo and Micco (2004), we multiply the measure of total credit by the share of public banks to decompose aggregate credit to the private sector into credit provided by state-owned and private banks. Industry-level requirements for external funding are taken from Rajan and Zingales (1998) and the share of intangible assets from Claessens and Laeven (2003). The database used for the regressions is a cross-section built by taking industry-country averages of the period 2008–2016. It covers 87 countries, of which 13 are from Asia.

Appendix A3.4 Public banks and district-level convergence in India.

We estimate conditional convergence of nightlight intensity (as a measure of economic activity and income levels) in Indian districts from time t to T using a standard regression model:

$$\Delta \log (light\ intensity)_{i,t,T} = \alpha + \beta \log (light\ intensity)_{i,t} + \left[\frac{\gamma_1}{\gamma_2} \right] \log \left[\frac{private\ bank\ branches_{i,t}}{public\ bank\ branches_{i,t}} \right] + \delta controls_{i,t} + state\ FE + \varepsilon_{i,t},$$

where the dependent variable is the growth rate of nightlight intensity of district i from time t to T . A negative and statistically significant coefficient of the initial nightlight intensity indicates that less developed districts grew faster than more developed ones. We include the number of private and public (including rural) bank branches to understand their effect on long-run growth. We control for district-level socio-economic indicators in time t that potentially affect the long-run economic growth. These are the population density (per squared km), the share of scheduled caste and tribe population, the share of the working-age population, literacy, the share of households with access to electricity, the employment share in agriculture, and the shares of households with access to improved water and sanitation. In addition, we include state fixed effects. Standard errors are clustered at the state level. We add a small constant term to the number of private bank branches in order to not lose observations before the log transformation.

Data on nightlight intensity is obtained from NOAA and cleaned according to Beyer *et al.* (2018). The growth in nightlight intensity is computed from the initial year 2007 to 2017. The socio-economic indicators are all from the 2011 Census and obtained from the South Asia Spatial Database (Li *et al.* 2015). The number of bank branches is from the Reserve Bank of India.



Appendix A3.5 Credit and elections India

We test the existence of an election cycle of credit by regressing the (log) level of credit at the district level in India on a state assembly election year dummy, closely following Cole (2009):

$$\log credit_{dt} = \beta_1 e_{dt} + \beta_2 rain_{dt} + \beta_3 public\ share_{dt} + \beta_4 private\ share_{dt} + \gamma_d + \varepsilon_{dt},$$

where e_{dt} is the election variable of interest, as in Cole (2009). Among the controls we include the average rainfall in that year, $rain_{dt}$, and the share of state-owned and private bank branches in the district, $public\ share_{dt}$ and $private\ share_{dt}$ respectively. We also control for district and state fixed effects, γ_d . One potential concern is that parties in power can call elections earlier than expected depending on the state of the economy, which would generate a spurious correlation between credit and election years. For this reason, we use as an instrument for the election variable the exogenous number of years left for the next scheduled election, S_{dt} , that must take place every 5 years (following Khemani 2004).

The data covers the period 2009-2018. The election data is from the Election Commission of India, and all other data sources have been described above.

South Asia country briefs





Afghanistan

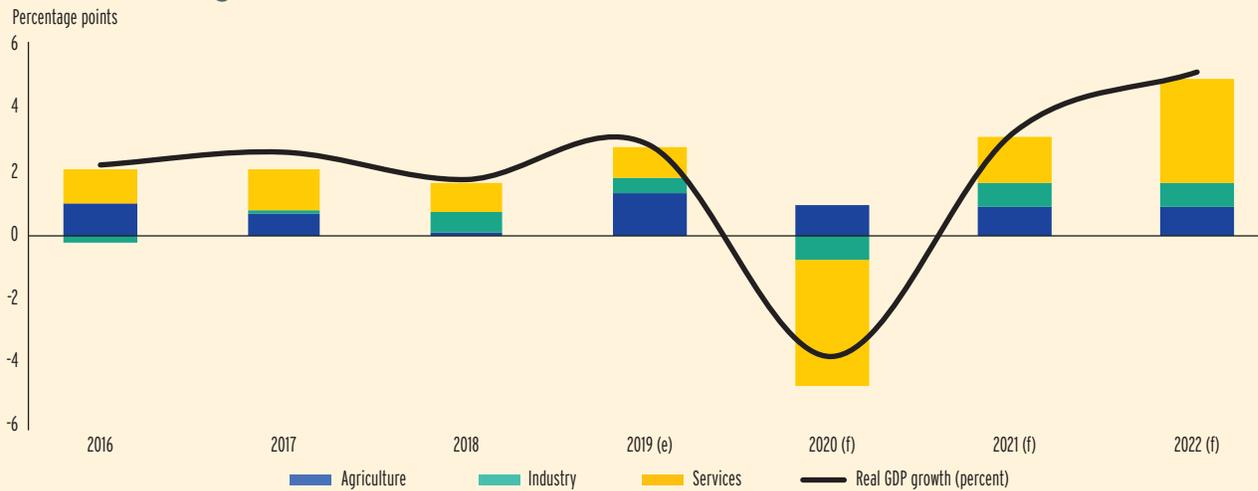
Afghanistan's economy recovered somewhat in 2019. The COVID-19 pandemic is expected to have major negative impacts on growth over 2020, due to border closures, reduced remittance flows, and economic disruptions associated with social distancing measures. Medium-term prospects remain highly vulnerable to political instability, worsening insecurity, and rapid declines in international grants. Political negotiations with the Taliban present upside potential over the medium-term.

TABLE 1

	2019
Population, million	38.0
GDP, current USD billion	19.4
GDP per capita, current USD	510
Poverty headcount ratio ^a	54.5
School enrollment, primary (percent gross) ^a	72.5
Life expectancy at birth, years ^b	64.1

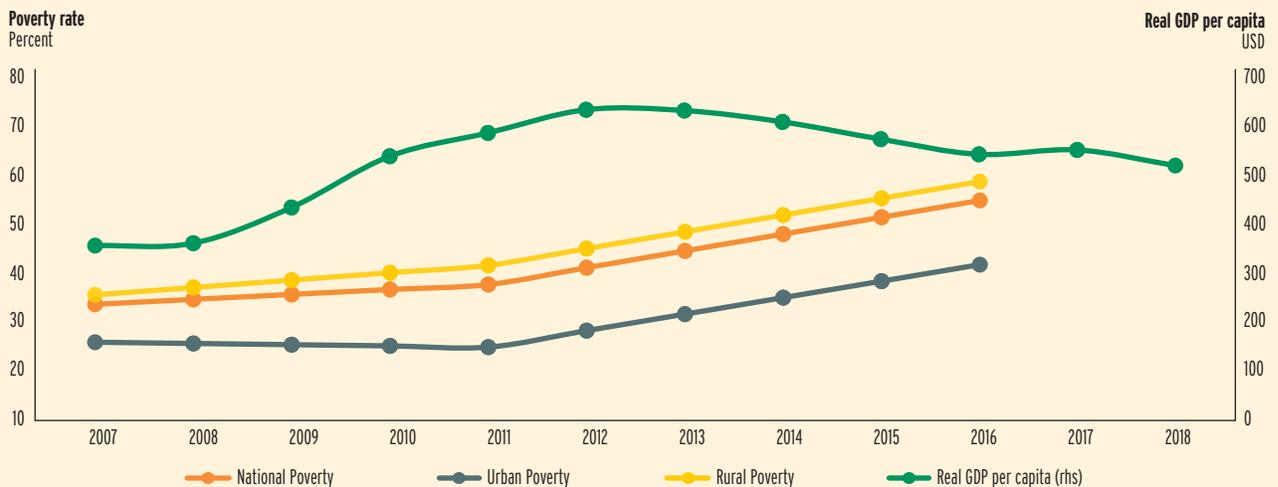
Note: (a) Afghanistan Living Condition Survey (ALCS) (2016-2017); (b) Most recent WDI value (2017)
Sources: WDI, World Bank, and official data.

FIGURE 1: Real GDP growth and contributions



Note: (e)=estimate; (f) = forecast.
Source: World Bank.

FIGURE 2: Poverty rates and real GDP per capita



Sources: WDI, NSIA, ALCS (2016-17), World Bank and staff calculations.



Recent economic developments

Growth is estimated to have picked-up slightly in 2019, to reach 2.9 percent (from 1.8 percent in 2018). Agricultural production is estimated to have increased by 7.5 percent, boosted by favorable weather. However, strong agricultural growth was largely offset by continued slow growth in services (1.8 percent) and industry (2 percent).

Inflation accelerated slightly but remained moderate. Consumer prices rose by 2.3 percent on average in 2019, largely driven by a 3.6 percent increase in food prices, mainly for cereals. Non-food inflation remained moderate at 1 percent, thanks mainly to low global energy prices.

The trade deficit is estimated to have narrowed to 31.4 percent of GDP in 2019 (from 32.7 percent in 2018). Imports declined by an estimated 6.6 percent thanks to stronger domestic agricultural production. Exports declined by 5.5 percent, reflecting the Afghani's appreciation against trading partner currencies (11.5 and 12 percent against the Pakistani Rupee and Iranian Toman, respectively) and heightened trade tensions with Pakistan. Grants continued to finance the large trade deficit, keeping the current account in surplus (3 percent of GDP). As a result, gross international reserves increased to USD 8.6 billion at end-2019, equivalent to 13 months of imports.

Fiscal balances deteriorated somewhat in 2019, though remaining broadly sound. Total domestic revenues reached 14.1 percent of GDP, thanks to significant one-off revenues, including transfers of Central Bank profits (Afs 24 billion, equivalent to 1.6 percent of GDP). Total expenditures increased by 9.8 percent, to 28.5 percent of GDP. The overall budget balance, reflecting reduced grants, recorded a deficit of 1.1 percent of GDP (from a surplus of 0.7 percent of GDP in 2018).

Poverty is expected to have worsened in 2018-19 (from 55 percent in 2016-17). Sizeable population displacements continued in 2019, with close to 400,000 Afghans internally displaced due to conflict, and an additional 505,000 returning mainly from Iran. Continued high levels of displacement have increased pressure on the government's capacity to provide basic public services.

Outlook

The economy is expected to contract by 3.8 percent in 2020, mainly because of economic disruptions resulting

from the COVID-19 virus, even assuming a rapid resumption of political stability. Growth is projected to recover in 2021 and stabilize towards four percent over the medium term, assuming: (i) gradual containment of the COVID-19 outbreak in 2020; (ii) improvements in political and security conditions; and (iii) continued substantial levels of grant support.

The trade deficit is projected to remain stable at around 31.2 percent of GDP in 2020. Despite stronger agricultural production, exports are expected to decline due to COVID-19 related disruptions at border posts and the closure of air-corridors restricting Afghanistan's access to regional markets. Imports are also expected to decline due to trade disruptions, lower domestic demand, and lower oil prices, largely offsetting the export contraction. As COVID-19 related disruptions recede through 2021, exports and imports will gradually recover and the trade deficit will remain substantial, above 30 percent of GDP. With declining aid flows, the current account is projected to gradually deteriorate into a deficit of around 2 percent of GDP by 2023.

Fiscal pressures will increase as international grants decline gradually over time and due to the short-term impacts of the COVID-19 virus. Under baseline projections, the fiscal deficit for 2020 is projected to widen to 2.9 percent of GDP from 1.1 percent in 2019, due to increased public health expenditures and negative revenue impacts from COVID-19 related economic disruptions. Thereafter, the planned introduction of VAT in 2021 and improvements in tax administration should boost domestic revenues, partially offsetting projected declines in grant receipts.

Economic contraction in 2020 would further undermine welfare conditions, especially with an abrupt increase of returnees from Iran amid the rapid spread of the COVID-19 outbreak there. Over the medium-term, projected growth rates will be insufficient to support adequate productive employment creation and make a significant dent on poverty.

Risks and challenges

Risks to the outlook include: (i) intensification of economic disruptions arising from spread of COVID-19 (ii) heightened instability in the political transition to a new administration, (iii) a deterioration of security conditions, (iv) precipitous reductions in aid, and (v) adverse regional economic and political developments. Significant improvements in security conditions following a sustainable and credible political settlement with the Taliban,

on the other hand, could help boost growth and private investment. Recent declines in global oil prices – if sustained – also have potential to drive stronger growth and a reduction of the trade deficit. Recent announcement of a USD 1 billion reduction in grants from the United States present additional risks to fiscal sustainability and the capacity of government to maintain security and service delivery.

The pandemic and the related containment measures, including border closures and the recent lockdown of major cities, can lead to: (i) reduced exports due to disruptions at border points; (ii) negative impacts on remittances; (iii) disruptions to domestic consumption and confidence; and (iv) increased fiscal pressures, with declining revenues and increased public expenditure needs. In a scenario where COVID-19 is not effectively brought under control (allowing for the movement of goods and people in and out of the country to resume normally in the second half of the year), GDP could decline by 5.9 percent in 2020, significantly lower than in the baseline projection.

A rapid spread of COVID-19 would also have negative poverty impacts. Disruption to trade could lead to higher prices or shortages for basic household goods. With high reliance on out-of-pocket expenditure for health services, households facing additional healthcare needs may be heavily impacted. Households facing increased health costs, higher prices for basic goods, or reduced incomes due to imposition of social distancing measures may be forced to reduce expenditure on education and food or sell assets, with long-lasting negative impacts on livelihoods and human capital accumulation.

In the short-term, government should maintain recent gains in revenue performance to avoid a fiscal crisis. Continued business environment and anti-corruption reforms should be pursued to reinvigorate private investment and assure the international community of the government's capacity to make effective and efficient use of grant resources. A clear and early commitment from international partners to provide sustained support would help reduce uncertainty and raise confidence and investment.

TABLE 2: Macro poverty outlook indicators (annual percent change unless indicated otherwise).

	2017	2018	2019 (e)	2020 (f)	2021 (f)	2022 (f)
Real GDP growth, at constant market prices	2.7	1.8	2.9	-3.8	3.3	5.2
Private consumption	4.3	1.2	0.5	-3.0	3.6	4.0
Government consumption	1.5	4.2	3.7	5.1	3.9	4.1
Gross fixed capital investment	6.4	0.5	-3.4	-14.8	0.7	9.0
Exports, goods and services	7.0	5.0	-2.0	-9.0	6.0	8.5
Imports, goods and services	8.0	1.0	-5.5	-7.0	3.0	5.0
Real GDP growth, at constant factor prices	2.2	1.3	2.9	-3.8	3.3	5.2
Agriculture	3.8	0.8	7.5	5.0	4.5	4.5
Industry	0.4	2.5	2.0	-3.0	3.0	3.0
Services	2.5	1.0	1.8	-7.5	2.9	6.6
Inflation (consumer price index)	4.7	0.6	2.3	4.5	4.5	5.0
Current account balance (percent of GDP)	2.2	2.7	2.9	4.2	0.3	-1.5
Net foreign direct investment (percent of GDP)	-0.1	-0.1	-0.1	0.0	0.0	0.1
Fiscal balance (percent of GDP)	-0.5	0.7	-1.1	-2.9	-1.6	-0.5
Debt (percent of GDP)	6.2	5.4	6.5	7.8	8.1	8.1
Primary balance (percent of GDP)	-0.4	1.7	-0.4	-2.6	-1.3	-0.2

Notes: (e) = estimate; (f) = forecast.
Source: World Bank.



Bangladesh

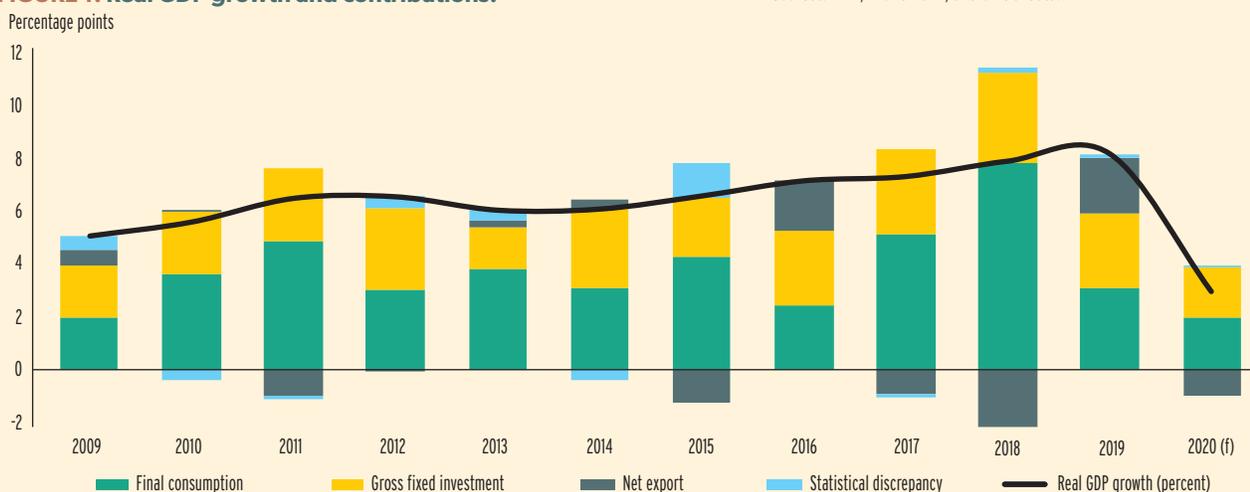
Growth is expected to decelerate to 3.0 percent in FY20 with declining garment exports, lower private investment growth and broader disruptions caused by COVID-19. Lower revenue collection and higher recurrent spending are likely to increase the fiscal deficit to 7.7 percent of GDP in FY20. While growth is expected to recover over the medium term, downside risks remain, particularly from a domestic outbreak of COVID-19 and fragilities in the financial sector. In the absence of mitigation measures, poverty is expected to increase significantly due to COVID-19.

TABLE 1

	2019
Population, million	168.6
GDP, current USD billion	303.0
GDP per capita, current USD	1797
International poverty rate (USD 1.9) ^a	14.8
Lower middle-income poverty rate (USD 3.2) ^a	52.9
Upper middle-income poverty rate (USD 5.5) ^a	84.5
Gini index ^a	32.4
Life expectancy at birth, years ^b	72.1

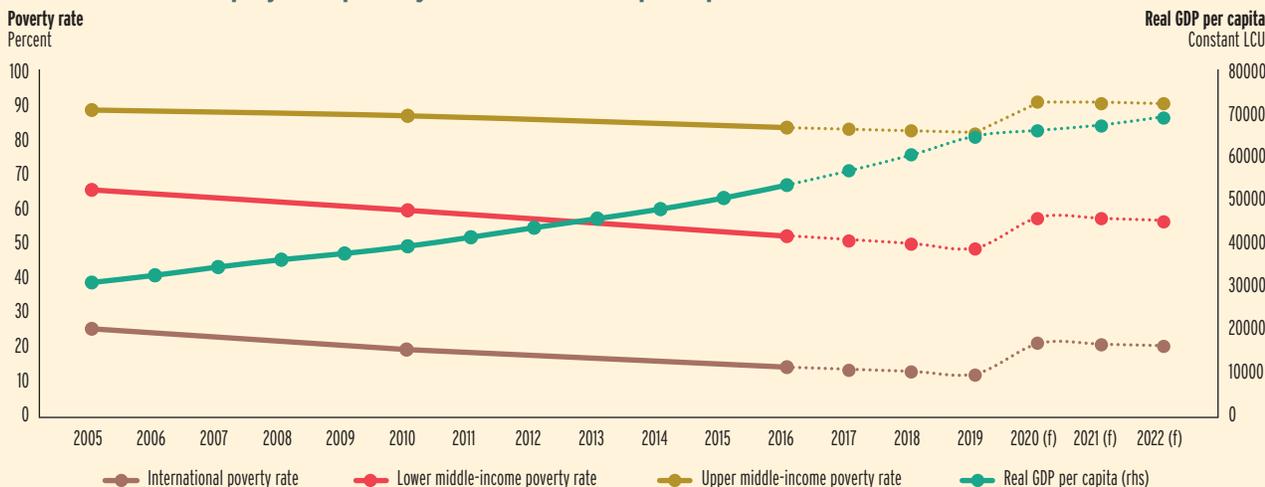
Notes: (a) Most recent value (2016), 2011 PPPs; (b) Most recent WDI value (2017).
Sources: WDI, World Bank, and official data.

FIGURE 1: Real GDP growth and contributions.



Note: (f) = forecast.
Sources: Bangladesh Bureau of Statistics (BBS) and staff calculations.

FIGURE 2: Actual and projected poverty rates and real GDP per capita.



Notes: (f) = forecast. See Table 2.
Source: World Bank.



Recent economic developments

In the first half of FY20 (July to December) growth gradually decelerated. Slower global trade and deteriorating external competitiveness lowered exports while tighter access to finance constrained private investment growth. Exports declined by 5.8 percent (y-o-y) in the first six months of FY20, reflecting a fall in orders for ready-made garments. A sharp contraction in capital goods imports (3.4 percent, y-o-y) suggests that private investment also fell. Growth during the first half of the year was primarily supported by remittance-fueled private consumption.

Inflation reached 5.6 percent y-o-y in January 2020, above the central bank's 5.5 percent CPI target, driven by higher vegetable and gas prices. New regulatory provisions for reduced interest rates and smaller down payments enabled the rescheduling of Tk 220 billion of overdue corporate loans. Nonetheless, NPLs remained high at 9.3 percent of outstanding loans in December 2019.

Declining exports drove an increase in the trade deficit in the first half of FY20, but this was more than offset by a 25.5 percent growth in remittance inflows. The number of overseas workers continued to rise, and recently introduced incentive payments encouraged the use of official remittance channels. As a result, the current account deficit narrowed to USD 1.3 billion in the first half of FY20. Despite tepid FDI and a decline in official foreign loan disbursements, the financial account remained in surplus and more than offset the CAD, resulting in a small balance of payments surplus. The real effective exchange rate appreciated, while the nominal taka depreciated against the US dollar marginally. Foreign exchange reserves remained adequate at USD 32.4 billion at the end of January 2020, equivalent to six months of goods and non-factor services imports.

The fiscal deficit exceeded 5 percent of GDP in FY19 and the first half of FY20 for the first time since FY01. Revenues underperformed, owing to lower import tax collections, complex new VAT legislation, and stagnating tax administration reforms. While overall government consumption growth slowed due to the base effect of an increase in civil service wages in the previous year, other expenditures rose, driven by an increase in subsidies and capital spending. The fiscal deficit increased, as did government borrowing from domestic banks. Public debt was 33.8 percent of GDP at the end of FY19 and Bangladesh is at a low risk of debt distress.

Projections suggest that the national poverty rate continued to fall through 2019, but at a slower pace. Fewer jobs created in the garment sector and an increase in poverty for urban households employed in the informal service sector contributed to this slower progress. In addition, poverty increased in Rangpur and stagnated in the Rajshahi and Khulna divisions. The Rohingya refugee crisis in Cox's Bazar continues to pose a largely localized development challenge.

Outlook

GDP growth is projected to decelerate to 3.0 percent in FY20, driven by COVID-19 disruptions and the already weak performance of exports and private investment in the first half of the year. The national shutdown is likely to impact private consumption, the main engine of growth. While remittances were robust in the first half of the year, they are likely to decline, reducing household consumption. The uncertainties related to COVID-19 are likely to further dampen private investment. A shortage of intermediate inputs is expected to lower industrial production, while staff shortages could adversely impact all sectors. The government announced a preliminary COVID-19 fiscal stimulus to scale up existing social protection schemes and support payroll of the manufacturing sector, although details are still emerging. In the medium term, a gradual recovery in growth is expected, with some increase in export demand and higher public spending.

Inflation is projected to remain above Bangladesh Bank's 5.5 percent target due to expansionary monetary and fiscal policies and higher food prices. The current account deficit is expected to widen in FY21 with a decline in exports and remittances. As the government ramps up spending in response to the COVID-19 outbreak, the fiscal deficit is projected to increase. Recurrent spending is expected to pick-up in the short term as the government focuses on relief measures while capital expenditures are projected to increase when the recovery phase kicks in.

In the absence of mitigation measures, poverty is expected to increase substantially. About 1 in 4 households currently living in poverty are engaged in informal activities in the non-farm service and construction sectors, which have been significantly affected by closures and disruptions. The decline in national and global demand for manufactured goods, particularly in the garment sector, is expected to create unemployment and deepen poverty – 1 in 4 households with income from the manufacturing sector are already poor. The negative impact of COVID-19 on poverty rates is expected to be higher in urban centers,



while the number of additional poor will be higher in rural areas. A decrease in international remittances is expected to have a smaller short-term impact on the poverty rate, as migrants tend to come from better-off households.

Risks and challenges

A protracted outbreak of COVID-19 with restrictive policies could reduce GDP growth in FY20 to 2.0 percent. In this scenario, private consumption and investment would decelerate along with a much larger contraction in exports. The main risk to the outlook is a large-scale domestic outbreak of COVID-19 with attendant social and economic costs. High density slum

and urban areas and refugee camps in Cox's Bazar are particularly vulnerable. Other risks include concerns on the stability of the financial sector, stagnant tax administration reforms, expanded subsidy programs, and donor fatigue for the Rohingya response. Increased deficit financing from domestic banks is expected to put upward pressure on interest rates and may further constrain credit to the private sector.

The government's pandemic response will be paramount, including testing, quarantining and treating patients and providing economic relief to the poor and vulnerable. Other ongoing priorities remain, including strengthening fragile banks, accelerating reforms in business regulation, addressing exchange rate overvaluation and deepening fiscal reforms.

TABLE 2: Macro poverty outlook indicators (annual percent change unless indicated otherwise).

	2017	2018	2019	2020 (f)	2021 (f)	2022 (f)
Real GDP growth, at constant market prices	7.3	7.9	8.2	3.0	2.9	3.9
Private consumption	7.4	11.0	3.9	2.4	2.3	2.7
Government consumption	7.8	15.4	9.0	7.7	2.3	2.9
Gross fixed capital investment	10.1	10.5	8.4	5.7	4.5	6.2
Exports, goods and services	-2.3	8.1	10.9	-19.8	-7.4	8.2
Imports, goods and services	2.9	27.0	-2.0	-10.9	-3.7	6.9
Real GDP growth, at constant factor prices	7.2	7.9	8.4	3.0	2.9	3.9
Agriculture	3.0	4.2	3.9	3.5	3.1	3.1
Industry	10.2	12.1	12.7	2.0	3.5	6.1
Services	6.7	6.4	6.8	3.5	2.4	2.6
Inflation (consumer price index)	5.4	5.8	5.5	5.7	5.7	5.8
Current account balance (percent of GDP)	-0.5	-3.5	-1.7	-2.9	-3.2	-2.9
Net foreign direct investment (percent of GDP)	0.7	0.6	0.8	0.7	0.3	0.6
Fiscal balance (percent of GDP)	-3.4	-4.6	-5.4	-7.7	-9.8	-8.4
Debt (percent of GDP)	30.8	31.9	33.8	39.1	45.6	50.2
Primary balance (percent of GDP)	-1.6	-2.8	-3.5	-5.3	-7.1	-5.5
International poverty rate (USD 1.9 in 2011 PPP) ^{a,b}	14.1	13.5	12.8	21.8	21.5	21.1
Lower middle-income poverty rate (USD 3.2 in 2011 PPP) ^{a,b}	51.7	50.6	49.3	58.3	57.9	57.4
Upper middle-income poverty rate (USD 5.5 in 2011 PPP) ^{a,b}	84.0	83.4	82.8	91.8	91.6	91.4

Notes: (f) = forecast. (a) Calculations based on SAR-POV harmonization, using 2010-HIES and 2016-HIES. Actual data: 2016. Nowcast: 2017-2019. Forecast are from 2020 to 2022. (b) Projection using point-to-point elasticity (2010-2016) with pass-through = 1 based on GDP per capita in constant LCU.
Source: World Bank.

Bhutan

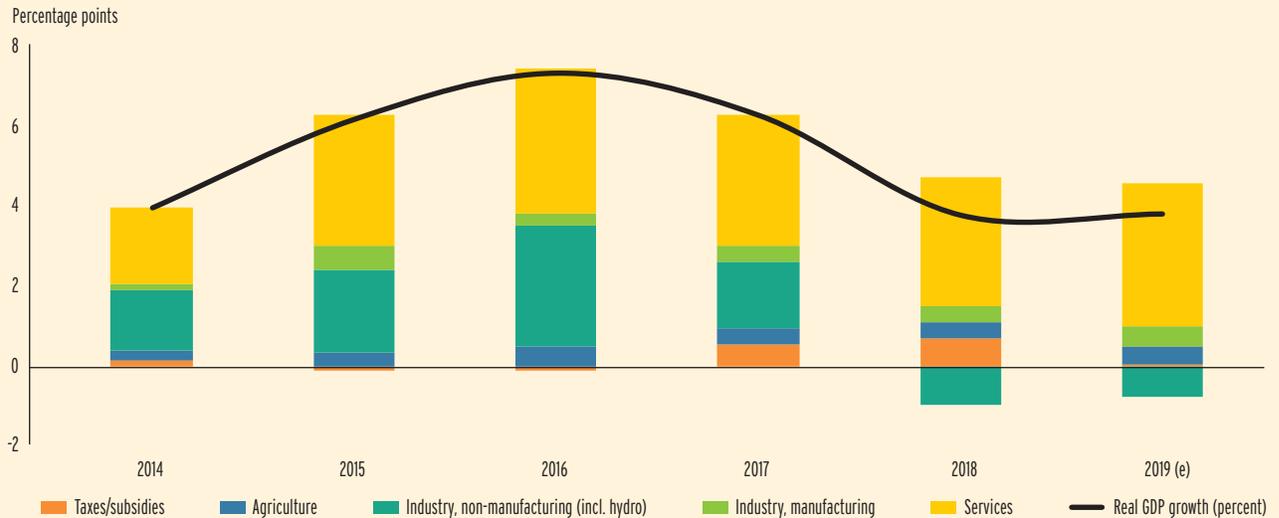
Real GDP growth is expected to decelerate to 2.9 percent in FY20 due to significant disruptions from COVID-19 to domestic production, tourism, and services. The government's efforts to contain the impact of the pandemic are expected to increase the fiscal deficit. Medium term growth prospects remain subdued and downside risks remain, particularly from a domestic outbreak of COVID-19. Poverty, measured using the USD 3.20 poverty line, is expected to decrease slightly to 9.8 percent in 2020. Food security in remote areas needs to be closely monitored.

TABLE 1

	2019
Population, million	0.8
GDP, current USD billion	2.6
GDP per capita, current USD	3412
International poverty rate (USD 1.9) ^a	1.5
Lower middle-income poverty rate (USD 3.2) ^a	12.0
Upper middle-income poverty rate (USD 5.5) ^a	38.6
Gini index ^a	37.4
School enrollment, primary (percent gross) ^b	101.3
Life expectancy at birth, years ^b	71.1

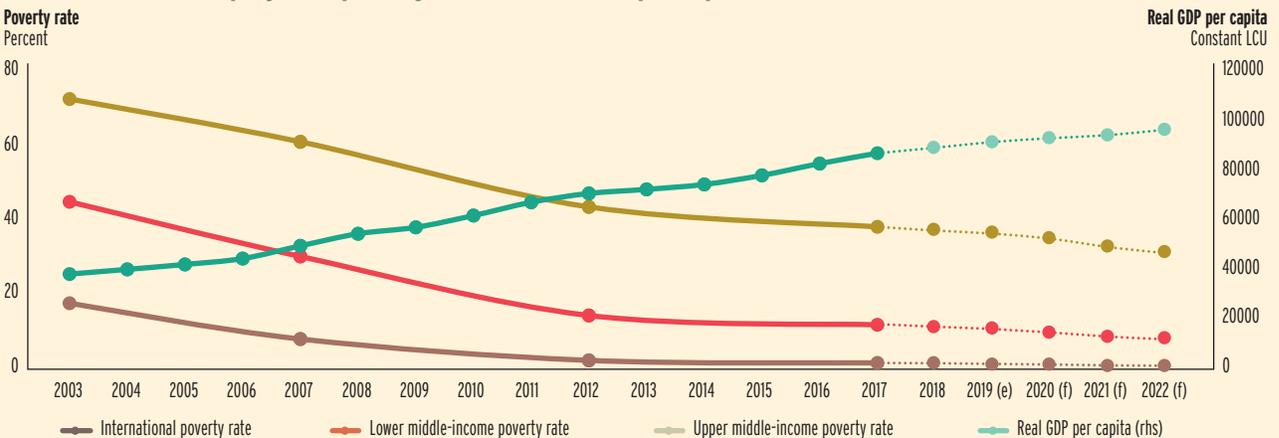
Notes: (a) Most recent value (2017), 2011 PPPs; (b) Most recent WDI value (2017). Sources: WDI, World Bank, and official data.

FIGURE 1: Real GDP growth and contributions.



Note: (e) = estimate
Sources: Government of Bhutan and staff calculations.

FIGURE 2: Actual and projected poverty rates and real GDP per capita.



Notes: (e) = estimate; (f) = forecast. See Table 2.
Source: World Bank.



Recent economic developments

At 3.9 percent in FY19, growth is estimated to have been subdued because of weak performance in the country's main growth drivers: hydropower and tourism. Hydropower output fell (y-o-y) due to (i) prolonged maintenance work at the Tala hydropower plant; (ii) lower-than-expected rainfall; and (iii) delays in the commissioning of the Mangdechhu project. While tourist arrivals increased, tourism receipts declined significantly, reflecting lower average spending by visitors. As in previous years, growth was primarily driven by the services sector, including retail trade, transport and communication.

Annual inflation decelerated to 2.8 percent in FY19, its lowest level since 2003, reflecting a rapid decline in food prices. However, since mid-2019, food prices have increased, in line with price developments in India, Bhutan's largest trading partner.

Financial sector vulnerabilities have increased. The Non-Performing Loan (NPL) ratio in the financial sector rose to 18.4 percent in September 2019, up from 12.8 percent in September 2018. While this reflects mid-year cyclical factors, NPL and provisioning ratios have deteriorated, overall, in recent years. The banking sector has adequate cushions to absorb potential losses, given sufficient capital adequacy, but some non-bank financial institutions are fragile, particularly in the insurance sector.

The current account deficit widened in FY19, on the back of lower electricity and tourism receipts. Imports also fell, reflecting slower construction activity and fuel imports, but to a lesser extent.

Despite a decline in revenues, the fiscal balance improved to a surplus of 0.8 percent of GDP in FY19, given a large decline in capital expenditures. Hydropower-related revenues, accounting for 17 percent of the total, decreased in line with lower production, while the discontinuation of excise duty refunds from India had a negative impact on non-hydro revenues. External grants, which mainly cover capital expenditures, decreased significantly due to delays in the initiation of new investment projects in FY19. Control over current expenditures remained tight.

The poverty headcount, measured at USD 3.20 per day per person (in 2011 PPP terms), is estimated to have decreased slightly, from 11.3 percent in 2018 to 10.7 percent in 2019. However, a recently published poverty map of rural gewogs showed deep pockets of poverty in Dagana, Monggar and Zhemgang, with poverty exceeding 50 percent in some gewogs in 2017. In contrast, most rural gewogs in Paro, Thimphu and Punakha had estimated poverty rates of less than 5 percent.

Outlook

Growth is expected to decelerate to 2.9 percent in FY20, primarily because of COVID-19 related disruptions. The tourism industry has come to a standstill since the government suspended travel for incoming tourists in early March. A sharp drop in tourist arrivals in the second half of FY20 is expected to dampen services growth and exports, as well as government revenues. Agriculture, construction and exporting sectors are expected to be adversely affected by the COVID-19 pandemic due to supply side disruptions for critical inputs, labor shortages and lower external demand, especially from India. The growth outlook is likely to remain subdued in FY21 with some recovery expected in FY22. Inflation is expected to remain moderate in the near term, as rising food prices in India and imported inflation are offset by low oil prices.

Exports and imports are expected to be depressed. The growth slowdown in India – exacerbated by the spread of COVID-19 – is expected to dampen external demand for non-hydro goods and services from Bhutan. In addition, domestic production in Bhutan is also likely to decline. Meanwhile import growth is projected to decelerate as the COVID-19 outbreak curbs hydropower and investment projects. On balance, the current account deficit is likely to persist given Bhutan's dependence on essential imports, both for consumption and investment. Over the medium-term, the external deficit is likely to narrow, in line with the increase in electricity exports, as the Mangdechhu and Punatsangchhu II projects come on line.

The fiscal deficit is expected to widen to 3.4 percent in FY20 due to a pickup in current spending in response to the COVID-19 outbreak, and an increase in salaries and wages. Capital expenditure is expected to decrease as the government reduces discretionary spending. While non-hydro revenues are projected to decline with the slowdown in the services sector, hydropower revenues will increase due to the one-off profit transfer from the commissioning of the Mangdechhu hydro power plant. Over the medium-term, improvements in tax policy and administration, and the implementation of the Goods and Services Tax will be critical to increase revenues.

Poverty reduction will continue at a modest pace. The poverty headcount rate at USD 3.20 per day is projected to gradually decline to 9.8 percent in 2020 and 8.8 percent in 2021. The impact of the COVID-19 outbreak on the poverty headcount rate is expected to be modest, as most of the poor work in subsistence agriculture. However, some social impacts may materialize primarily through an impact on labor income. A large number of households

that directly or indirectly depend on tourism may suffer from job or earnings losses. Reduced demand for agricultural products could lower exports and hurt agribusinesses and their employees. Given high levels of pre-existing malnutrition, food security needs to be monitored closely, especially in remote areas.

Risks and challenges

In the event of a protracted outbreak of COVID-19 – with precautionary behaviors and restrictive policies remaining in place for several months, and supply chains

and external demand continuing to be affected – economic growth could decelerate further to 2.2 percent in FY20. Further, a domestic outbreak of COVID-19 would have substantial societal and economic costs.

Other risks include possible further delays in hydro project completion and lower-than-expected rainfall, which would negatively impact growth, and reduce exports and government revenues. Slower than expected implementation of the Goods and Services Tax would also affect fiscal outcomes, because of the discontinuation of excise duty refunds and lower levels of grant financing from India. In addition, the risks from weaknesses in the non-banking financial sector remain and need to be monitored and contained.

TABLE 2: Macro poverty outlook indicators (annual percent change unless indicated otherwise).

	2017	2018	2019 (e)	2020 (f)	2021 (f)	2022 (f)
Real GDP growth, at constant market prices	6.3	3.8	3.9	2.9	2.5	3.5
Private consumption	0.0	10.1	6.0	2.5	1.5	3.2
Government consumption	4.3	3.7	4.5	8.0	7.0	3.0
Gross fixed capital investment	4.4	-3.6	-0.5	-0.7	0.5	3.1
Exports, goods and services	0.4	5.5	-2.5	-2.0	-1.2	3.2
Imports, goods and services	-5.3	3.6	-1.2	-1.9	-1.0	2.4
Real GDP growth, at constant factor prices	6.0	3.3	3.9	2.9	2.5	3.5
Agriculture	3.6	3.7	4.2	3.0	3.3	3.5
Industry	4.7	-1.2	-0.5	3.3	2.7	3.6
Services	8.2	7.9	8.1	2.4	2.0	3.4
Inflation (consumer price index)	4.3	3.7	2.8	2.7	3.1	2.7
Current account balance (percent of GDP)	-23.6	-19.6	-23.9	-19.7	-22.3	-21.8
Fiscal balance (percent of GDP)	-4.8	-3.3	0.8	-3.4	-3.5	-2.7
Debt (percent of GDP)	111.5	110.1	105.4	104.2	103.2	101.0
Primary balance (percent of GDP)	-3.5	-2.0	1.7	-2.5	-2.2	-1.5
International poverty rate (USD 1.9 in 2011 PPP) ^{a,b}	1.5	1.4	1.3	1.1	0.9	0.8
Lower middle-income poverty rate (USD 3.2 in 2011 PPP) ^{a,b}	12.0	11.3	10.7	9.8	8.8	8.1
Upper middle-income poverty rate (USD 5.5 in 2011 PPP) ^{a,b}	38.6	37.6	36.7	35.4	33.1	31.4

Notes: (e)=estimate; (f) = forecast. (a) Calculations based on SAR-POV harmonization, using 2017-BLSS. Actual data: 2017. Nowcast: 2018-2019. Forecast are from 2020 to 2022. (b) Projection using neutral distribution (2017) with pass-through = 0.7 based on GDP per capita in constant LCU. Source: World Bank.



India

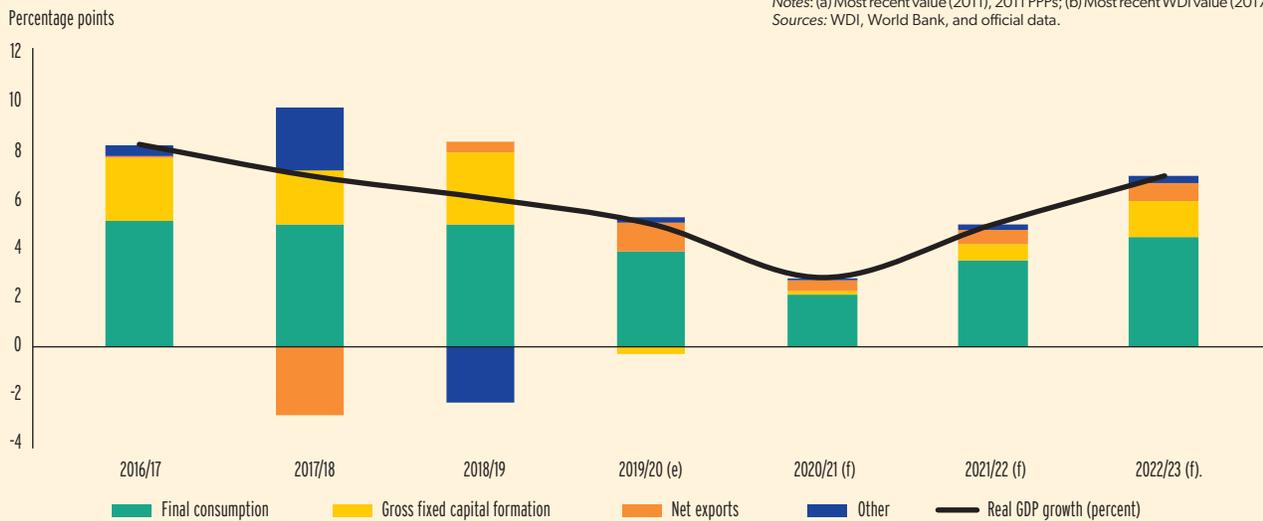
Growth is estimated to have decelerated to 5.0 percent in FY20 and it is expected to slow down again in FY21. Structural and financial-sector weaknesses are compounded by severe disruptions to economic activity caused by the COVID-19 outbreak. Fiscal balances are also being affected by weak tax proceeds and high spending needs. While poverty declined to an estimated 13.4 percent in 2015, at the USD 1.90 international poverty line, the slowdown in growth and in the rural economy may have dampened the pace of poverty reduction.

TABLE 1

	2019
Population, million	1371.3
GDP, current USD billion	2924.9
GDP per capita, current USD	2133
International poverty rate (USD 1.9) ^a	21.6
Lower middle-income poverty rate (USD 3.2) ^a	61.1
Upper middle-income poverty rate (USD 5.5) ^a	87.3
Gini index ^a	35.4
School enrollment, primary (percent gross) ^b	113.0
Life expectancy at birth, years ^b	69.2

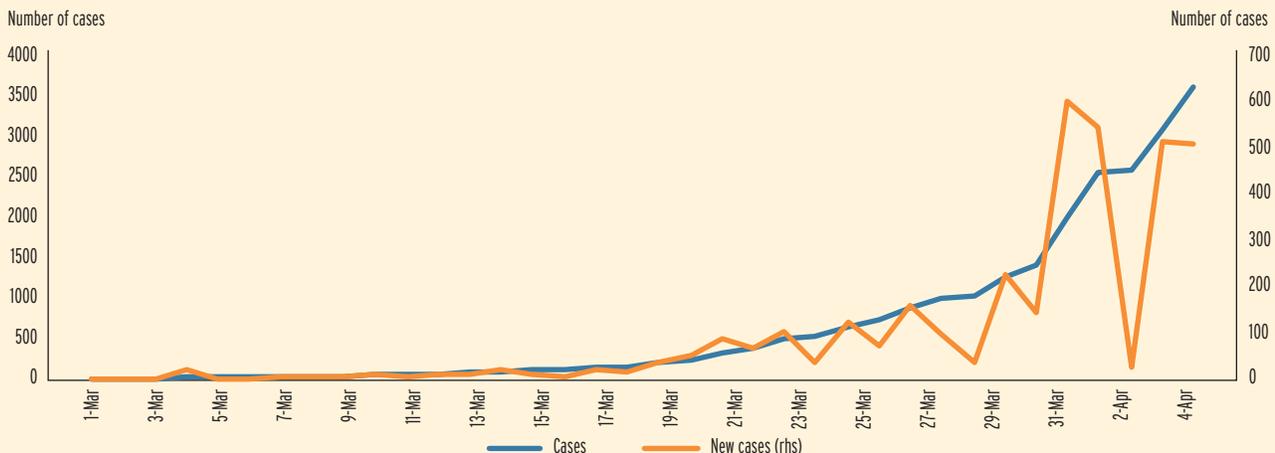
Notes: (a) Most recent value (2011), 2011 PPPs; (b) Most recent WDI value (2017). Sources: WDI, World Bank, and official data.

FIGURE 1: Real GDP growth and contributions.



Notes: (e) = estimate; (f) = forecast. India's fiscal year is from April 1 to March 30. Sources: Central Statistics Office and World Bank staff calculations.

FIGURE 2: COVID-19 outbreak.



Sources: John Hopkins CSSE and World Bank.

Recent economic developments

Economic growth moderated from 8.3 percent in FY17 to 6.1 in FY19. It slowed to 5.1 percent over the first three quarters of FY20 (y-o-y). On the expenditure side, weak private investment has been compounded by slowing private consumption growth. On the supply side, industry (especially manufacturing and construction) and services growth slowed to 1.6 percent and 7.2 percent, respectively. Because India's fiscal year ends in March, the full effects of the COVID-19 outbreak will materialize in FY21, with FY20 growth expected at 5.0 percent.

Between September 2019 and January 2020, CPI inflation increased due to a spike in food prices. Consequently, the Reserve Bank of India (RBI) paused its monetary easing stance and focused on improving macroprudential oversight to address financial sector vulnerabilities. In March 2020, however, given the extension of the COVID-19 outbreak, the RBI cut the repo rate by 75 basis points to 4.4 percent.

India's current account deficit declined to 1.0 percent of GDP during the first three quarters of FY20 (compared to 2.6 percent during the same period in FY19) thanks to a reduction in the trade deficit and an improvement in net services exports. Foreign reserves remained comfortable, at approximately 10 months of imports cover, thanks to continued positive net capital inflows, over the April-December 2019 period.

The general government deficit is expected to widen to 7.5 percent of GDP in FY20 reflecting the effects of a fiscal stimulus -adopted in March- and weak revenue growth. Public debt, though largely domestic and long term, is expected to rise significantly as a result.

Between FY12 and 2015, the poverty rate may have declined from 21.6 to 13.4 percent (USD 1.90 PPP/day), according to projections based on 2011-12 data, which is the most recent official survey available for India. Since then the deceleration in GDP-per-capita growth has likely magnified the risks for the poorest households, as shown by trends in key indicators. For example, real average daily rural wages have fallen by 4 percent between FY19 and FY20.

Outlook

The COVID-19 outbreak came at a time when India's economy was already slowing, due to persistent financial sector weaknesses. To contain it, the government imposed a

'lockdown' with restrictions on mobility of goods and people. The resulting domestic supply and demand disruptions (on the back of weak external demand) are expected to result in a sharp growth deceleration in FY21, to 2.8 percent in a baseline scenario (an estimate subject to wide confidence intervals). The services sector will be particularly impacted. A revival in domestic investment is likely to be delayed given enhanced risk aversion on a global scale, and renewed concerns about financial sector resilience. Growth is expected to rebound to 5.0 percent in FY22 as the impact of COVID-19 dissipates, and fiscal and monetary policy support pays off with a lag.

The balance of payments position is expected to improve. Weak domestic demand, low oil prices and COVID-19-related disruptions are expected to narrow the current account deficit to 0.2 percent in FY21 and to keep it low in the following years.

The general government deficit is anticipated to rise, owing to recently adopted tax cuts and the impact of significantly slower growth of tax proceeds, before moderating towards the end of the forecast horizon. The combined fiscal deficit of the center and states is projected to widen to 9.0 percent in FY21, as revenue performance dips with the growth slowdown and expenditure commitments increase in line with the stimulus program announced. Thereafter it should improve gradually.

Recent retail indicators from Nielsen show that rural and urban consumption growth fell to 5.0 and 8.0 percent respectively in Q3-2019 (for rural areas, this is an all-time low over the past seven years). Further, poorer households are more exposed to the risk of COVID-19. In a 2018 survey, only 22 percent households in the lowest consumption decile reported washing hands with soap before meals. The high density of households in urban slums further reduces the efficacy of social distancing measures. The lockdown will also have an adverse economic impact on self-employed and casual workers. The closure of shops, hotels and restaurants alone will affect 11 percent of such workers in these sectors. Domestic migrants scrambling to return to their homes in rural areas and currently stuck in transit are also facing significant vulnerabilities. A welfare package from the government can help poorer households cope with short-term COVID-related losses. Lower oil prices, if sustained over the medium-term, could also help mitigate inflationary concerns.

Risks and challenges

The COVID-19 outbreak has magnified pre-existing risks to the outlook. The government is undertaking measures to contain the health and economic fallout, and the RBI has begun providing calibrated support in the form



of policy rate cuts and regulatory forbearance. Given significant uncertainties, there is a wide confidence interval around the baseline estimate. If a large-scale domestic contagion scenario is avoided, early policy measures pay-off, and restrictions to the mobility of goods and people can be lifted swiftly, an upside scenario could materialize in FY21, with growth around 4 percent. However, if domestic contagion is not contained, and the nationwide shutdown is extended, growth projections could be revised downwards to 1.5 percent, and fiscal slippages would be larger.

Broad-based poverty reduction with respect to (i) presently excluded groups (such as women and scheduled tribes), and (ii) extending gains to a broader range of human development outcomes remains a major challenge. The prolonged distress in the rural economy high youth unemployment; and the potentially regressive impacts of COVID-19 on prices and labor markets, present risks to sustaining the rate of poverty reduction. Furthermore, outdated information on indicators of poverty and employment limit the scope of reliably correlating growth forecasts with projected rates of poverty reduction.

TABLE 2: Macro poverty outlook indicators (annual percent change unless indicated otherwise).

	2017/18	2018/19	2019/20 (e)	2020/21 (f)	2021/22 (f)	2022/23 (f)
Real GDP growth, at constant market prices	7.0	6.1	5.0	2.8	5.0	7.0
Private consumption	7.0	7.2	5.4	2.0	4.5	7.5
Government consumption	11.8	10.1	8.1	9.1	9.1	3.0
Gross fixed capital investment	7.2	9.8	-0.9	0.6	2.4	5.3
Exports, goods and services	4.6	12.3	-2.0	-1.0	4.0	10.0
Imports, goods and services	17.4	8.6	-6.5	-3.0	1.0	6.0
Real GDP growth, at constant factor prices	6.6	6.0	4.9	2.7	5.0	7.0
Agriculture	5.9	2.4	3.5	2.7	3.0	3.5
Industry	6.3	4.9	1.9	0.0	3.0	6.5
Services	6.9	7.7	6.9	4.1	6.6	8.2
Inflation (consumer price index)	3.6	3.4	4.1	3.0	3.5	4.0
Current account balance (percent of GDP)	-1.8	-2.1	-1.0	-0.2	-0.3	-0.3
Net foreign direct investment (percent of GDP)	1.1	1.1	1.3	0.9	1.1	1.5
Fiscal balance (percent of GDP)	-5.8	-6.2	-7.5	-9.0	-7.9	-7.7
Debt (percent of GDP)	69.5	70.2	72.3	76.7	78.4	78.0
Primary balance (percent of GDP)	-1.1	-1.4	-2.6	-3.8	-2.4	-2.0

Notes: (e) = estimate; (f) = forecast.
Source: World Bank.

Maldives

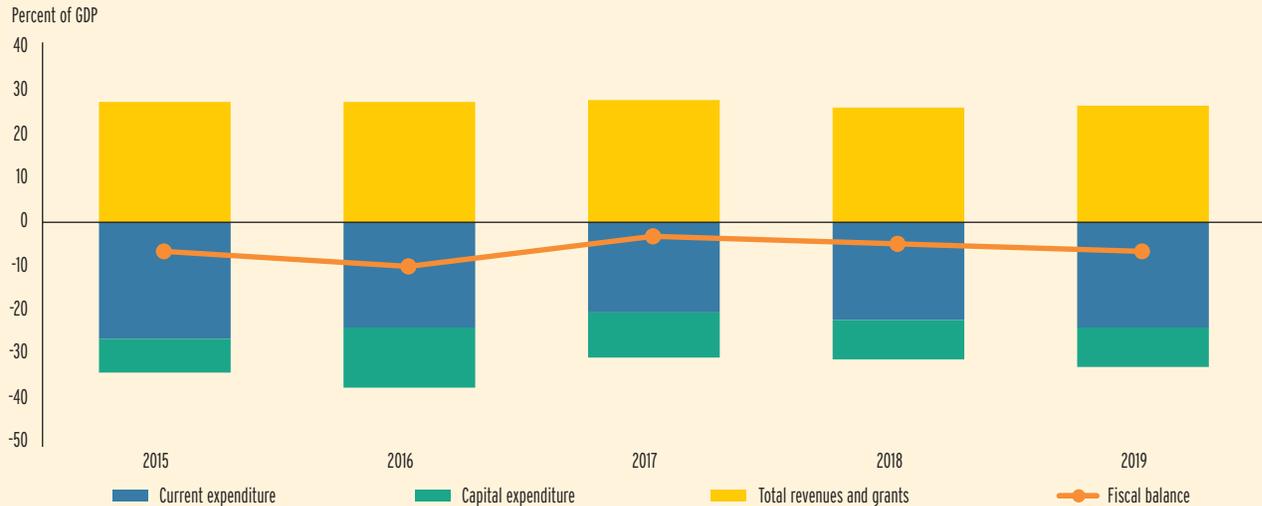
Growth is expected to contract by 8.5 percent in 2020 as the COVID-19 outbreak dampens tourism and construction. The current account deficit will improve as remittance outflows and imports decline, more than offsetting the contraction in exports. The decline in capital expenditures is not expected to cover for the loss in tourism revenues, leading to an increase in fiscal deficit and public debt. Poverty is expected to increase as livelihoods are heavily linked to tourism and fisheries.

TABLE 1

	2019
Population, million	0.5
GDP, current USD billion	5.7
GDP per capita, current USD	12677
School enrollment, primary (percent gross) ^a	97.1
Life expectancy at birth, years ^a	78.3

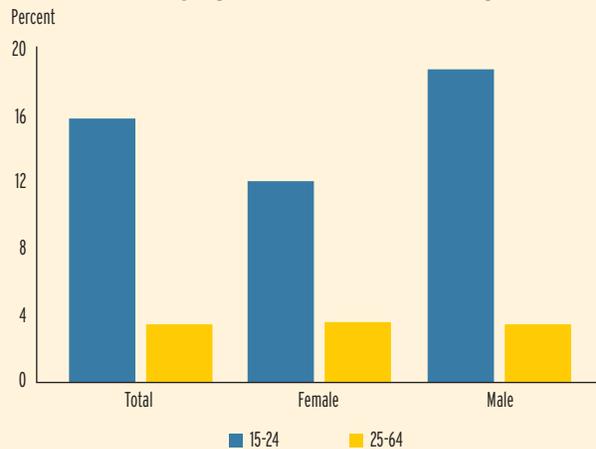
Note: (a) Most recent WDI value (2017).
Sources: WDI, World Bank, and official data.

FIGURE 1: Fiscal developments.



Sources: World Bank calculations and estimates based on Ministry of Finance data.

FIGURE 2: Unemployment rate of adults and youth.



Source: World Bank estimates based on HIES 2016.

Recent economic developments

After three years of rapid expansion, real GDP growth decelerated to an estimated 5.2 percent in 2019 due to a slowdown in retail trade and construction. Construction expanded by just 0.5 percent over January–September 2019 (y-o-y) as several infrastructure projects concluded, compared to 19.2 percent the previous year.

Tourism flourished in 2019 as visitor arrivals grew by 14.7 percent (y-o-y). Total arrivals reached a record 1.7 million. China remained the largest source, accounting for 16.7 percent of all visitors, whereas India contributed the most to arrivals growth. However, the impact of the COVID-19 pandemic is beginning to weigh down on the prospects of the sector, and more broadly, on the economy of the



Maldives. Visitor arrivals have started to dwindle in February (arrivals dropped by 11.2 percent (y-o-y)) and are expected to contract further as travel bans and wide-ranging entry restrictions to contain the spread of COVID-19 have become more stringent around the world.

The overall CPI inflation was muted in 2019 (0.2 percent y-o-y). However, to prevent price hikes as COVID-19 disrupts imports, authorities have implemented a range of price controls on staple foods. In addition, to ensure financial system stability, the Maldives Monetary Authority (MMA) announced measures aimed at providing liquidity to financial institutions. The MMA also obtained a foreign currency swap facility amounting to USD 150 million with the Reserve Bank of India. The Maldives maintains a de facto stabilized exchange rate arrangement.

The current account deficit narrowed to an estimated 21.8 percent of GDP in 2019 as imports of machinery and materials declined. Despite record tourist arrivals, tourism-related services exports only grew by 4.1 percent y-o-y in 2019 compared to 10.4 percent y-o-y previously. Gross official reserves increased to USD 753 million at end-2019, but usable reserves (after netting out short-term foreign currency liabilities to domestic banks) only amount to USD 316 million, equivalent to 1.4 months of goods imports. As of end-February 2020, usable reserves have further declined to USD 278 million, as lower tourist flows reduce foreign exchange earnings.

The fiscal deficit widened to an estimated 6.4 percent of GDP in 2019. Total expenditure grew by 11.7 percent y-o-y while total revenues increased by 6.0 percent due to lower GST collections and state-owned enterprise dividends. As a result of the COVID-19 outbreak, revenues fell by an estimated 23.4 percent in the first quarter of 2020 (y-o-y) as tourist-related revenues shrank, whereas spending grew by 10.2 percent. Central government debt rose to an estimated 61.8 percent of GDP in 2019 from 58.5 percent in 2018.

Last available estimates (2016) indicate that 8.2 percent of the population is under the national poverty line of MVR 74 (USD 4.80) or 6.6 percent under the international poverty line of USD 5.50 for upper middle-income countries. Many households are bunched close to the poverty line; hence, a small change in their consumption levels could lead to a sizeable increase in the national poverty rate. The poverty rate (12.8 percent) is significantly higher in the atolls than that in Male' (1.7 percent). The Gini coefficient of 31.3 compares favorably to that of other South Asian countries.

Outlook

Real GDP is expected to contract by 8.5 percent in 2020, 13.9 pp lower than the baseline (pre-COVID-19). This

is mostly due to the slump in tourism, which directly and indirectly accounts for two-thirds of GDP, but also due to suppressed construction activity. The shock to tourism adversely affects employment and household earnings, as one-third of adult males and a quarter of females are engaged in tourism-related jobs. Lower-income households that depend on fisheries are also affected as exports of raw fish have ceased due to weak demand. The national poverty rate is expected to increase as households close to the poverty line would likely fall into poverty due to the loss of income sources. A larger impact is expected in the atolls, as there is greater dependence on fisheries and the poverty rate was already higher.

Despite the slump in tourism and related services exports, the current account balance is projected to improve to 15.7 percent of GDP, as remittance outflows and imports related to construction, fuel and tourism decline. The fiscal deficit is projected to double to 12.9 percent of GDP as tourism-related revenues plummet further. Although income taxes will be collected for the first time in 2020, the amount is unlikely to make a significant impact in the current environment. The government has pledged to cut expenditure by MVR 1 billion (equivalent to 1.2 percent of GDP) to address the revenue shortfall, and to reallocate resources to the health sector, and economic relief for affected households and businesses. Central government debt is expected to rise to 72.9 percent of GDP by end-2020 as the government seeks new sources of external financing to cover the fiscal gap.

Risks and challenges

The key short-term challenge is to contain the spread of COVID-19 while trying to limit the economic repercussions. Should infections fail to decline domestically and in key tourist markets in Q2, resulting in an extension of the lockdown, growth would contract more significantly. Fiscal sustainability risks, already high in the pre-COVID scenario, are further elevated as foreign exchange receipts dry up.

The negative shock to tourism will significantly hurt household incomes, as those employed in related sectors will see temporary or permanent job losses or wage cuts. As the Maldives no longer focuses solely on luxury tourism, the shock will also affect the livelihoods of small guesthouse owners and their employees on local islands.

Although tourist arrivals are expected to rebound once the pandemic subsides, the loss in global wealth will dampen worldwide tourism growth, especially the luxury



segment. Construction activity will be constrained by limited fiscal space. In the medium term, it is critical to build stronger fiscal buffers and more resilience to macroeconomic shocks. It is also important to enable the expansion

of a more vibrant private sector that can create more and better jobs. This is especially critical for the growing working-age population, as youth are more likely to be unemployed than adults.

TABLE 2: Macro poverty outlook indicators (annual percent change unless indicated otherwise).

	2017	2018	2019	2020 (f)	2021 (f)	2022 (f)
Real GDP growth, at constant market prices	6.8	6.9	5.2	-8.5	7.3	5.5
Real GDP growth, at constant factor prices	6.7	6.9	5.2	-8.5	7.3	5.5
Agriculture	8.3	4.8	6.0	2.0	3.5	4.0
Industry	10.7	10.5	5.0	-0.5	1.5	3.0
Services	6.0	6.5	5.2	-10.3	8.5	6.0
Inflation (consumer price index)	2.8	-0.1	0.2	1.3	1.2	1.1
Current account balance (percent of GDP)	-21.7	-26.1	-21.8	-15.7	-16.3	-17.7
Fiscal balance (percent of GDP)	-3.1	-4.7	-6.4	-12.9	-11.9	-9.9
Debt (percent of GDP)	60.1	58.5	61.8	72.9	74.3	75.7
Primary balance (percent of GDP)	-1.4	-3.4	-4.6	-10.6	-9.9	-7.9

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



Nepal

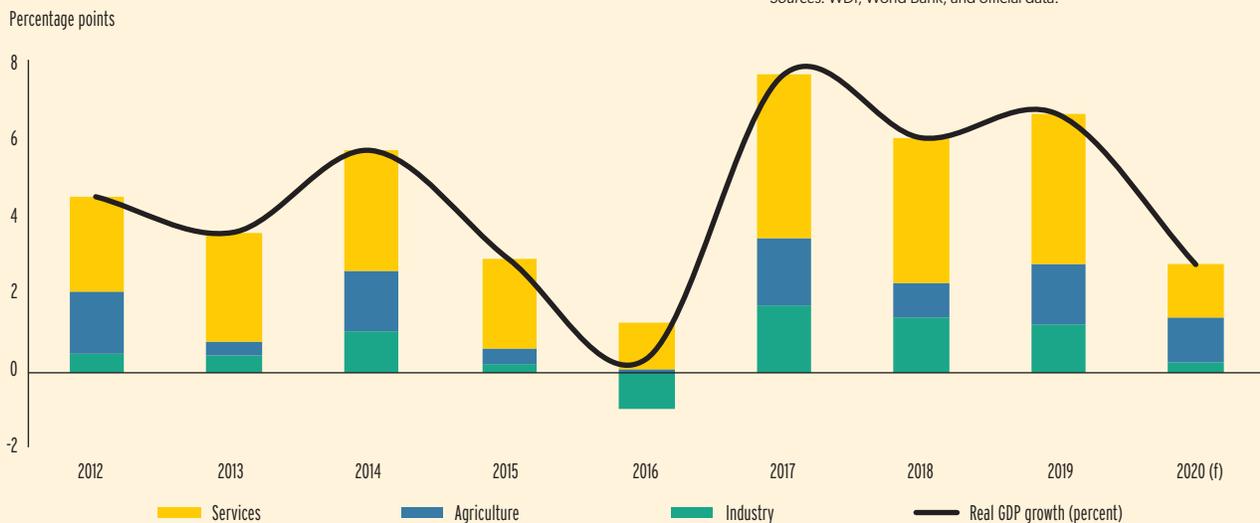
Growth is expected to decelerate to 2.8 percent in FY20, reflecting lower remittances, trade and tourism, and broader disruptions caused by the COVID-19 outbreak. Consequently, the twin deficits are likely to increase significantly. Risks to the outlook stem primarily from a large-scale domestic transmission of COVID-19 and weak capacity of the government to implement emergency relief and recovery measures. The risk of falling into poverty is high, and it will increase in 2020.

TABLE 1

	2019
Population, million	29.9
GDP, current USD billion	30.7
GDP per capita, current USD	1025
International poverty rate (USD 1.9) ^a	15.0
Lower middle-income poverty rate (USD 3.2) ^a	50.9
Upper middle-income poverty rate (USD 5.5) ^a	83.0
Gini index ^a	32.8
School enrollment, primary (percent gross) ^b	143.9
Life expectancy at birth, years ^b	70.2

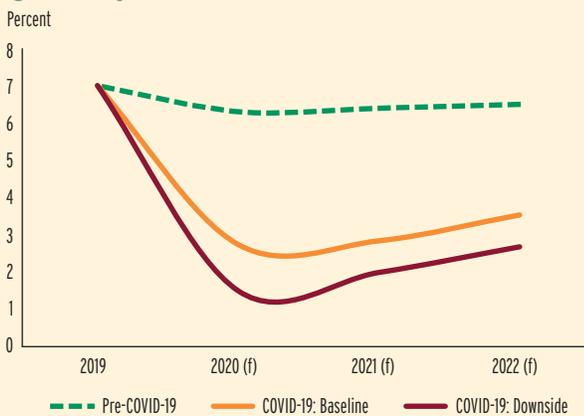
Notes: (a) Most recent value (2010), 2011 PPPs.; (b) Most recent WDI value (2017). Sources: WDI, World Bank, and official data.

FIGURE 1: Real GDP growth and contributions.



Notes: (f) = forecast. Nepal's fiscal year runs from July 16th to July 15th. Sources: Central Bureau of Statistics and staff calculations.

FIGURE 2: GDP growth is expected to decelerate significantly.



Notes: (f) = forecast. Nepal's fiscal year runs from July 16th to July 15th. Sources: Central Bureau of Statistics and staff calculations.

Recent economic developments

During July-January FY20 (H1FY20), weak agricultural activity is expected to have depressed economic growth. Delays in the monsoons and crop damage by army worms and fake seeds reduced paddy production by 1.1 percent (y-o-y). Growth in services, particularly, hotels and restaurants, is also likely to have moderated with lower tourist arrivals in H1FY20, mainly from India. On the demand side, growth was primarily supported by government consumption (higher wages) and net ex-ports (lower imports).



Average inflation was 6.4 percent (y-o-y) in H1FY20, driven by higher vegetable prices and increased import duties on certain agricultural and industrial goods. This widened the inflation gap with India and contributed to a 2.1 percent real effective ex-change rate appreciation of the Nepalese Rupee. Credit growth, at 8.7 percent, exceeded deposit growth, reducing loanable funds. But the financial sector remained well-capitalized, with the non-performing loan ratio at 1.8 percent in January 2020.

The current account deficit narrowed by 44.3 percent (y-o-y) during H1FY20, as the trade deficit contracted because of lower imports. Imports declined by 3.5 percent (y-o-y), with lower demand for reconstruction-related industrial supplies (iron, steel, and coal) and gold (due to higher prices) and lower petroleum prices. Exports remained low (3.3 percent of GDP in FY19) but grew by 22.2 percent y-o-y on the back of higher external demand for refined palm and soybean oil. Meanwhile, remittance inflows grew only by 1.2 percent (y-o-y) to USD 3.9 billion, reflecting reduced net outmigration. Loans and a drawdown of foreign exchange reserves financed the external deficit. As a result, foreign reserves stand at USD 9.7 billion or 8.4 months of imports as of January 2020.

As in H1FY19, the budget remained in surplus in H1FY20. The recorded surplus was however larger, y-o-y, because of lower execution of the capital budget, at 15.4 percent of the total in H1FY20 (compared with 17.7 percent in H1FY19). Recurrent spending in H1FY20 grew by 3.7 percent y-o-y, driven by transfers to subnational governments and higher wages and social security payments. Meanwhile, revenue growth decelerated to 13.3 percent in H1FY20, y-o-y, because of lower import tax proceeds.

In 2019, the poverty headcount ratio (at the international line of USD 1.90/day) is estimated at 8 percent (down from 15 percent in 2010) while 39 percent of the population is estimated to be poor at a higher line (USD 3.20/day). About 31.2 percent of the population that are estimated to live between USD 1.9 and USD 3.2 a day face significant risks of falling into extreme poverty, primarily because of reduced remittances, foregone earnings of potential migrants, job losses in the informal sector, and rising prices for essential commodities as a result of COVID-19.

Outlook

Growth is expected to decelerate to 2.8 percent in FY20 reflecting headwinds to agricultural growth, a significant reduction in remittances and tourism, and broader

disruptions from the pandemic. Industrial sector growth is expected to decline because of lower industrial imports, supply chain disruptions, and shortages of skilled workers. The countrywide lockdown together with lower remittances and tourist arrivals is likely to impact services growth. Economic growth during FY21 is also likely to remain subdued due to the lingering effects of the pandemic and slow growth in India. Some recovery is expected in FY22.

Limited availability of imported goods, higher duties on certain agricultural and industrial imports, and the removal of value-added-tax exemptions on some intermediate goods and services are likely to raise inflation over the medium term, despite the decline in oil prices.

The current account deficit is expected to widen to 10.2 percent of GDP in FY20, and remain elevated over the medium term, because of a significant decline in remittances. With the fall in oil prices and limited prospects for outmigration, remittance inflows are likely to remain subdued over the medium-term.

The fiscal deficit is expected to increase to 7.3 percent of GDP in FY20 because of increased spending on quarantine and health facilities to contain COVID-19, higher salaries, social security, and fiscal transfers (also in response to the pandemic) to local governments. Meanwhile, revenues are projected to remain subdued because of slower growth and lower import tax proceeds.

Risks and challenges

A prolonged outbreak of COVID-19 would impact growth significantly with a further deceleration or contraction in services and industrial production. In this scenario, growth could fall further to 1.5 percent in FY20 but with a large confidence interval given the uncertainties surrounding the evolution of the pandemic.

The biggest risk to the outlook is from large-scale domestic transmission of COVID-19 with significant social and economic costs. The weak capacity of the recently formed subnational governments to effectively implement relief and recovery efforts compounds the risks. With the government machinery focused on dealing with the pandemic, there could be further delays in hiring staff and building subnational institutional capacity, which could in turn hamper spending and impede service delivery, and eventually growth.

**TABLE 2: Macro poverty outlook indicators (annual percent change unless indicated otherwise).**

	2017	2018	2019	2020 (f)	2021 (f)	2022 (f)
Real GDP growth, at constant market prices	8.2	6.7	7.1	2.8	2.9	3.6
Private consumption	2.6	2.5	6.5	-1.5	0.8	1.1
Government consumption	10.5	13.4	8.3	6.2	9.2	12.0
Gross fixed capital investment	44.3	18.1	14.3	-8.7	-5.8	5.4
Exports, goods and services	11.3	7.8	7.9	-14.6	3.2	4.6
Imports, goods and services	27.2	19.0	17.9	-9.4	-2.3	3.5
Real GDP growth, at constant factor prices	7.7	6.1	6.7	2.8	2.9	3.6
Agriculture	5.2	2.8	5.0	3.8	3.3	3.9
Industry	12.4	9.6	8.1	1.7	2.6	4.1
Services	8.1	7.2	7.3	2.5	2.8	3.3
Inflation (consumer price index)	4.5	4.2	4.5	5.8	6.0	5.9
Current account balance (percent of GDP)	-0.4	-8.2	-7.7	-10.2	-8.8	-4.7
Fiscal balance (percent of GDP)	-3.1	-6.7	-2.6	-7.3	-6.7	-5.3
Debt (percent of GDP)	26.1	30.2	30.1	35.5	39.8	41.9
Primary balance (percent of GDP)	-2.7	-6.1	-2.0	-6.5	-5.9	-4.3

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

Pakistan

Pakistan made considerable progress toward macroeconomic stabilization during the first 8 months of FY20. Measures taken by the authorities helped reduce domestic and external imbalances although at the cost of dampened economic activity. COVID-19 pandemic related disruptions have further strained economic activity. Output is expected to contract sharply in Q4-FY20, bringing overall FY20 growth to -1.3 percent. These developments have put pressure on Pakistan's fiscal position, as tax collection is being adversely impacted while spending needs are increasing.

TABLE 1

	2019
Population, million	204.7
GDP, current USD billion	282.5
GDP per capita, current USD	1380
International poverty rate (USD 1.9) ^a	3.9
Lower middle-income poverty rate (USD 3.2) ^a	34.7
Upper middle-income poverty rate (USD 5.5) ^a	75.4
Gini index ^a	33.5
School enrollment, primary (percent gross) ^b	90.6
Life expectancy at birth, years ^b	66.9

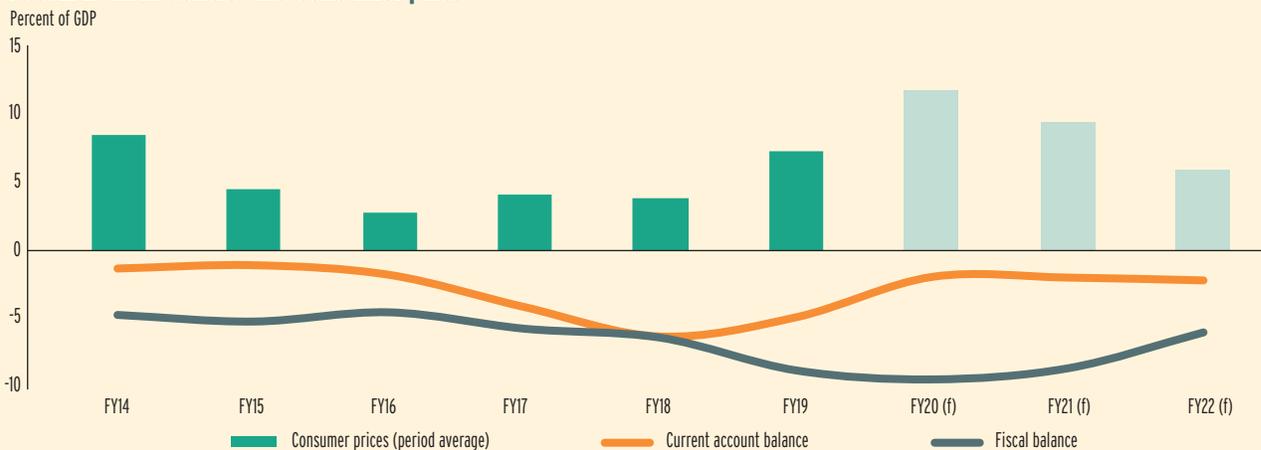
Notes: (a) Most recent value (2015), 2011 PPPs; (b) Most recent WDI value (2017).
Sources: WDI, World Bank, and official data.

FIGURE 1: Contributions to Real GDP growth.



Notes: (f) = forecast. Pakistan reports data on fiscal year (FY) basis. The fiscal year runs from July 1 through June 30.
Sources: Ministry of Finance and staff calculations.

FIGURE 2: Twin deficits and consumer prices.



Note: (f) = forecast.
Sources: State Bank of Pakistan, Ministry of Finance and staff calculations.



Recent economic developments

In July 2019, Pakistan entered into a 39-month Extended Fund Facility (EFF) arrangement with the International Monetary Fund. Stabilization measures under the EFF were expected to moderate aggregate demand pressures in the economy. Leading indicators suggested a slowdown in growth in the first 7-8 months of FY20. The output of large-scale manufacturing (which accounts for around 50 percent of industrial output) contracted by 3.4 percent in Jul-Jan FY20. The agriculture sector, however, registered growth in the rice and livestock sub-sectors.

However, the rapid spread of the COVID-19 virus since February 2020 has brought economic activity to a near-halt. Most of the country has been placed under a partial lockdown. The closure of non-essential businesses and domestic supply chain disruptions are having a significant impact on wholesale and retail trade and transport, storage and communication, the largest sub-sectors of the services sector. The drop in domestic and global demand is also compounding the woes of the industrial sector, which is hit by both supply and demand shocks. In addition, the country's main industrial sector – textiles and apparel – is highly exposed to COVID-19 related disruptions due to its labor-intensity. As a result, real GDP growth in FY20 is expected to contract by 1.3 percent.

Average inflation increased to 11.8 percent during Jul-Mar FY20 (from 6.8 percent in Jul-Mar FY19) reflecting upward adjustments in administrated prices and exchange rate depreciation pass-through. The State Bank of Pakistan (SBP) maintained a tight monetary stance during this period, keeping the policy rate at 13.25 percent to dampen inflationary expectations. However, as the COVID-19 pandemic spread, it reduced the policy rate to 11.0 percent in March 2020.

The current account deficit (CAD) narrowed to 1.0 percent of GDP in Jul-Feb FY20, from 3.5 percent in the same period in FY19, thanks to a 17.5 percent decline in goods imports. This, together with large multilateral disbursements and higher foreign investment flows, helped shore up gross international reserves to USD 13.2 billion (as of March 27th, 2020)—or equivalent to 3.5 months of imports. However, due to global developments, foreign investors have offloaded more than half of their position in domestic securities since February 2020. The exchange rate, which had remained relatively stable through June-February FY20 depreciated by 7.3 percent in March.

In H1-FY20, the fiscal deficit stood at 2.3 percent of GDP, compared to 2.7 percent in H1-FY19. The fiscal adjustment was achieved through increases in domestic revenue collections and slower growth in non-interest recurrent expenditures. However, the COVID-19 pandemic is likely to put significant pressure on expenditures whereas revenue collections are expected to be negatively impacted. Pakistan's public debt, which stood at 87.5 percent of GDP at the end of FY19, may rise as a result.

The informal sector and daily wage workers employed in the formal sector are expected to bear most of the costs of expected slow-down in internal demand. The informal sector accounts for 72 percent of employment (LFS 2017) while informal workers in the formal sector account for another 5 percent of the total. The expected reduction of employment and incomes in the informal sector will have negative impact on poverty, particularly in urban areas. Poverty projections will be updated upon the release of the HIES 2018-19 household survey data.

Outlook

Real GDP growth is projected to contract by 1.3 percent in FY20 as domestic and global economic activity slows down sharply in the last four months of the fiscal year. The outbreak of COVID-19 will impact growth beyond FY20. Under the baseline scenario, growth will remain muted at 0.9 percent in FY21 before reaching 3.2 percent in FY22. Inflation is expected to average 11.8 percent in FY20 and to gradually decline thereafter.

The current account deficit is projected to narrow to 1.9 percent in FY20, as imports contract more than exports. Export growth is expected to remain negative in FY21 but to rebound thereafter and reach 6.7 percent in FY22. Similarly, imports are expected to recover slowly from FY22 onwards, as domestic industrial activities pick up. Remittances are expected to contract by 6.5 and -6.0 percent in FY20 and FY21, respectively, due to lower growth in the Gulf Cooperation Council economies. Increased multilateral and bilateral flows are expected to be the main financing sources over the medium-term.

The fiscal deficit is expected to remain elevated, at 9.5 and 8.7 percent of GDP in FY20 and FY21, respectively. Revenue mobilization efforts will be negatively impacted by subdued domestic activity, while expenditures will increase to contain the spread of COVID-19 and support the economy. The fiscal deficit is expected to fall gradually to 6.0 percent of GDP by FY22 as the impact of the crisis tapers-off. However, the public debt-to-GDP ratio is

expected to increase and remain elevated over the medium-term, with Pakistan's exposure to debt-related shocks remaining high.

The poverty outlook for FY21 will depend critically on the ability of the informal off-farm sector to recover from the current crisis. The duration of the crisis and the capacity of government interventions to protect investments in physical and human capital of the most vulnerable segments of the population will be important to prevent long lasting consequences.

Risks and challenges

There are considerable downside risks to the outlook. If the COVID-19 outbreak worsens or lasts longer than

expected, the real GDP for FY20 could contract by 2.2 percent before marginally recovering to 0.3 percent growth in FY21 (an estimate subject to a wide interval). In the near-term, continued outflows of portfolio investments in government securities may further erode Pakistan's limited external buffers and contribute to exchange rate volatility. Additionally, volatility of oil prices and difficulty in rolling-over of bilateral debt from non-traditional donors (China, KSA and UAE) would compound Pakistan's external risks and contribute to higher financing gaps. The immediate challenge for the government is to contain the spread of the COVID-19 pandemic, while minimizing economic losses and protecting the poorest. In the medium-to-long term, the government should remain focused on implementing much needed structural reforms to boost private investment sustainably.

TABLE 2: Macro poverty outlook indicators (annual percent change unless indicated otherwise).

	2016/17	2017/18	2018/19	2019/20 (f)	2020/21 (f)	2021/22 (f)
Real GDP growth, at constant market prices	5.6	5.8	3.3	-1.3	0.9	3.2
Private consumption	8.5	6.8	4.1	-4.9	0.3	3.2
Government consumption	5.3	8.6	10.0	1.4	1.1	1.9
Gross fixed capital investment	10.3	7.1	-8.9	-4.3	-1.0	3.8
Exports, goods and services	-0.6	10.4	13.2	-19.7	-5.3	7.3
Imports, goods and services	21.2	15.8	5.8	-26.3	-7.7	4.8
Real GDP growth, at constant factor prices	5.2	5.5	3.3	-1.3	0.9	3.2
Agriculture	2.2	3.9	0.8	1.0	1.7	2.3
Industry	4.6	4.9	1.4	-2.1	0.7	3.7
Services	6.5	6.2	4.7	-1.7	0.8	3.4
Inflation (consumer price index)	4.2	3.9	7.3	11.8	9.5	6.0
Current account balance (percent of GDP)	-4.1	-6.3	-4.9	-1.9	-2.0	-2.2
Net Foreign Direct Investment (percent of GDP)	0.9	1.1	0.6	0.7	0.6	0.8
Fiscal balance (percent of GDP)	-5.8	-6.4	-8.8	-9.5	-8.7	-6.0
Debt (percent of GDP)	70.0	75.2	87.5	90.6	91.8	89.6
Primary balance (percent of GDP)	-1.5	-2.1	-3.4	-3.2	-2.5	-0.2

Notes: (f) = forecast. Pakistan's fiscal year runs from July 1 through June 30.
Source: World Bank.



Sri Lanka

The COVID-19 outbreak will lead to a contraction in the economy. Periods of economic inactivity and disruptions will trigger jobs and earnings losses in 2020. Poverty is expected to increase, especially if the outbreak is protracted. The 2019 growth stimulus package and possible additional spending in the wake of the COVID-19 outbreak will exert pressure on fiscal sustainability, in a context of preexisting constrained fiscal space. Macroeconomic vulnerabilities will remain high, with limited fiscal buffers, high indebtedness and large refinancing needs.

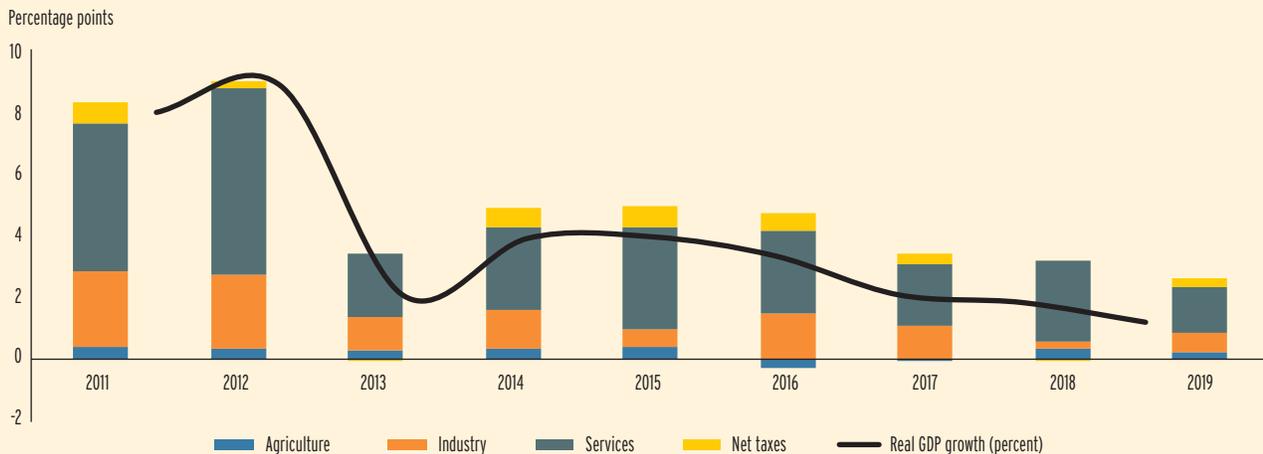
TABLE 1

	2019
Population, million	21.8
GDP, current USD billion	87.7
GDP per capita, current USD	4030
International poverty rate (USD 1.9) ^a	0.8
Lower middle-income poverty rate (USD 3.2) ^a	10.1
Upper middle-income poverty rate (USD 5.5) ^a	40.4
Gini index ^a	39.8
School enrollment, primary (percent gross) ^b	100.6
Life expectancy at birth, years ^b	76.6

Notes: (a) Most recent value (2016), 2011 PPPs.; (b) Most recent WDI value (2017).

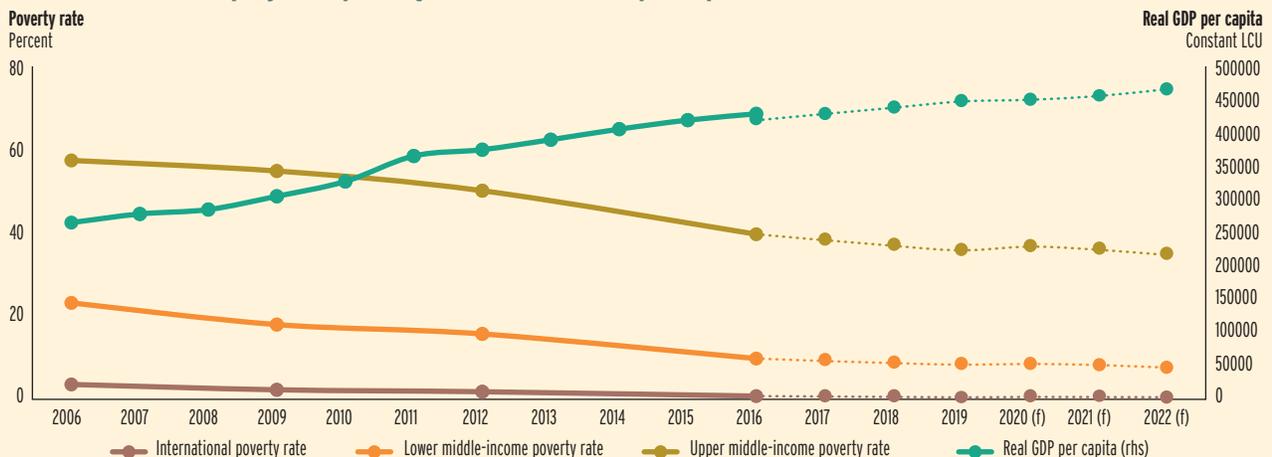
Sources: WDI, Macro Poverty Outlook, and official data.

FIGURE 1: Real GDP growth and contributions.



Sources: Department of Census and Statistics and staff calculations.

FIGURE 2: Actual and projected poverty rates and real GDP per capita.



Note: (f) = forecast. See Table 2.

Source: World Bank.

Recent economic developments

Growth is estimated to have been 2.6 percent in 2019, an 18-year low, partly explained by the impact of the April terrorist attacks. The COVID-19 outbreak is believed to have further weakened growth at the outset of 2020. An island-wide curfew and a lockdown of several hotspots is likely to have affected manufacturing and services activity. Tourism has also been severely affected by the closure of international airports for arrivals since March 19.

Inflation remained benign amid weak demand. Annual average inflation measured by the Colombo Consumer Price Index was 4.7 percent in March 2020. Muted inflation and the outbreak of COVID-19 prompted the Central Bank to ease monetary policy several times in the first half of 2020, bringing the policy rates down by 100 basis points.

The external current account deficit is estimated to have narrowed to 2.1 percent of GDP in 2019, thanks to a reduction in imports, despite the slowdown in tourism receipts. The issuance of international sovereign bonds (USD 4.4 billion) helped debt repayment. However, reserves are low relative to short-term external liabilities. The exchange rate, which had been stable against the US Dollar since August 2019, depreciated by 4.5 percent in the second half of March 2020, after the first Sri Lankan COVID-19 case was reported.

Fiscal accounts deteriorated in 2019. Tax revenues fell due to weak collection of VAT, excise and import taxes. Meanwhile, expenditures increased due to relief packages adopted after the April attacks and the implementation of expansionary budget proposals in an election year. As a result, the budget deficit is estimated to have increased to 6.4 percent of GDP. The central government debt-to-GDP ratio is high (84 percent), with more than half of the debt denominated in foreign currency.

With a view to raise growth in the medium-term, the new administration announced a growth stimulus package in December 2019. It combines tax cuts - including a reduction of the VAT rate from 15 percent to 8 percent, new hiring of civil servants and debt relief for SMEs. Fitch and S&P revised Sri Lanka's outlook from 'stable' to 'negative' on account of rising risks to debt sustainability. The COVID-19 is likely to worsen fiscal accounts through reduced revenues and increased expenditures related to further fiscal stimulus.

Poverty measured using the USD 5.50 poverty line (in 2011 PPP) is estimated to have declined from 37.6

percent in 2018 to 36.5 percent in 2019. The reduction in the VAT rate, to the extent that the benefits were passed on to consumers, was likely pro-poor. Labor market outcomes - both employment and wages - are expected to have deteriorated since the curfew was imposed in the second half of March. While there is no food shortage, access to food remains a challenge in poorer areas.

Outlook

The COVID-19 outbreak has substantially weakened the outlook as it exacerbated an already challenging macroeconomic situation of low growth rates and significant fiscal pressures. The economy is expected to contract by 0.5 percent in 2020 as the outbreak dampens export earnings, private consumption and investment. The external current account deficit is expected to remain benign thanks to the reduction in oil prices and a deceleration of imports, which will largely offset the reduction in receipts from garment exports, tourism and remittances. Refinancing requirements will be high, with annual gross foreign exchange requirements estimated at 6-7 percent of GDP during 2020-2022. The fiscal deficit will further expand, and the debt level is expected to increase due to the implementation of the stimulus package and settling of arrears. Public investment will be reduced to mitigate the impact of revenue shortfalls and create space for additional recurrent expenditures under the stimulus package and for COVID-19 related expenses.

The slowdown in economic activity will trigger sharp jobs and earnings losses. Informal workers comprise about 70 percent of the workforce and are particularly vulnerable as they lack employment protection or paid leave. Social-distancing measures will directly impact services sector activities and extended travel restrictions will hurt tourism. Construction activities slowed down at the start of the year due to a shortfall of Chinese workers and projects are at risk of being stalled. The apparel industry which accounts for about half a million jobs has announced significant job cuts due to low global demand and a shortage of raw materials. Meanwhile, agricultural production is expected to be largely undisrupted, amid government efforts to ramp up domestic production and import substitution. However, export-related subsectors will be negatively affected.

As a result of deteriorating labor market conditions, the USD 5.50 poverty rate is projected to increase to 41.7 percent in 2020. Remittances will fall in response to the global slowdown as well as the recent drop in oil prices, which will adversely impact some poor households. Cash support to beneficiaries of various social protection



programs have been announced in response to the fallout from the COVID-19 outbreak. However, many poor and vulnerable people are excluded from these initiatives and the cash amount is likely not sufficient to effectively help mitigate the adverse impacts.

Risks and challenges

The immediate challenge is to contain the domestic spread of COVID-19. A prolonged outbreak could lead

to further movement restrictions and deeper disruptions in economic and labor market activities. Small and Medium Enterprises will struggle to survive. In this scenario the economy would contract by 3.0 percent and poverty would increase to 43.9 percent in 2020. Fiscal sustainability would be further strained.

Sri Lanka is vulnerable to uncertain global financial conditions as the repayment profile requires the country to access financial markets frequently. A high deficit and rising debt levels could further deteriorate debt dynamics and negatively impact market sentiments.

TABLE 2: Macro poverty outlook indicators (annual percent change unless indicated otherwise).

	2017	2018	2019 (e)	2020 (f)	2021 (f)	2022 (f)
Real GDP growth, at constant market prices	3.4	3.2	2.6	-0.5	1.2	2.5
Private consumption	2.5	2.3	2.3	-0.6	1.2	2.5
Government consumption	-5.4	-5.5	2.7	5.8	3.9	2.5
Gross fixed capital investment	5.9	-1.3	0.5	-4.2	-0.1	2.8
Exports, goods and services	7.6	0.5	-0.8	-17.8	1.3	2.9
Imports, goods and services	7.1	1.8	-2.7	-12.7	0.1	1.9
Real GDP growth, at constant factor prices	3.4	3.6	2.6	-0.4	1.2	2.5
Agriculture	-0.4	4.8	3.2	1.0	2.0	2.5
Industry	4.1	0.9	2.6	-0.5	1.1	2.4
Services	3.6	4.7	2.5	-0.5	1.2	2.5
Inflation (consumer price index)	6.6	4.3	4.3	5.0	5.0	5.0
Current account balance (percent of GDP)	-2.6	-3.2	-2.1	-2.1	-2.3	-2.4
Net Foreign Direct Investment (percent of GDP)	1.5	1.7	0.7	0.1	0.5	1.1
Fiscal balance (percent of GDP)	-5.5	-5.3	-6.4	-9.8	-8.1	-8.1
Debt (percent of GDP)	76.9	82.9	84.1	91.6	95.9	99.0
Primary balance (percent of GDP)	0.0	0.6	-0.4	-3.5	-1.7	-1.7
International poverty rate (USD 1.9 in 2011 PPP) ^{a,b}	0.7	0.6	0.5	1.2	1.0	0.9
Lower middle-income poverty rate (USD 3.2 in 2011 PPP) ^{a,b}	9.5	8.9	8.5	11.3	11.0	10.2
Upper middle-income poverty rate (USD 5.5 in 2011 PPP) ^{a,b}	39.0	37.6	36.5	41.7	41.1	39.7

Notes: (e) = estimate; (f) = forecast. (a) Calculations based on SAR-POV harmonization, using 2016-HIES. Actual data: 2016. Nowcast: 2017-2019. Forecast are from 2020 to 2022; (b) Projection using neutral distribution (2016) with pass-through = 0.87 based on GDP per capita in constant LCU; (c) Projections for 2020 are from a microsimulation.
Source: World Bank.



South Asia at a glance

		Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	South Asia	
OUTPUT and PRICES	Real GDP Growth	2016	2.4	7.1	7.4	8.3	6.3	0.6	5.5	4.5	7.7
		2017	2.7	7.3	6.3	7.0	6.8	8.2	5.6	3.4	7.1
		2018	1.8	7.9	3.8	6.1	6.9	6.7	5.8	3.2	6.2
		2019 (e)	2.9	8.2	3.9	5.0	5.2	7.1	3.3	2.6	4.8
		2019 Q3 (CY)	..	..	..	5.1	..	..	..	2.3	..
		2019 Q4 (CY)	..	..	..	4.7	..	..	..	2.0	..
	Inflation (Consumer Price Index)	2016	4.3	5.9	3.3	4.5	0.5	9.9	2.9	4.0	3.9
		2017	4.7	5.4	4.3	3.6	2.8	4.5	4.2	6.6	3.9
		2018	0.6	5.8	3.7	3.4	-0.1	4.2	3.9	4.3	3.5
		2019 (e)	2.3	5.5	2.8	4.1	0.2	4.5	7.3	4.3	3.5
		2020 January	3.8	5.6	2.5	7.6	1.2	7.5	14.6	7.6	..
		2020 February	3.8	5.5	..	6.6	0.9	7.3	12.4	8.1	..
	REER (CY)	2016	..	..	..	105.2	..	..	110.3	..	105.7
		2017	..	..	..	110.0	..	..	106.9	..	109.7
2018		..	..	..	105.0	..	..	103.0	..	104.8	
2019 (e)		..	..	..	107.0	..	..	103.4	..	106.6	
2020 February		..	..	..	108.3	..	..	102.8	..	107.8	
2020 March		..	..	..	104.7	..	..	103.5	..	104.6	
BALANCE of PAYMENTS	Current Account Balance (percent of GDP)	2016	5.6	1.9	-31.7	-0.6	-23.6	6.2	-1.7	-2.1	-0.7
		2017	2.2	-0.5	-23.6	-1.8	-21.7	-0.4	-4.1	-2.6	-2.0
		2018	2.7	-3.5	-19.6	-2.1	-26.1	-8.2	-6.3	-3.2	-2.5
		2019 (e)	2.9	-1.7	-23.9	-1.0	-21.8	-7.7	-4.9	-2.1	-1.6
	Import Growth (percent, y-o-y)	2016	25.8	-7.1	2.9	4.4	..	2.8	16.0	7.9	4.7
		2017	8.0	2.9	-5.3	17.4	..	27.2	21.2	7.1	16.2
		2018	1.0	27.0	3.6	8.6	..	19.0	15.8	1.8	10.2
		2019 (e)	-5.5	-2.0	-1.2	-6.5	..	17.9	5.8	-2.7	-4.5
	Export Growth (percent, y-o-y)	2016	-0.3	2.2	-4.2	5.0	..	-13.7	-1.6	-0.7	4.1
		2017	7.0	-2.3	0.4	4.6	..	11.3	-0.6	7.6	3.9
		2018	5.0	8.1	5.5	12.3	..	7.8	10.4	0.5	11.5
		2019 (e)	-2.0	10.9	-2.5	-2.0	..	7.9	13.2	-0.8	-0.3
BALANCE of PAYMENTS	Foreign Reserves (months of goods import cover, CY)	2016	..	8.8	..	12.1	3.4	..	5.4	3.8	11.0
		2017	..	8.4	..	10.3	2.8	..	4.0	3.8	9.5
		2018	..	7.1	..	9.5	2.8	..	2.8	4.4	8.7
		2019 (e)	..	7.0	..	10.7	..	..	3.1	4.5	9.7
		2019 December	..	7.0	..	12.0	..	..	3.9	4.5	10.8
		2020 January	..	7.8	..	11.4	..	..	4.2	4.5	10.5



		Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	South Asia	
BALANCE of PAYMENTS	Personal Remittances Received (USD million, CY)	2016	628	13,574	34	62,744	4	6,612	19,808	7,262	110,666
		2017	1,084	13,502	43	68,967	4	6,928	19,807	7,190	117,526
		2018	804	15,562	58	78,790	4	8,294	21,194	7,043	131,749
		2019 (e)	..	..	..	..	..	..	..	..	..
		2019 Q3	..	4,519	..	16,373	..	..	5,477	1,660	..
		2019 Q4	..	4,889	..	15,185	..	..	5,918	1,787	..
GOVERNMENT FINANCES	Fiscal Balance (percent of GDP, FY)	2016	0.1	-3.7	-1.9	-6.9	-10.0	1.4	-4.5	-5.3	-6.3
		2017	-0.5	-3.4	-4.8	-5.8	-3.1	-3.1	-5.8	-5.5	-5.6
		2018	0.7	-4.6	-3.3	-6.2	-4.7	-6.7	-6.4	-5.3	-6.0
		2019 (e)	-1.1	-5.4	0.8	-7.5	-6.4	-2.6	-8.8	-6.4	-7.3
	Public Debt (percent of GDP, FY)	2016	6.1	31.5	112.4	68.9	56.7	27.9	70.1	78.3	65.8
		2017	6.2	30.8	111.5	69.5	60.1	26.1	70.0	76.9	66.2
		2018	5.4	31.9	110.1	70.2	58.5	30.2	75.2	82.9	67.2
		2019 (e)	6.5	33.8	105.4	72.3	61.8	30.1	87.5	84.1	69.9
Private Consumption Growth (percent, y-o-y)	2016	-0.2	3.0	3.9	8.1	..	-0.7	7.6	7.4	7.4	
	2017	4.3	7.4	0.0	7.0	..	2.6	8.5	2.5	7.0	
	2018	1.2	11.0	10.1	7.2	..	2.5	6.8	2.3	7.2	
	2019 (e)	0.5	3.9	6.0	5.4	..	6.5	4.1	2.3	5.0	
Gross Fixed Capital Investment Growth (percent, y-o-y)	2016	-6.0	8.9	11.5	8.5	..	-12.3	7.5	7.8	8.2	
	2017	6.4	10.1	4.4	7.2	..	44.3	10.3	5.9	7.8	
	2018	0.5	10.5	-3.6	9.8	..	18.1	7.1	-1.3	9.5	
	2019 (e)	-3.4	8.4	-0.5	-0.9	..	14.3	-8.9	0.5	-0.4	
Net Foreign Direct Investment (percent of GDP, FY)	2016	-0.1	0.6	-0.6	1.6	-10.4	-0.5	0.8	0.8	1.4	
	2017	-0.1	0.7	0.7	1.1	-9.7	-0.8	0.9	1.5	1.1	
	2018	-0.1	0.6	-0.1	1.1	-10.1	-0.2	1.1	1.7	1.1	
	2019 (e)	-0.1	0.8	..	1.3	..	..	0.6	0.7	1.2	
CONSUMPTION and INVESTMENT	Net Foreign Portfolio Investment (USD million)	2016	98.7	-42.1	..	4,725.2	132.3	..	-153.0	-993.0	..
		2017	-29.1	178.8	..	-30,637.8	-479.4	..	-1,198.0	-1,771.6	..
		2018	141.2	550.4	169.5	9,597.9	-103.4	..	288.0	-129.1	..
		2019 (e)	..	..	..	..	..	..	..	..	..
		2019 Q2 (CY)	..	319.5	..	5,469.9	..	..	-1,031.0	..	..
		2019 Q3 (CY)	..	240.4	..	1,533.7	..	..	232.0	..	..



Notes:

(e)	Estimate
CY	Series for Calendar Year
FY	Series for Fiscal Year Afghanistan's fiscal year is from December 21 to December 20 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	Notes: Real GDP growth rates (percent change, y-o-y) at Market Prices; Pakistan is in factor costs. Sources: Central Statistics Office of India, Sri Lanka Department of Census and Survey, and World Bank MTI.
Inflation (Consumer Price Index)	Note: Median annual percent change in CPI inflation. Sources: World Bank DEC GEM and World Bank MTI.
REER (CY)	Notes: 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 (percent of GDP)	Note: Does not include grants unless otherwise stated. Source: World Bank MTI and staff calculations.
Import Growth (percent, y-o-y)	Notes: Annual trade change is in (respective) fiscal year and covers goods and non-factor services (GNFS) imports. Source: World Bank DEC GEM, World Bank MTI, and staff calculations.
Export Growth (percent, y-o-y)	Notes: Annual trade change is in (respective) fiscal year and covers goods and non-factor services (GNFS) exports. Source: World Bank DEC GEM, World Bank MTI, and staff calculations.
Foreign Reserves, months of import cover (CY)	Source: World Bank DEC GEM.
Remittances (USD million, CY)	Note: Personal remittances including personal transfers and compensation of employees in current USD. Sources: Haver Analytics, World Bank WDI, and staff calculations.
Fiscal Balance (percent of GDP)	Note: Does not include grants unless otherwise stated. Source: World Bank MTI.
Public Debt (percent of GDP)	Note: Gross public debt stock including domestic and foreign liabilities, end of Period. Source: World Bank MTI.
Private Consumption Growth (percent, y-o-y)	Note: Annual (respective) fiscal year percent change in gross consumption expenditure. Source: World Bank MTI.
Gross Fixed Capital Investment Growth (percent, y-o-y)	Note: Annual (respective) fiscal year percent change in gross fixed capital expenditure. Source: World Bank MTI.
Net Foreign Direct Investment (percent of GDP)	Note: Net balance of Foreign Direct Investment assets and liabilities as ratio to GDP. Sources: Haver Analytics and World Bank MTI.
Portfolio Investment (USD million)	Notes: Portfolio investment covers transactions in equity securities and debt securities. Balances are calculated as net assets minus net liabilities. Data is in current USD. Source: Haver Analytics and staff calculations.





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