

Global Economic Prospects

South Asia

June 2014
Andrew Burns



THE WORLD BANK



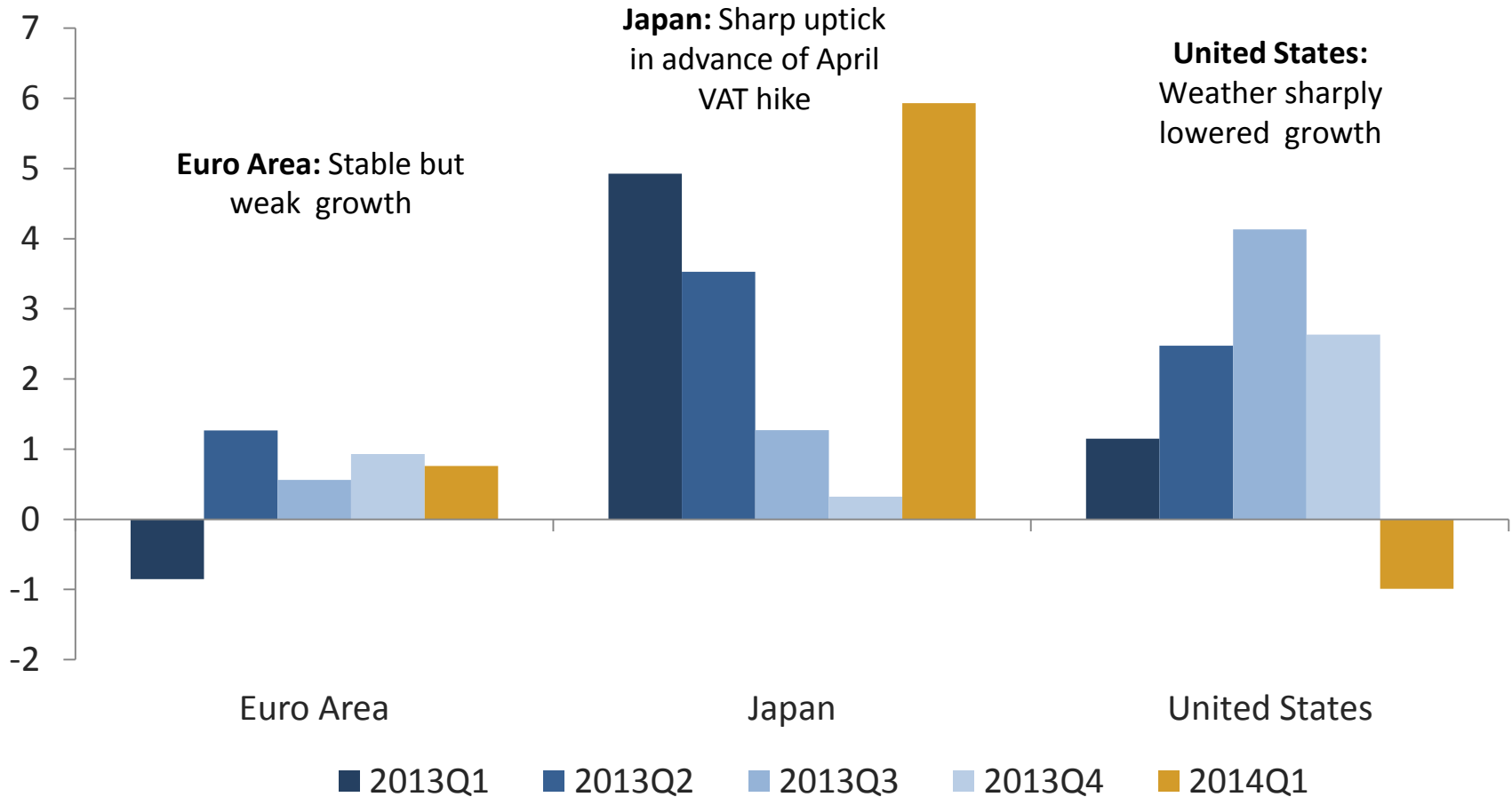
Main Messages



- 2014 Global forecast has been downgraded, mainly reflecting one-off factors
- Financing conditions have eased temporarily, but are expected to tighten once again– carrying with them risks
- Medium-term outlook is for growth to remain flat in 2014 and to rise moderately in 2014 and 2015.
- Growth in South Asia has been disappointing, and although vulnerabilities are declining they remain
- Inflation, fiscal sustainability and the pace of structural reform are central challenges

First quarter GDP data in high-income countries was mixed

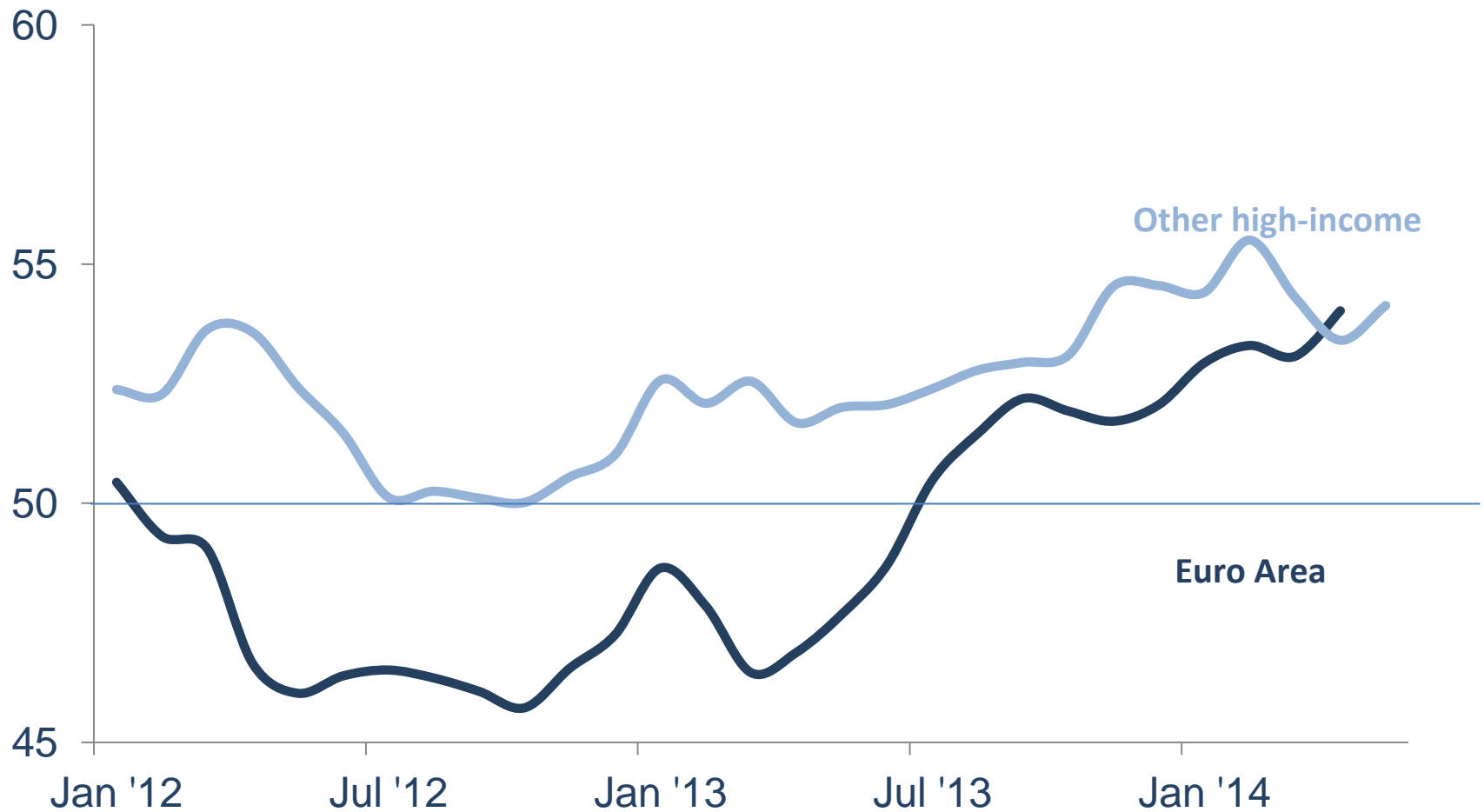
Percent quarterly GDP growth, annualized pace



Source: World Bank, Haver Analytics.

Despite first quarter, business confidence in high-income countries remains strong

Purchasing Managers, indexes (50 or more indicates expansion)



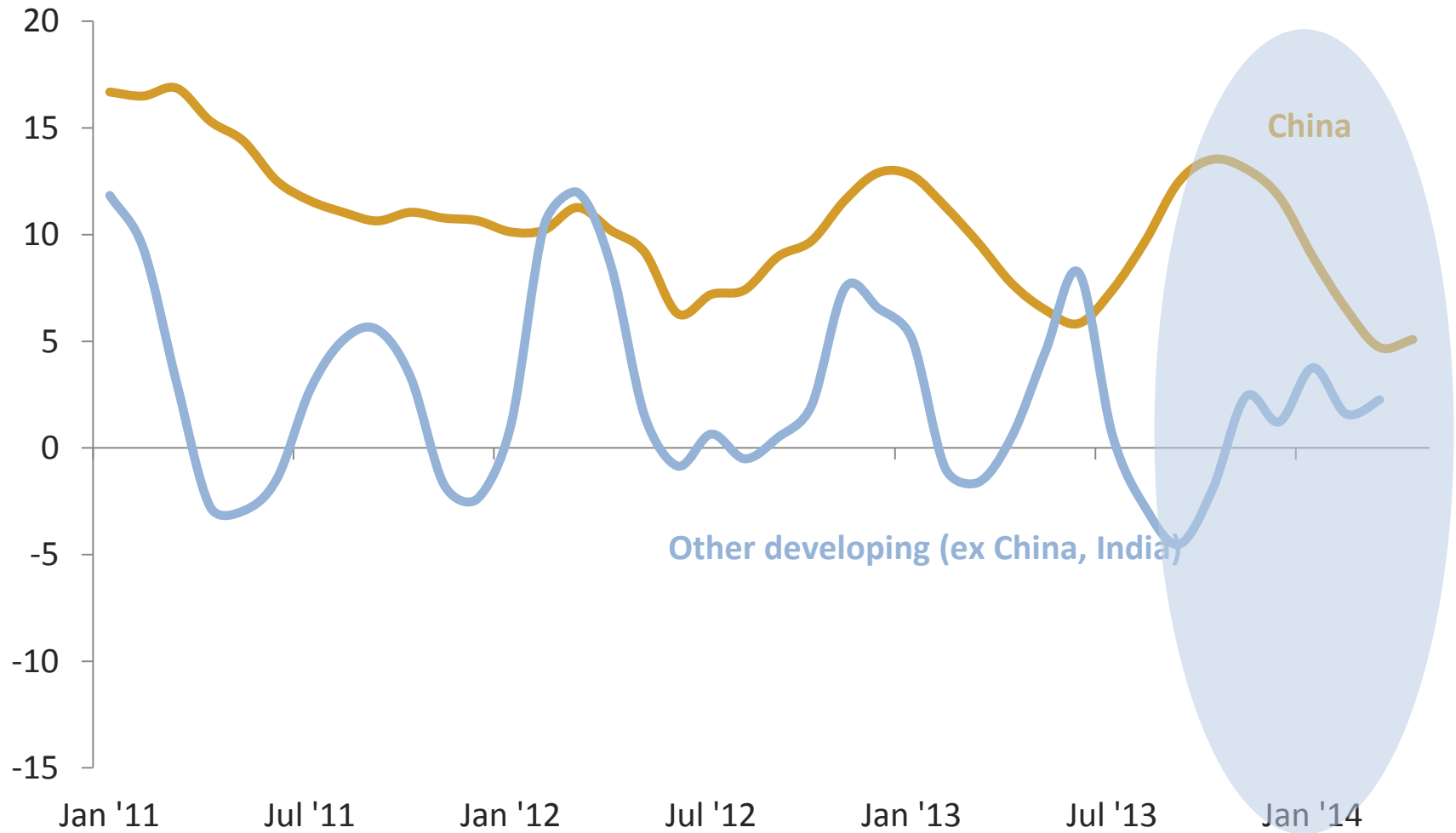
Source: World Bank, Markit, Haver Analytics.

Developing countries

- Real data still positive for most countries, but confidence measures have weakened— perhaps because of Ukraine
- Financial turmoil has eased, borrowing costs are up, but remain low
- Forecast is for modest pickup in growth
- Growth has been disappointing in some regions

First quarter growth in most developing countries about the same as 2013Q4

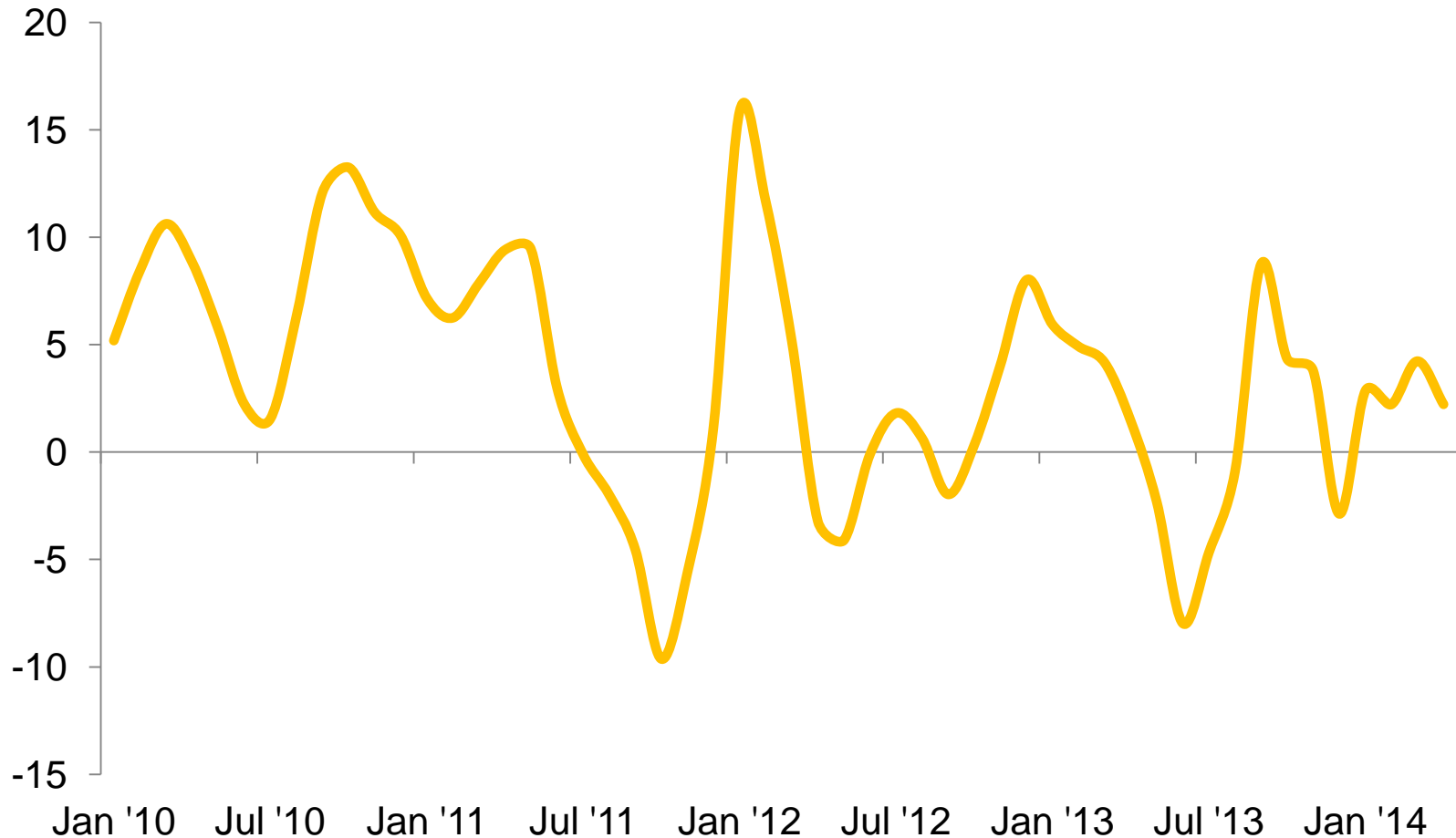
Industrial production growth, 3m/3m saar



Source: World Bank, Haver Analytics.

Regional industrial production appears to be stabilizing

South Asian Industrial production growth, 3m/3m saar



Source: World Bank, Haver Analytics.

Financial conditions have loosened since January in contrast to earlier expectations

- Most developing countries not affected by turmoil
- Capital flows have recovered
- Developing country yields have returned to fall levels, and are actually 55 basis points lower than before the crisis
- Market remains volatile, in part because rising rates will change portfolio decisions
- Vulnerabilities have declined but remain

Rather than rising further, developing country borrowing have declined

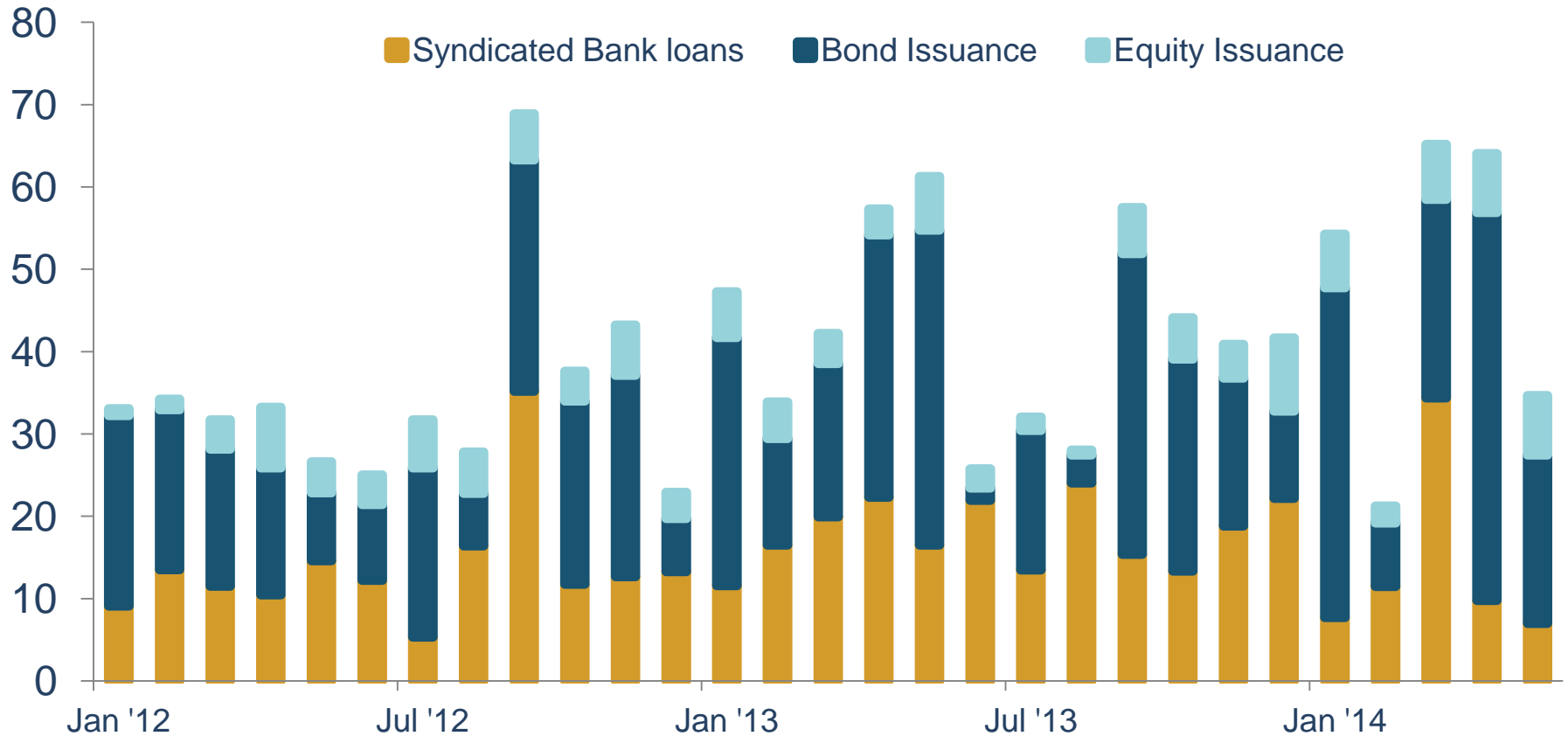
Yields on sovereign debt, basis points



Source: World Bank, JPMorgan, Haver Analytics.

Capital inflows declined abruptly in February, but recovered in March & April

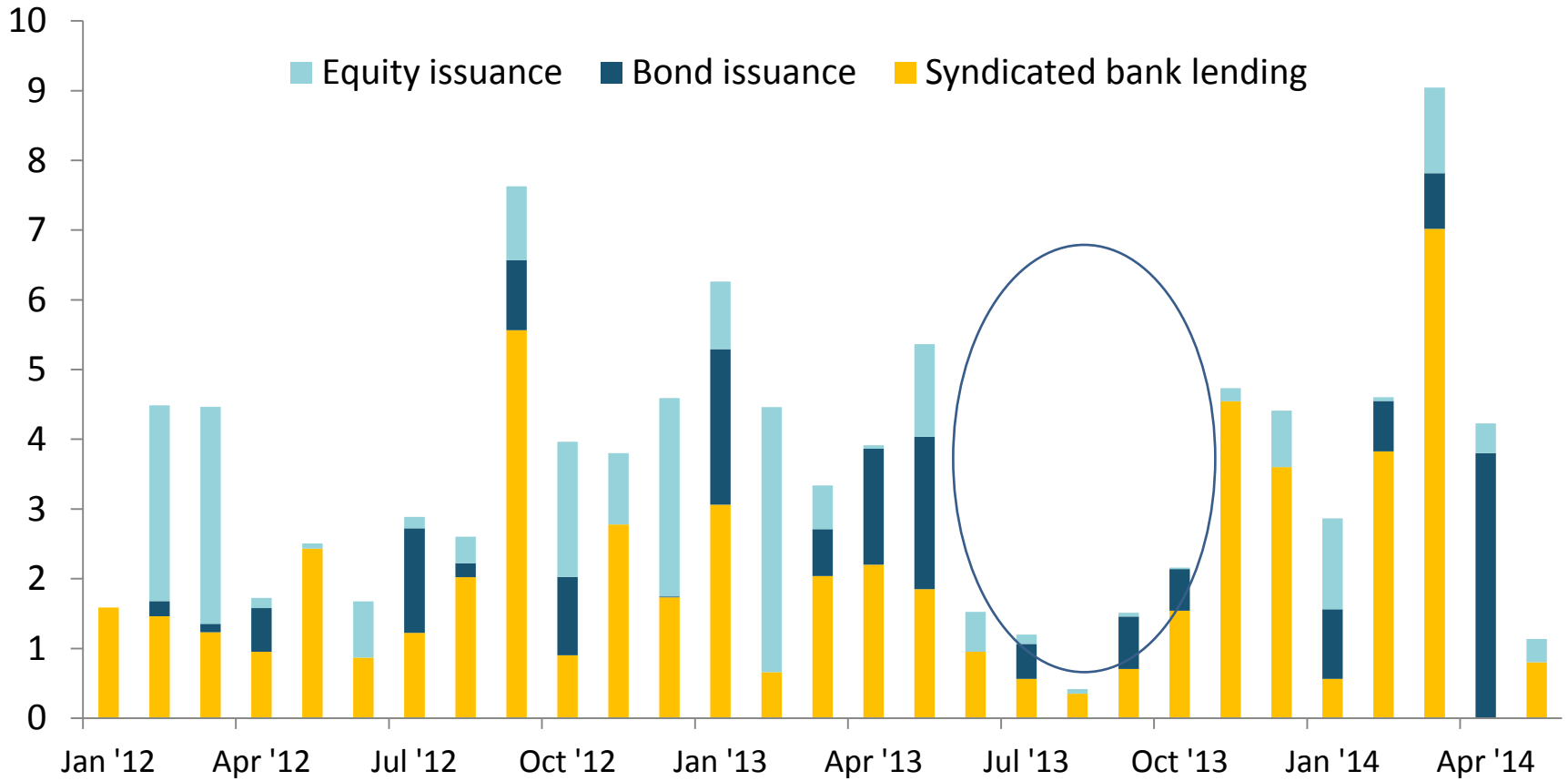
Gross capital flows, billions USD



Source: World Bank, Dealogic.

Gross capital flows to South Asia have also recovered

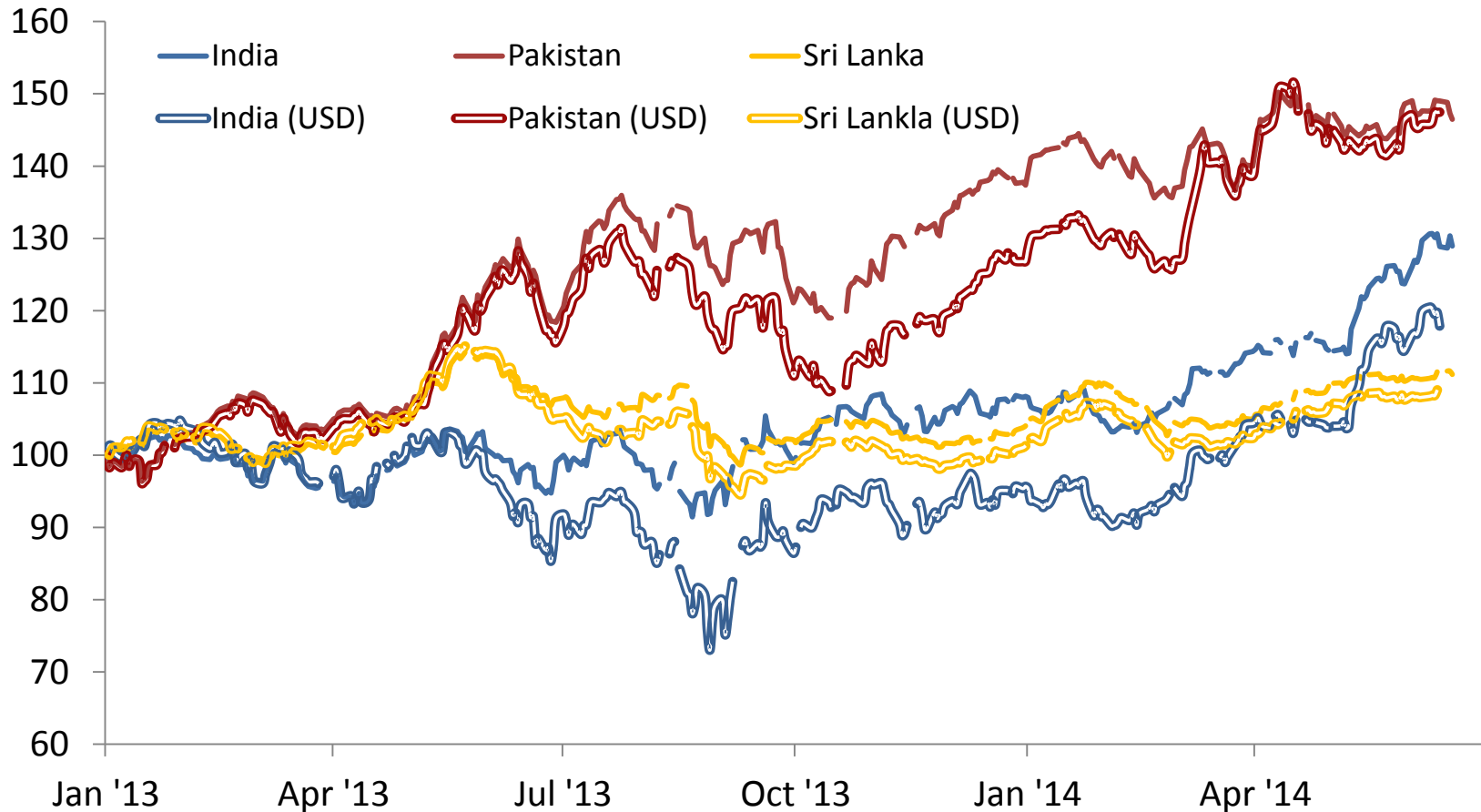
Gross capital flows, \$ billions



Source: World Bank and Dealogic

Local currency valuations of stock markets have recovered from last summer

Stock market valuations (USD, LUC), indexes, Jan 1. 2013=100



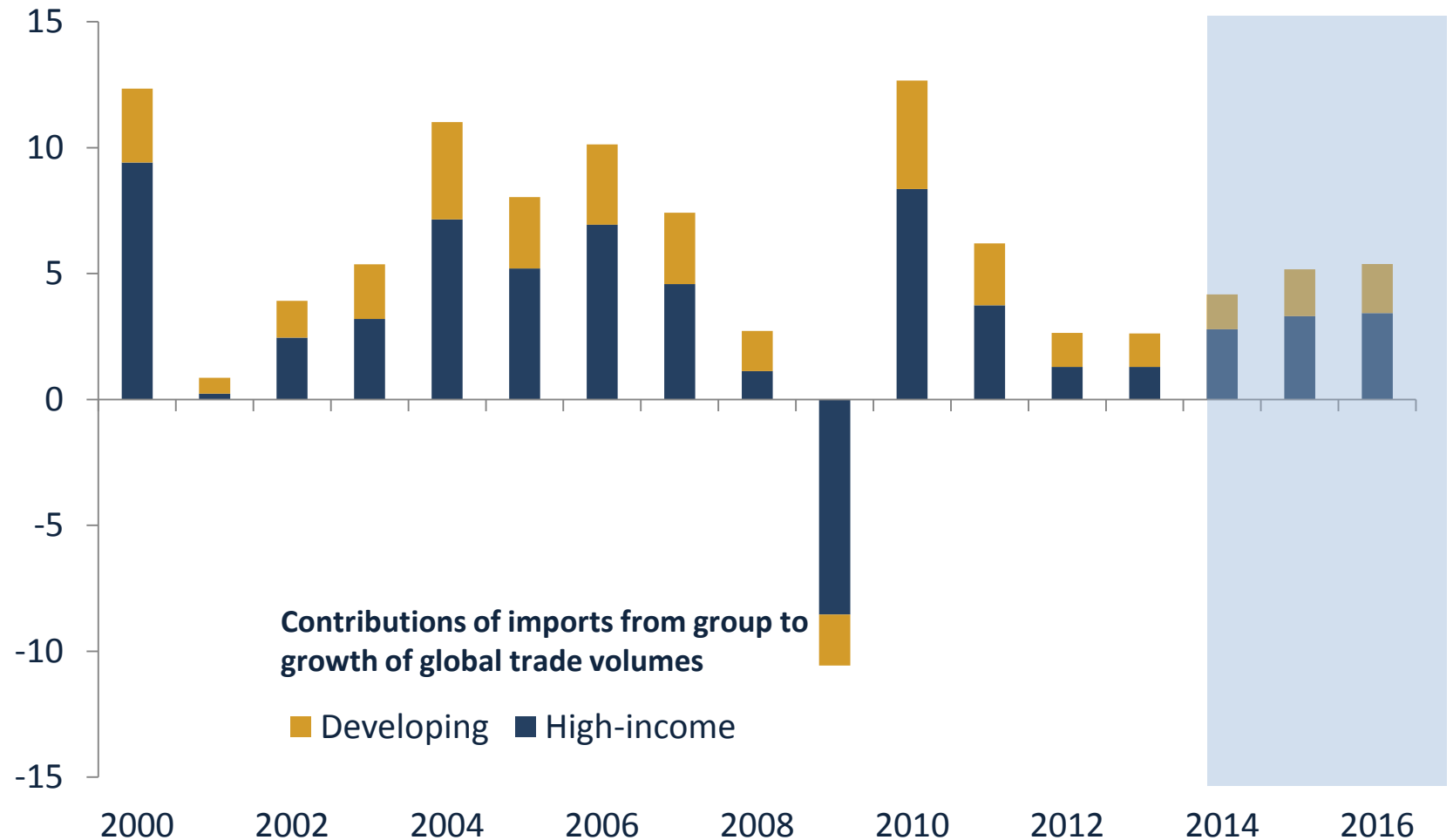
Source: World Bank and Dealogic

Tailwinds to support growth

- High-income acceleration will double their contribution to global import demand growth
- Growth impact of eventual tightening of financial conditions has been postponed
- Commodity prices are stable or falling (good for importers, modest headwind for exporters)

Contribution of high-income countries to global trade growth will more than double

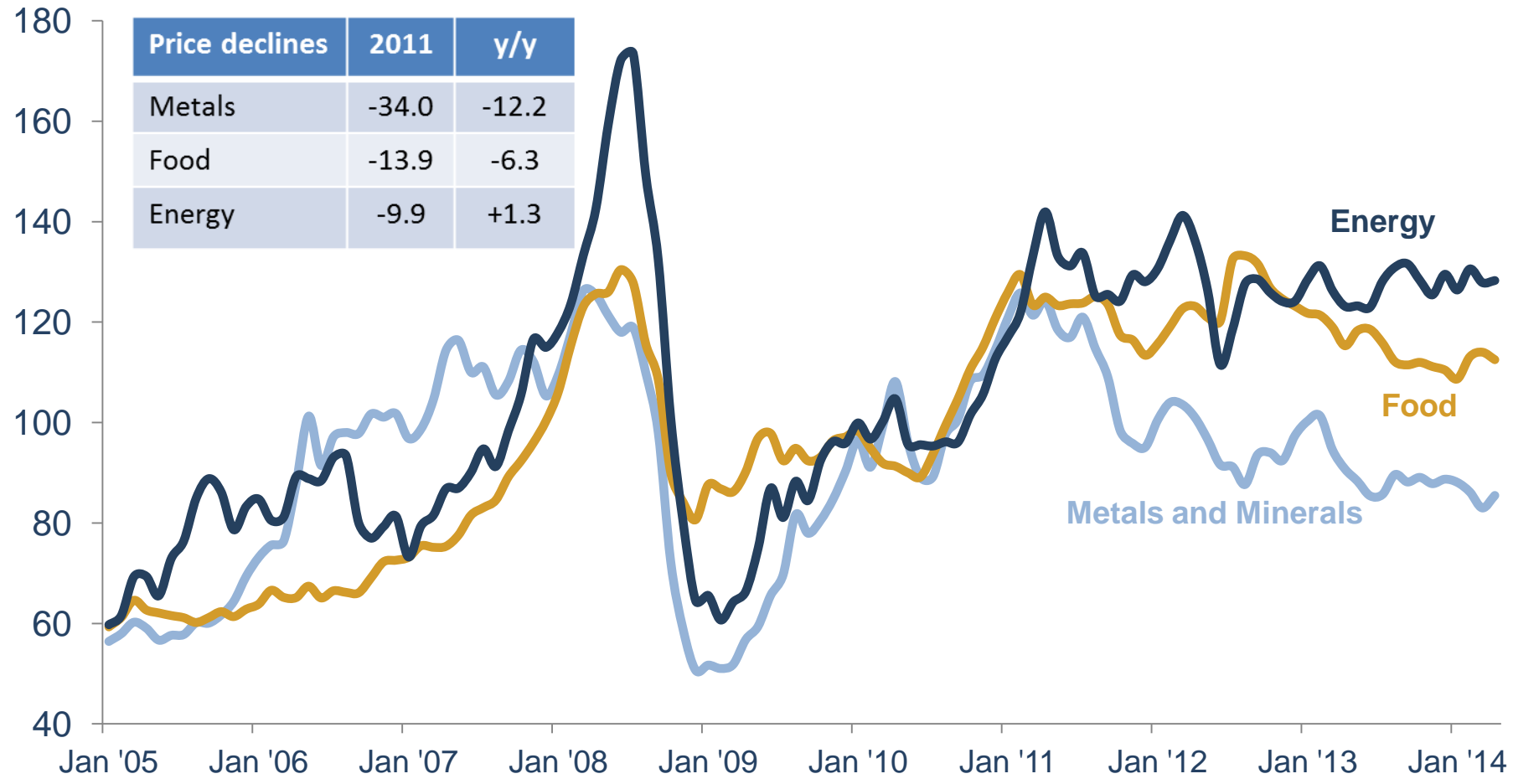
Contribution to annual growth of global trade



Source: World Bank.

Commodity prices are critical to region and expected to remain stable or decline

USD price of internationally traded commodities, index 2010=100



Source: World Bank.



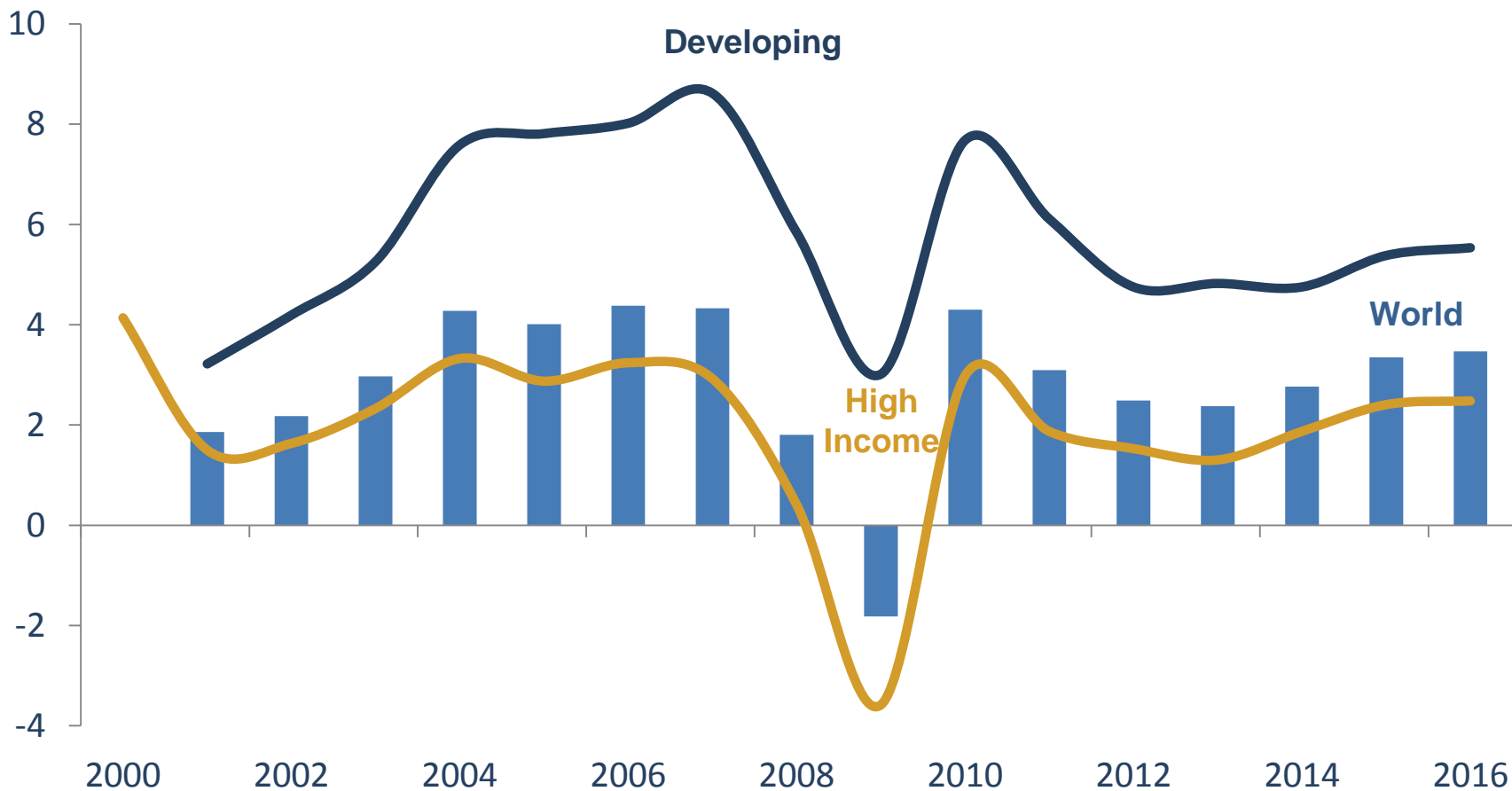
Outlook



- Projected pick up in growth to be led by high-income countries
- Developing-country growth in line with underlying potential
- Regional growth shows strengthening or stability going forward
- Slower growth in middle-income countries may reflect weaker than thought potential

A gradual pick up in growth, led by high-income countries

Percent annual GDP growth



Source: World Bank.



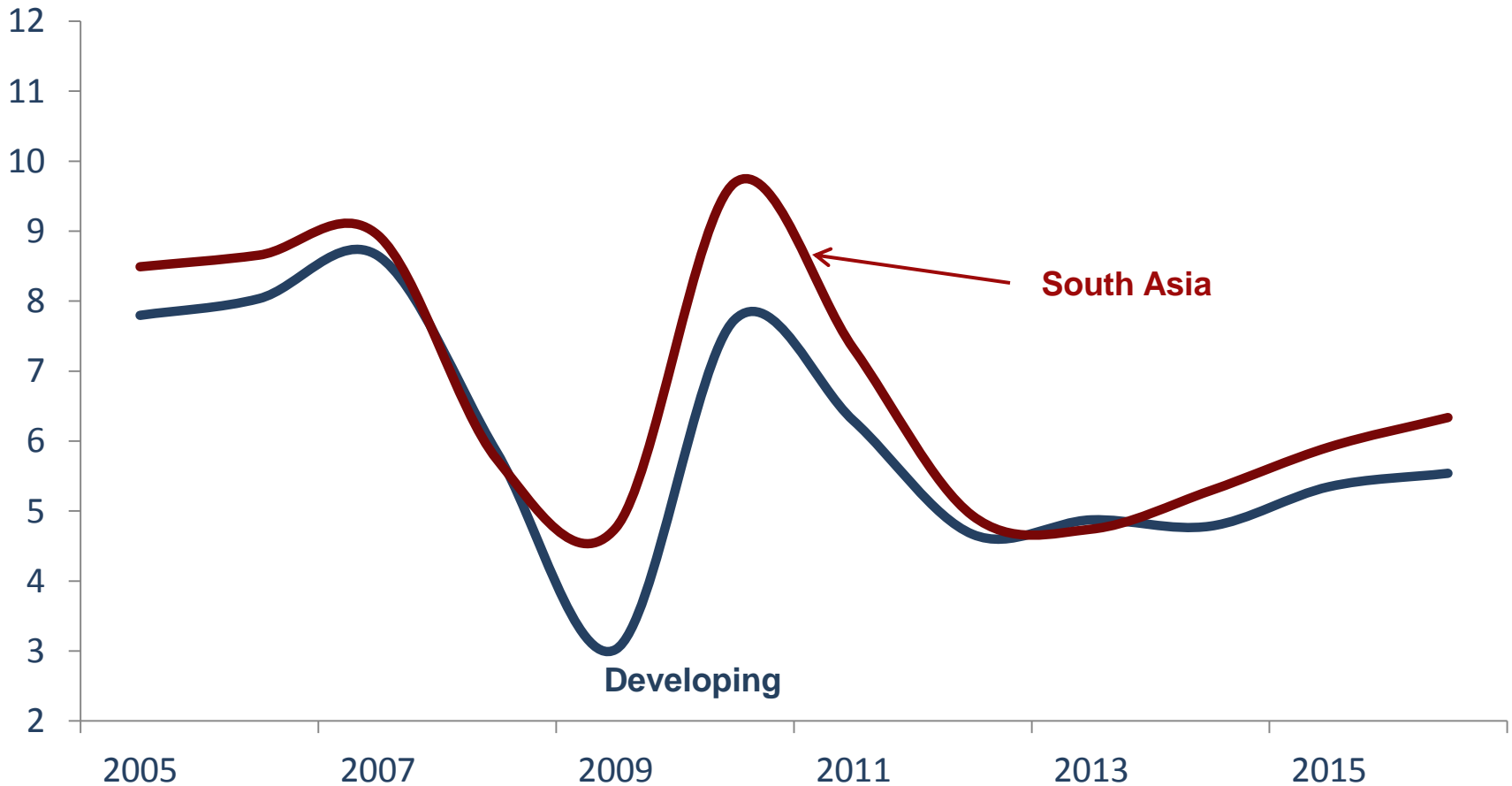
Regional Outlook



- Medium-term outlook for the region is for growth to remain flat in 2014 and pick up moderately in 2015 and 2015.
- Growth is projected to remain weak in South Africa, owing to tight monetary policy, tense labor relations, and electricity constraints.
- Excluding South Africa, outlook is for growth to remain robust in the rest of the region, with FDI flows in the natural resources sector, public investment in infrastructure, expansion in agriculture, and firming external demand as key drivers of growth.
- Mozambique's GDP is projected to grow faster than the regional average, supported by strong investment and production in the coal sector.

Despite slowdown, South Asia continues to outperform developing country average

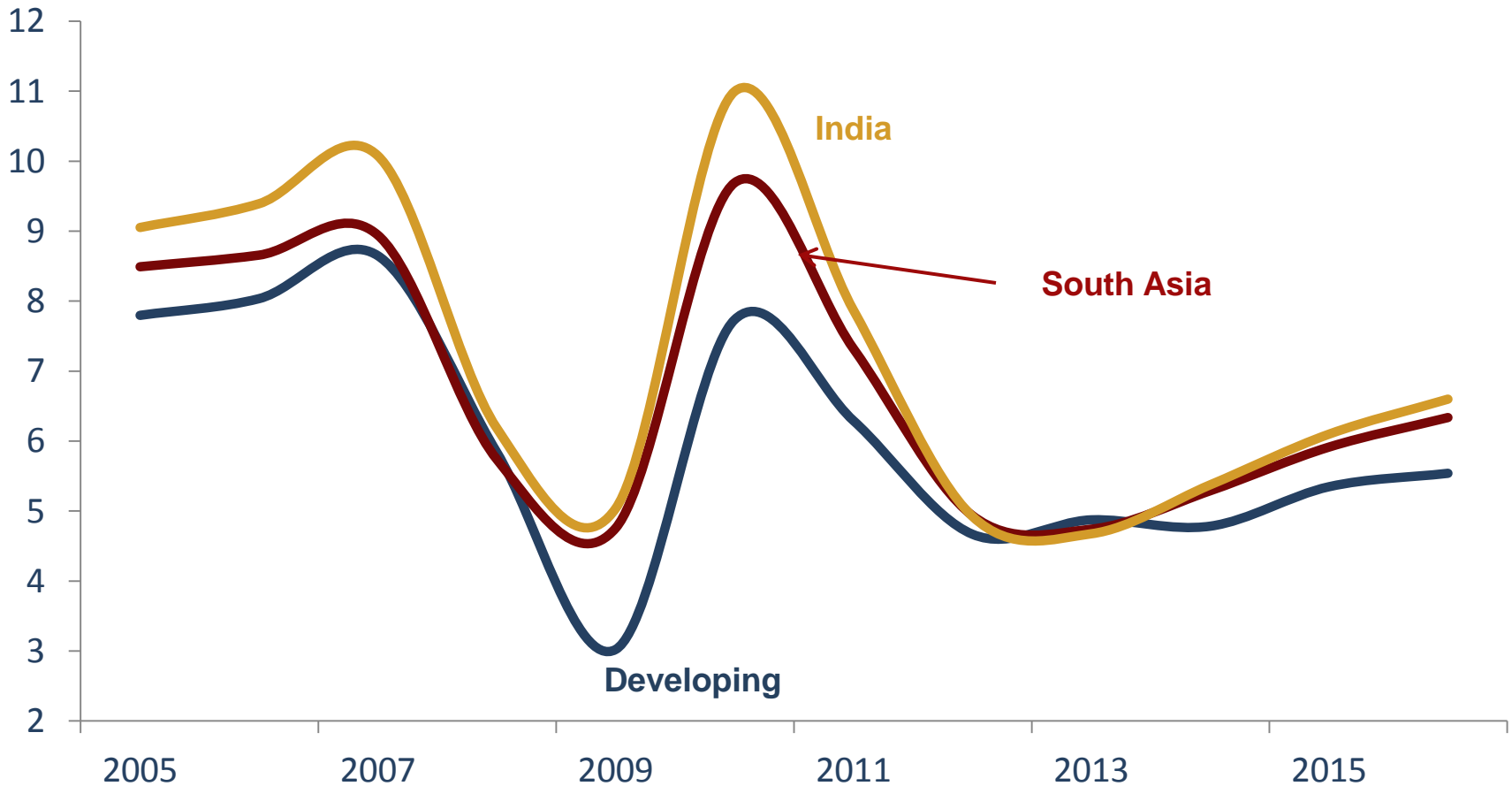
Percent annual GDP growth



Source: World Bank.

Despite slowdown South Asia continues to outperform developing country average

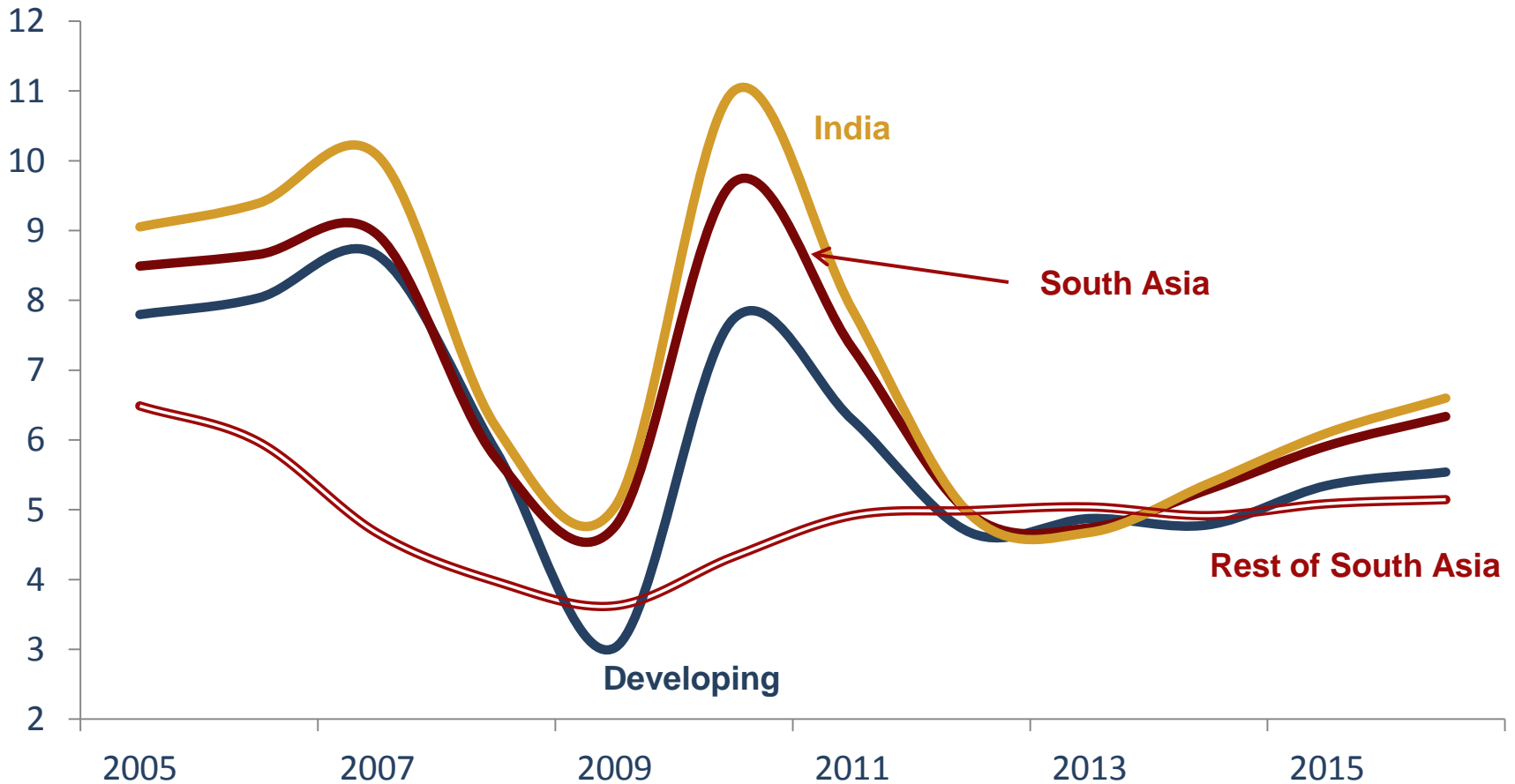
Percent annual GDP growth



Source: World Bank.

Despite slowdown South Asia continues to outperform developing country average

Percent annual GDP growth

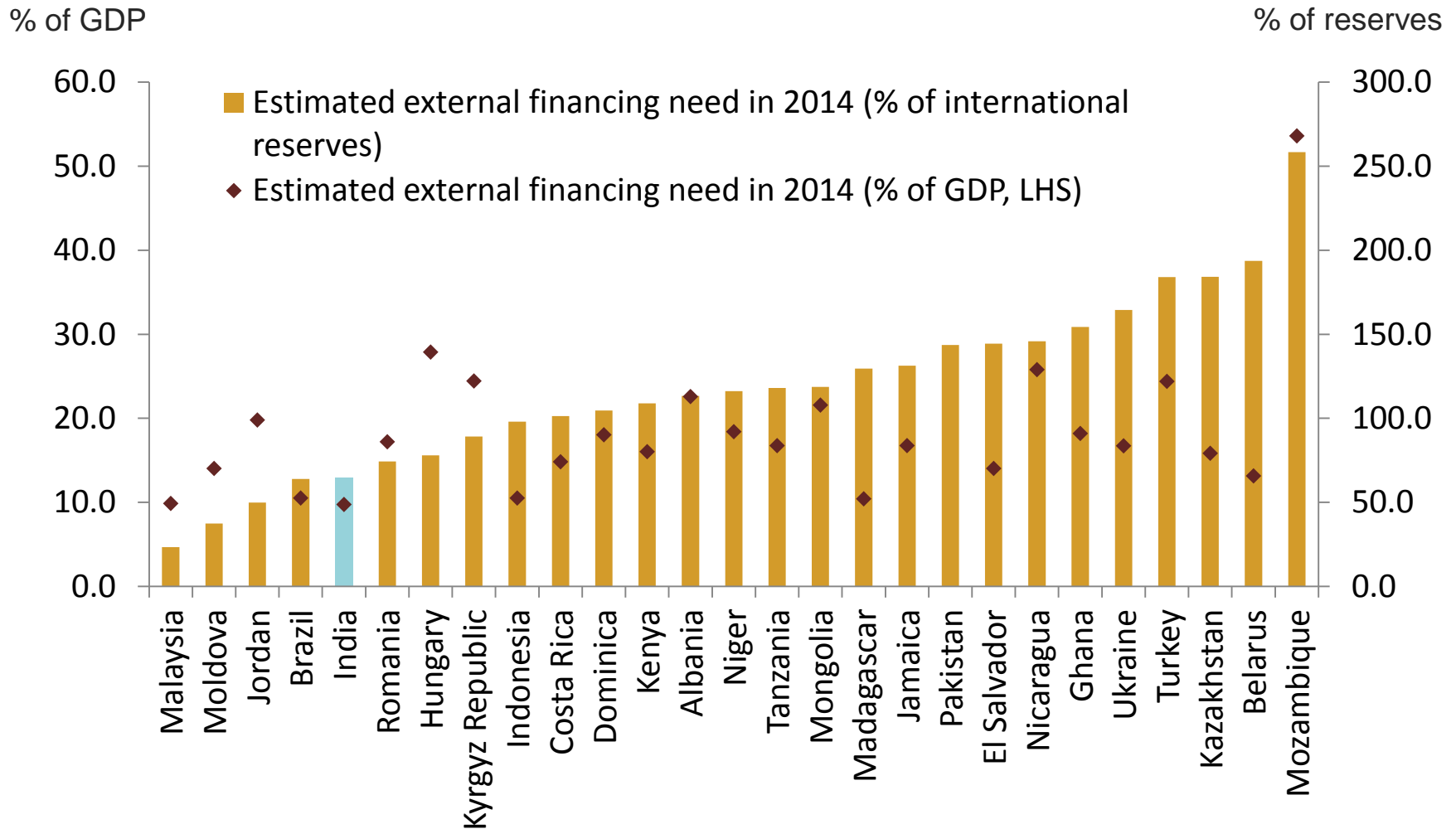


Source: World Bank.

Risks

- Today's loose financial conditions could regenerate vulnerabilities (longer term they will tighten, increasing weaker financial flows, higher capital costs).
 - Fiscal conditions have deteriorated
 - External financing requirements have risen
- A key near term risk for the region is weak monsoon rains due to El Nino weather conditions.
- Longer term growth has to come from structural reforms: improving education quality; health and infrastructure.

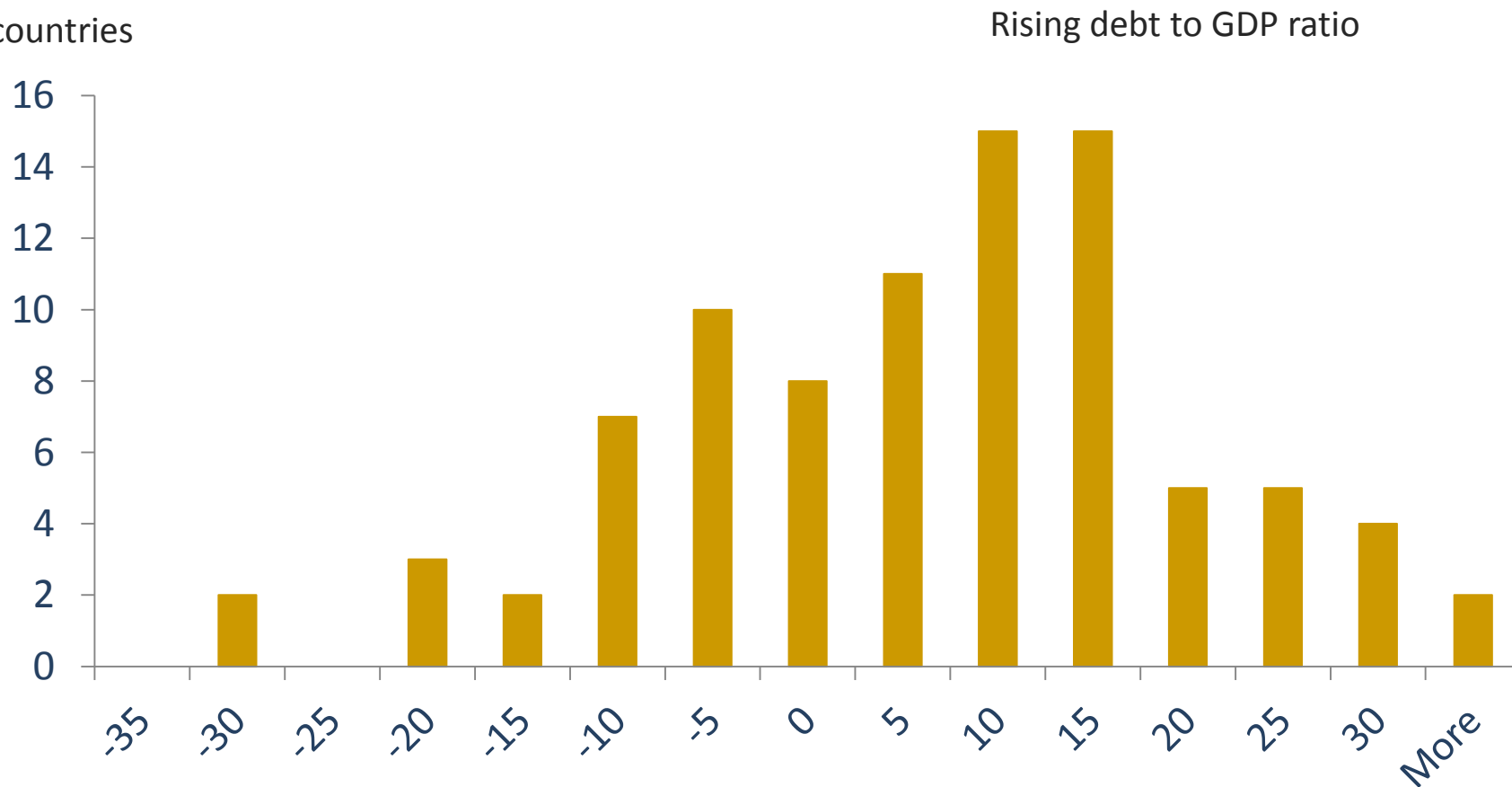
Financial vulnerabilities have declined but remain



Source: World Bank

Partly as a result, developing country debt to GDP ratios have been rising

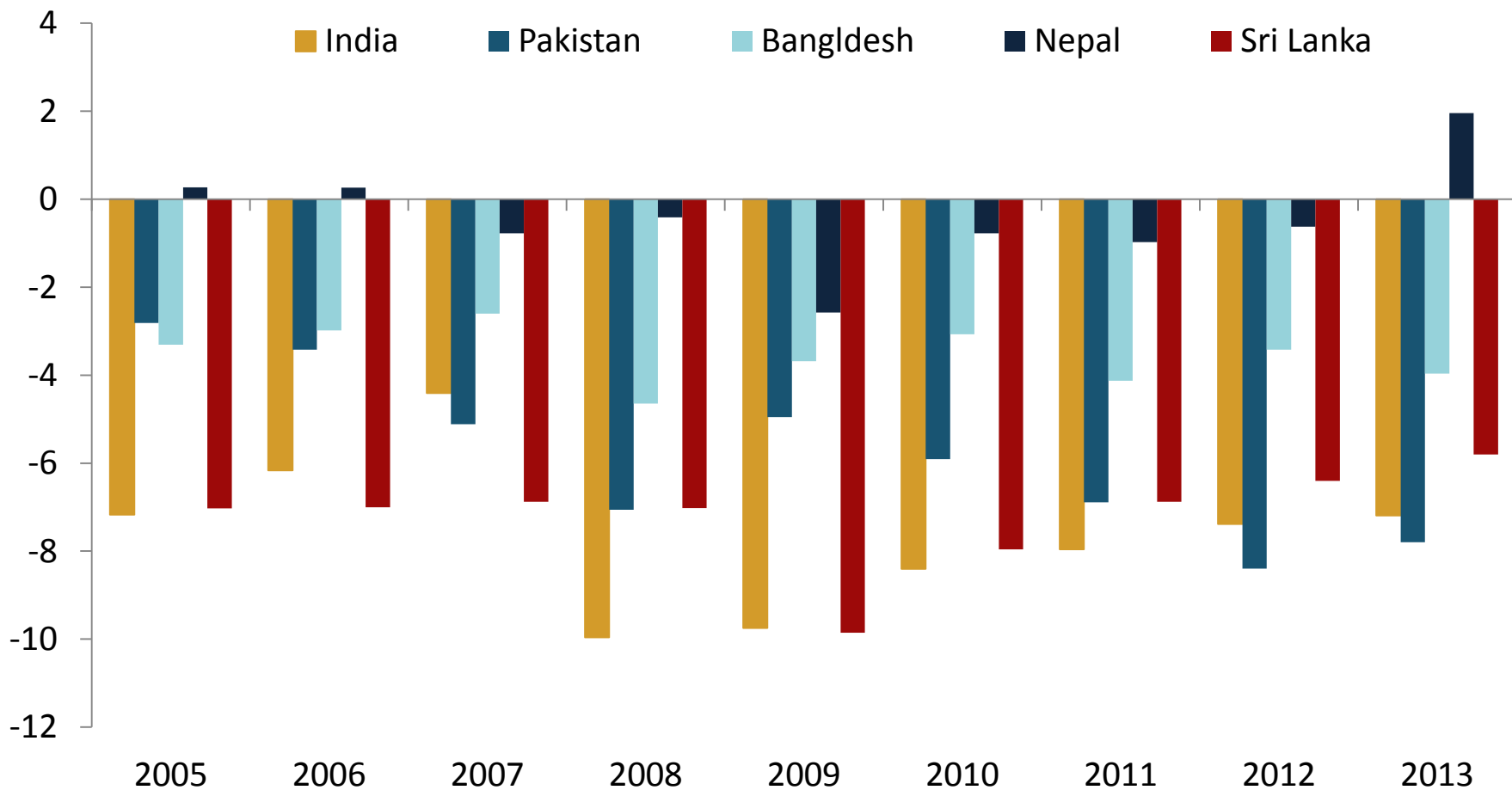
of countries



Source: World Bank.

Fiscal deficits have declined but remain high

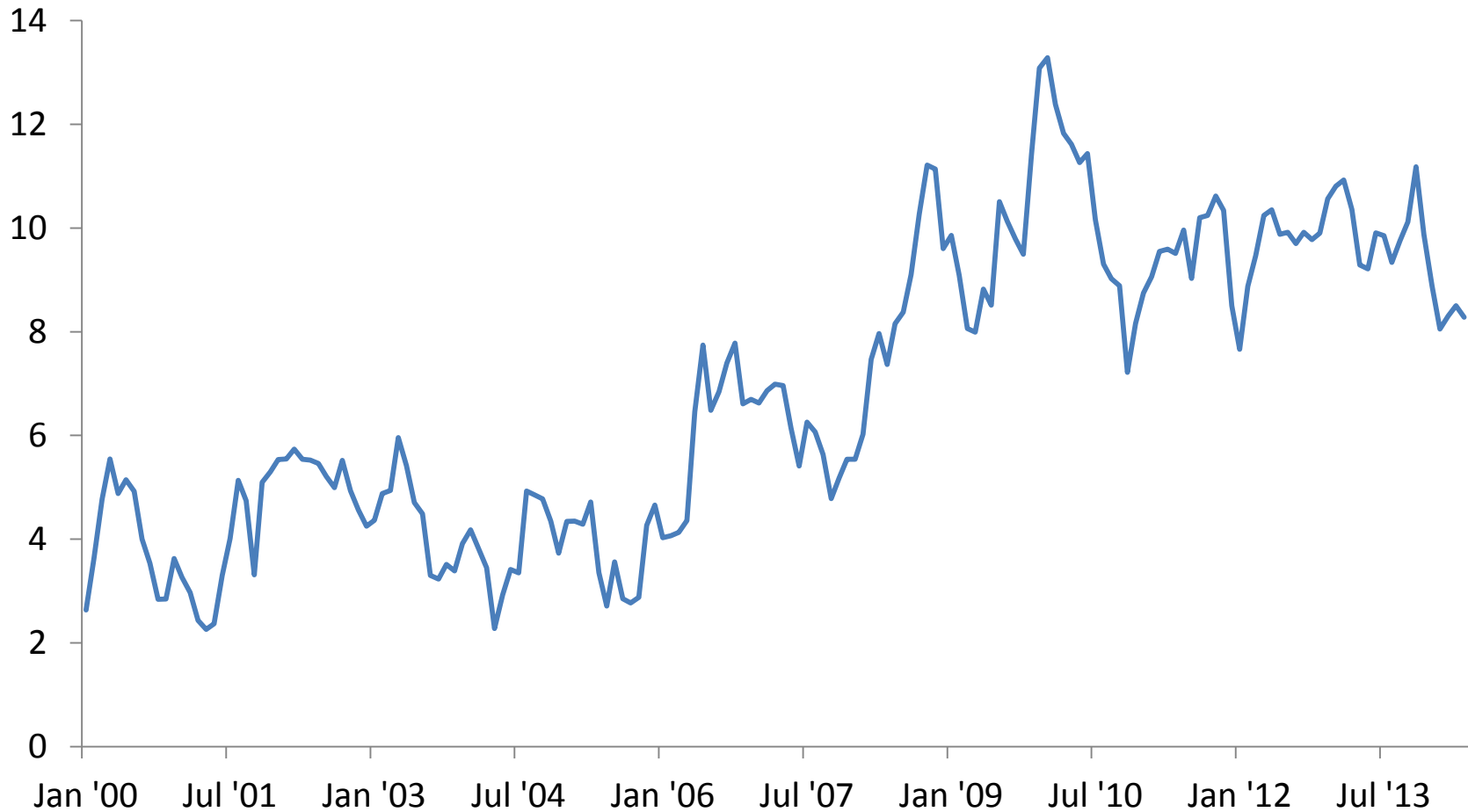
General government balance, % of GDP



Source: World Bank

Inflation in India has eased somewhat, but remains high

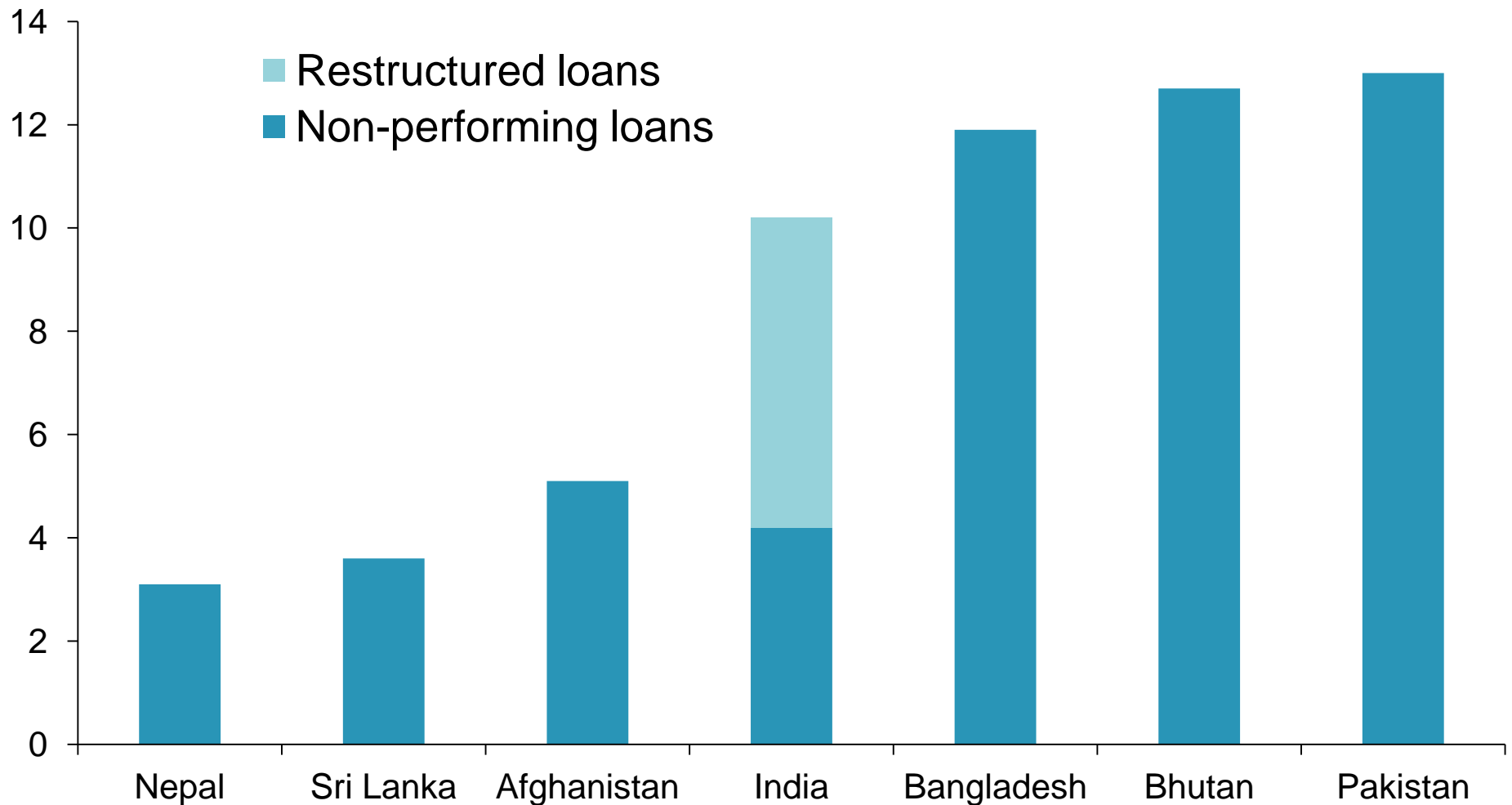
Inflation y/y, percent



Source: World Bank, Haver, national sources

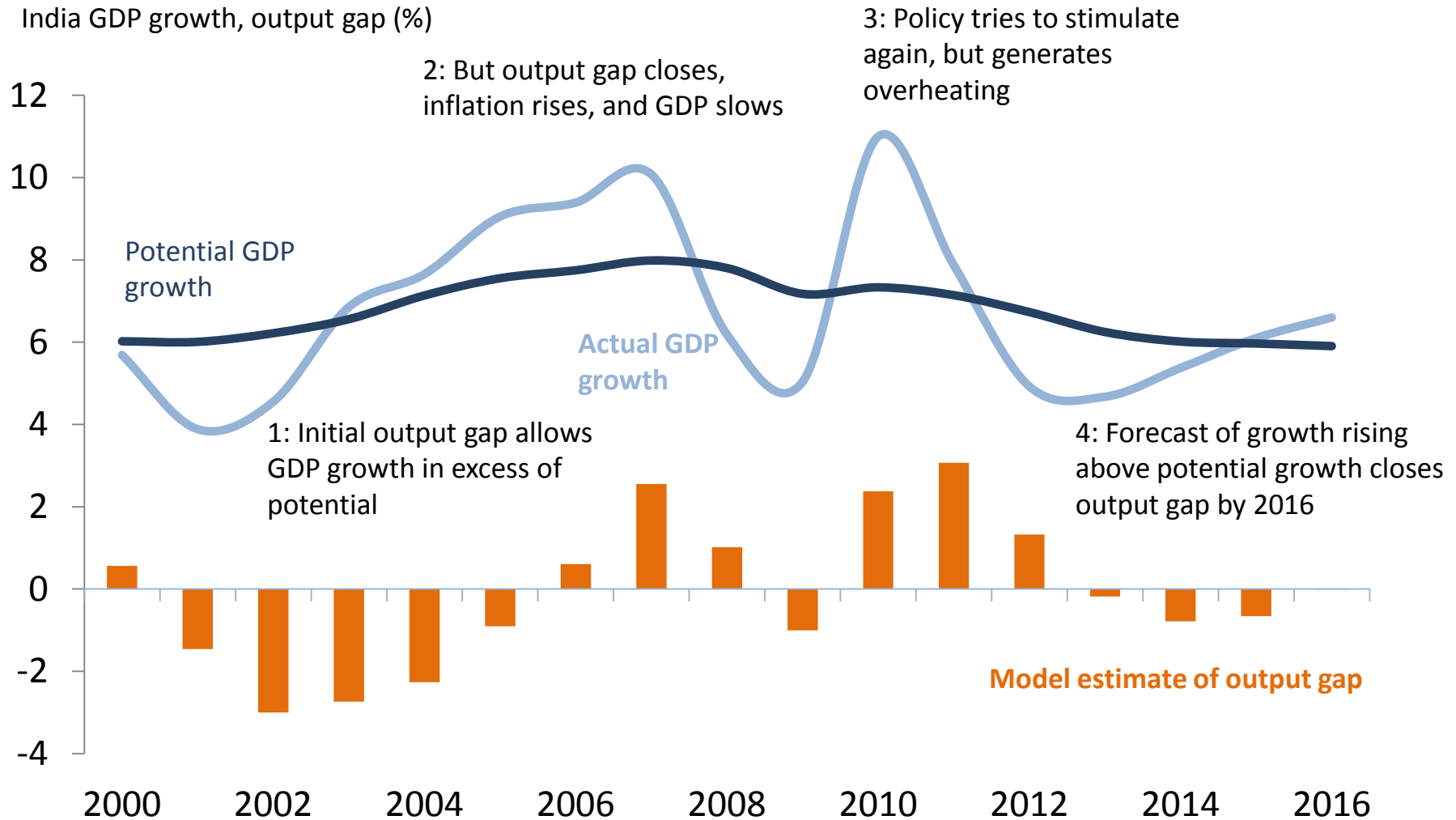
Stressed loans (including restructured loans) are more than 10 percent of total loans in four South Asian countries

Stressed loans as percent of total loans (H2 2013)



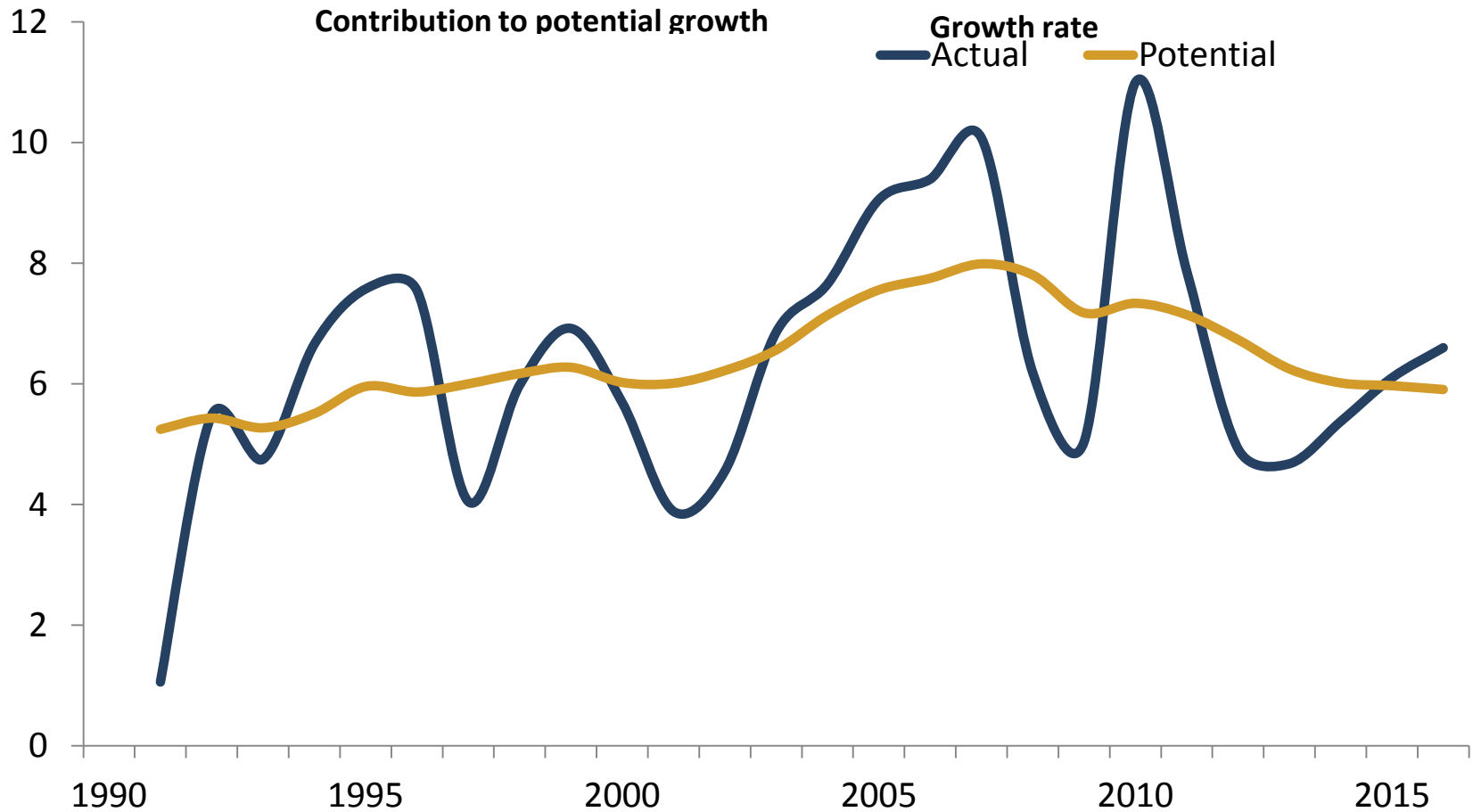
Source: IMF and World Bank estimates based on national sources

Structural policies will be key for sustaining stronger growth



Decomposing potential output

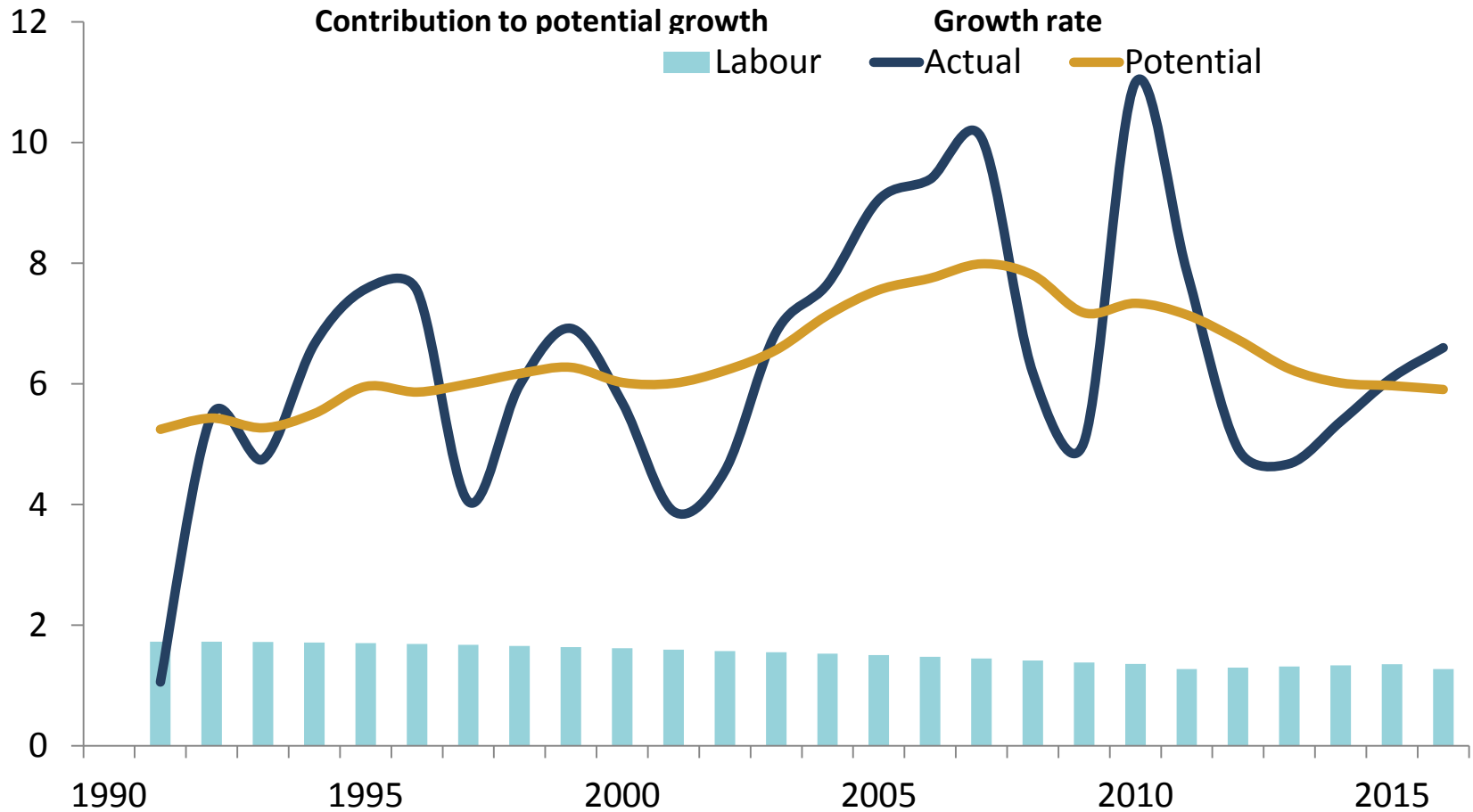
GDP and potential Growth, and contributions to potential, percent



Source: World Bank.

Decomposing potential output

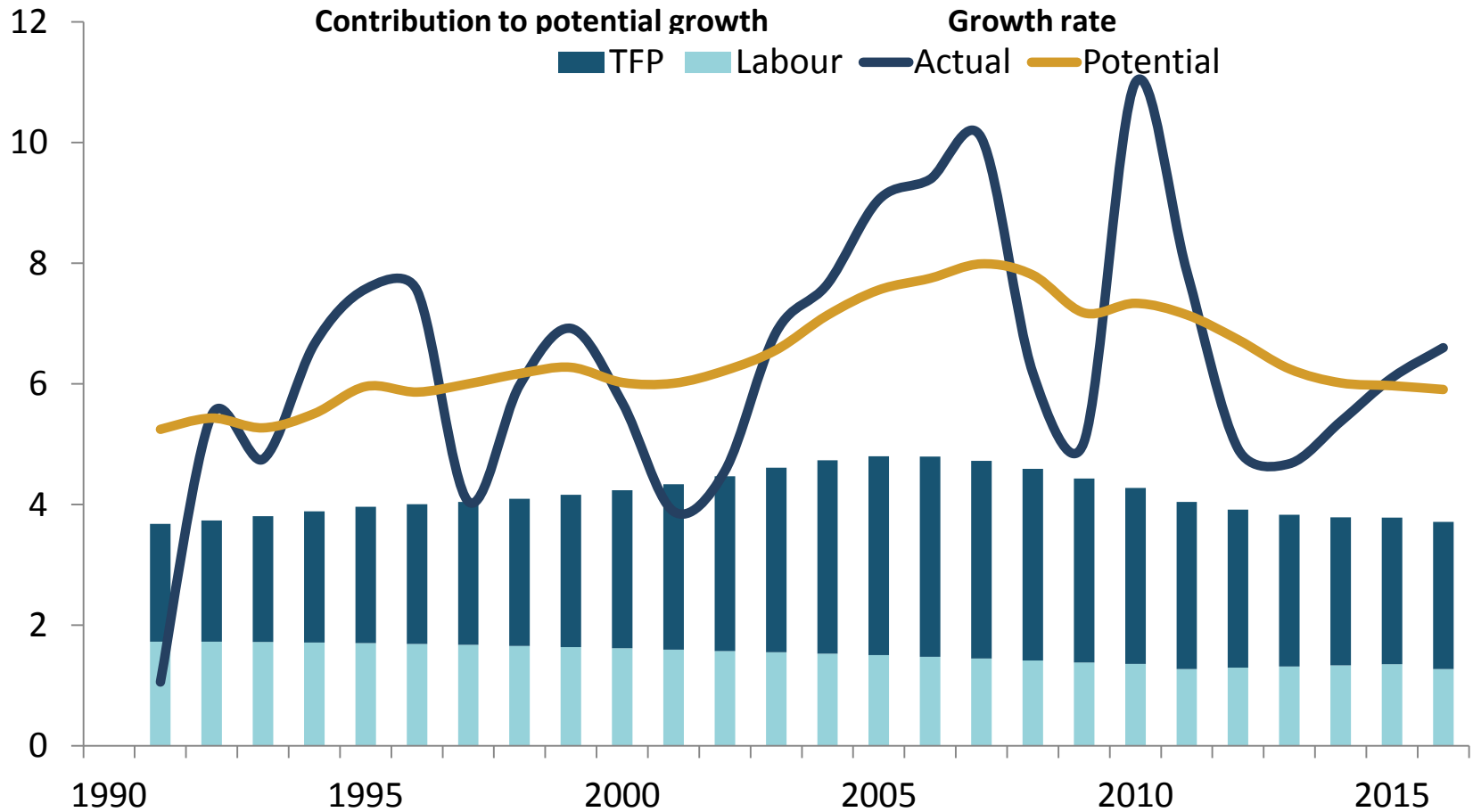
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Source: World Bank.

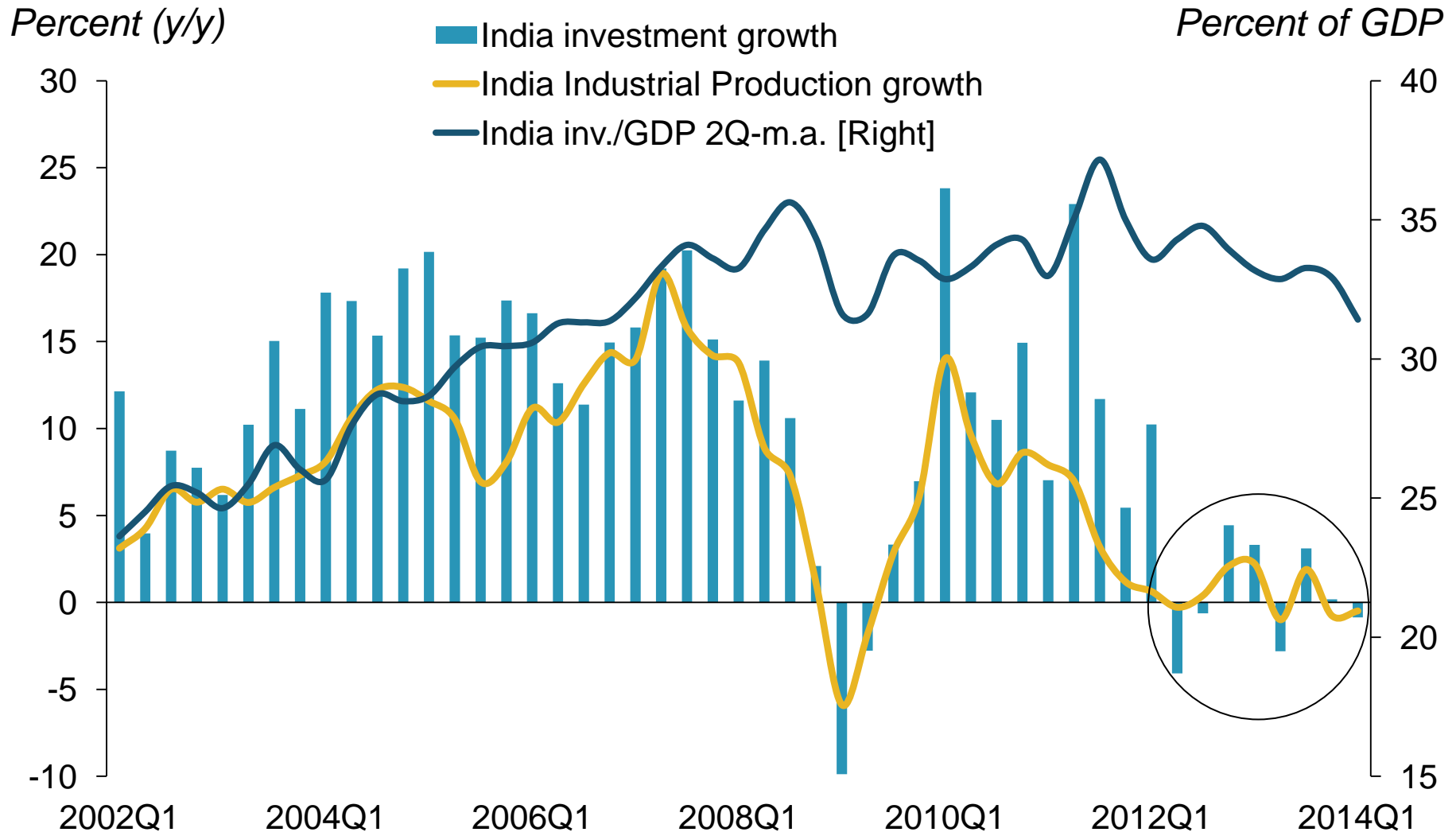
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GDP and potential Growth, and contributions to potential, percent



Source: World Bank.

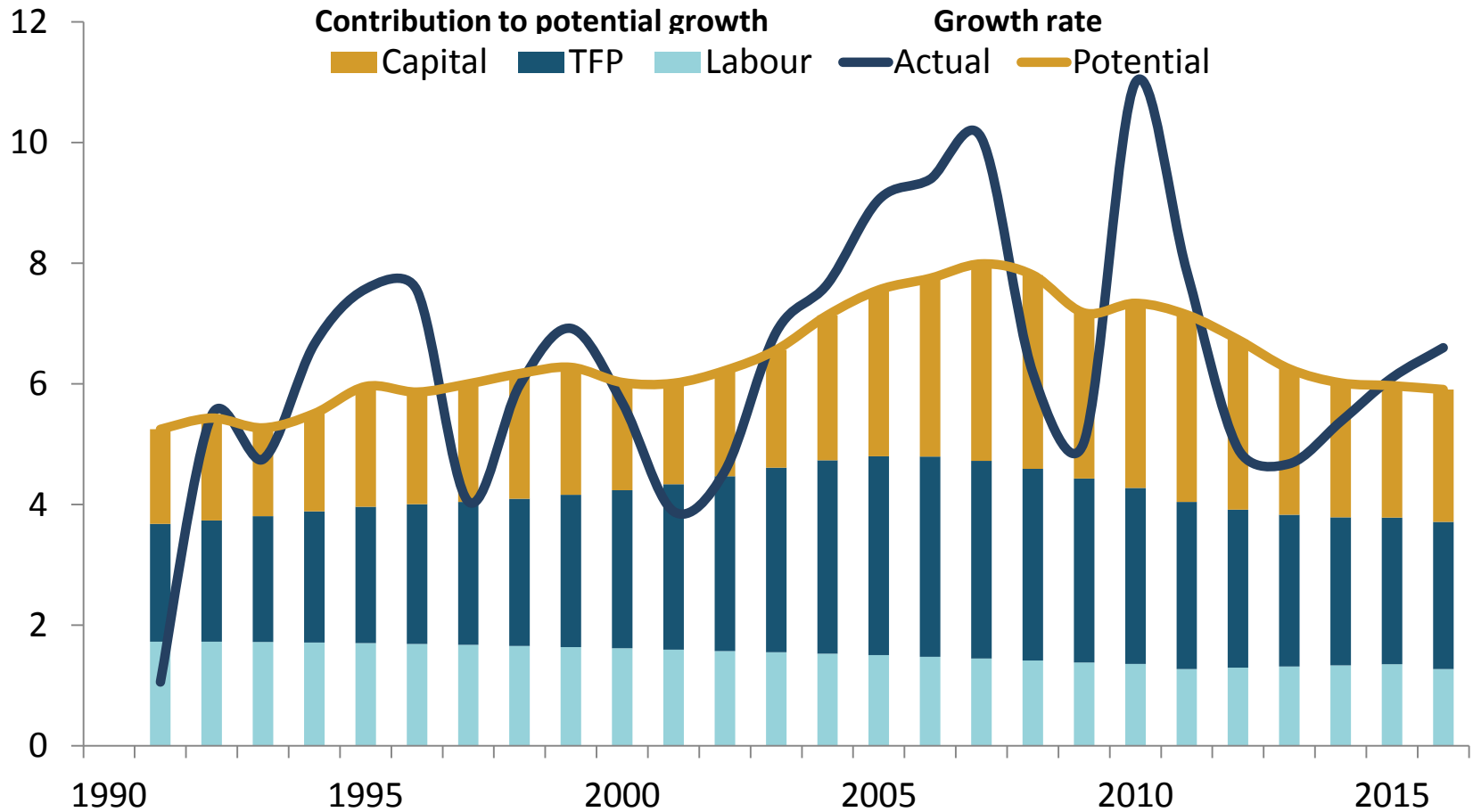
Investment growth in India slowed sharply since 2012, dragging down the investment rate (as % of GDP) and overall GDP growth



Note: Investment excludes acquisition of valuables such as gold

Decomposing potential output

GDP and potential Growth, and contributions to potential, percent



Source: World Bank.

Concluding remarks

- Downgrade in 2014 growth mainly explained by weak first quarter and situation in Ukraine
- Looser than expected financial conditions now could mean faster tightening in the future
- Developing country growth has disappointed for 3 years running – reinforcing the need to focus on structural policies to speed growth
- Vulnerabilities have declined but remain, macro cushions should be gradually rebuilt

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