SOUTH ASIA

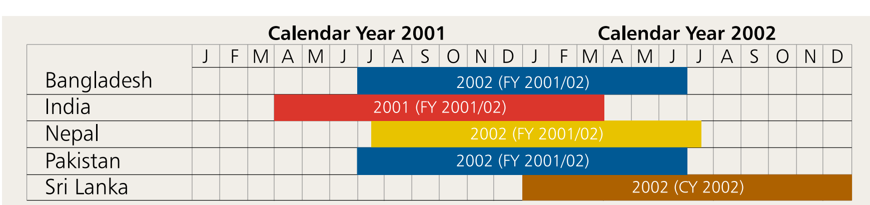
South Asian economic performance has been negatively affected by abnormal weather patterns, the global slowdown, and security concerns. Expansionary fiscal policies and accommodative monetary policies have helped partly counteract those influences. With expectations of mild global recovery and more normal weather, the subregion's performance should continue to improve, although at a more subdued pace than previously expected.

MACROECONOMIC ASSESSMENT

Economic growth and development in South Asia are less dependent on trade and capital flows than in East Asia or Southeast Asia. However, the relatively large share of agriculture in output and employment makes the subregion more dependent on the vagaries of the weather. In Afghanistan and Pakistan, the disruptions connected with military operations in the former play an important role, while internal security concerns are more prominent in Nepal.

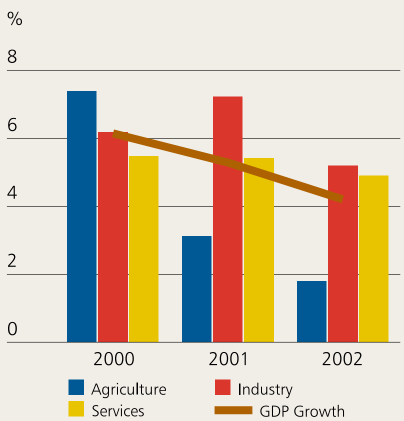
In South Asia, both floods and drought have impaired agricultural production, while the global economic slowdown has lowered export performance for the countries with a fiscal year ending in June 2002.[1] Political unrest and conflicts are also taking their toll. Consequently, real GDP growth in the subregion is now expected to be about 3.9% for 2002, well below the *ADO 2002* forecast of 5.4%. Afghanistan is an exception, since a sharp production rebound, which could easily be of 10% or more from the current deteriorated economic base, is expected. In Bangladesh, real GDP growth for 2002 (year ended June 2002) is expected to have moderated to 4.2% from 5.2% in 2001 due to lower agriculture sector growth and a slowdown in exports. In India, real GDP grew by 5.4% in 2001 (year ended March 2002), up from 4.0% growth in 2000. Manufacturing GDP grew by only 2.8% in 2001, compared to 6.7% in 2000, while growth rates of 5% or more were

[1] 2001 refers to fiscal year 2001/02, ending on 20 March, in Afghanistan and on 31 March in India; 2002 refers to fiscal year 2001/02, ending on 30 June in Bangladesh and Pakistan, and on 15 July in Nepal. In Sri Lanka, the fiscal year coincides with the calendar year. See the graphic below for a visualization of the overlapping fiscal years.



Bangladesh sector growth remains depressed.

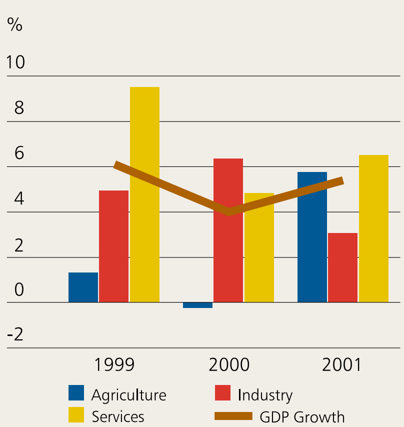
GDP Growth by Sector, Bangladesh, 2000-2002



Sources: ADO database; staff estimates.

With a significant improvement in the agriculture sector, the Indian economy recovers.

GDP Growth by Sector, India, 1999-2001



Sources: ADO database; www.nic.in.stat.

achieved in agriculture, forestry, and fishing; and services sectors (trade, hotels, and transport and communications; financing, insurance, real estate, and business services; and community, social, and personal services). More significant recovery is now also evident in the services sector, and to a lesser extent, in manufacturing. However, expectations that the mild recovery of a few months ago would be sustained have been belied by drought conditions that are prevailing in many parts of India as a consequence of delayed monsoon rains. Now, floods will also affect 2002 output (year ending March 2003).

The continued escalation of the insurgency, the irregular monsoon, and weak external demand have further exacerbated the economic downturn that Nepal has been facing since June 2001. These disruptions have adversely affected the performance of several key sectors, such as manufacturing, tourism, and exports. Real GDP growth is estimated to have fallen sharply from 4.7% in 2001 to 0.8% in 2002 (year ending July 2002). Meanwhile, the economy of Pakistan demonstrated great resilience during 2002 in the face of external shocks generated by the September 2001 attacks in the US, subsequent military operations in Afghanistan, heightening tensions with India, and the global slowdown. The real GDP growth rate was estimated at 3.6% in 2002 (year ending June 2002) compared to 2.5% in 2001 and the *ADO 2002* estimate of 3%. The improvement in GDP growth performance was mainly due to the agriculture sector, which performed better than in the previous year, despite a continuing drought. Growth in the agriculture sector in 2002 is estimated at 1.4% in contrast to a contraction of 2.6% in 2001. In the first quarter of 2002, the Sri Lankan economy grew marginally by 0.1%, an improvement when compared to a contraction in the latter half of the previous year. The impact of some of the negative phenomena of 2001, such as severe drought, prolonged power cuts, and low global economic growth that continued in the first few months of 2002, has ameliorated. The agriculture sector, which had been affected by drought, recovered during the first half of the year. However, the sluggish growth in the economies of Sri Lanka's main export markets—the US and EU—adversely affected manufacturing and industrial growth, with both exports and imports declining considerably in the first half of the year.

The fiscal arena remains a major area of concern in South Asia, with large fiscal deficits commonplace. In Bangladesh, during January–June 2002, a rigorous mobilization drive, effective monitoring and enforcement, and a moderate pick-up in domestic production partly offset the subdued performance in customs duty and other import-based taxes due to the decline in imports. Nevertheless, given the unfavorable external environment and political transitions in the country during the year, overall revenue growth in 2002 at 14.5% still only brought the total to 9.6% of GDP, which was below target. However, the lower revenue intake was more than offset by cuts in both current and annual development program expenditures. As a result, the overall fiscal deficit for 2002 was reduced to 4.4% of GDP from the projected level of 5.5%. India experienced a shortfall of 4% in total revenue receipts in 2001 compared to the original budget estimate. This pushed the central Government's fiscal deficit to 5.7% of GDP, against the budgeted target of 4.7%. Fiscal imbalances at the state level are equally a cause for concern. The ratio of the states' outstanding debt to GDP is now estimated to be 25.6% and the combined fiscal deficit of the central and state governments amounts to almost 10% of GDP. The resulting heavy recourse to market borrowing by the central and state governments has continued to place upward pressure on real interest rates. In Nepal, the sharp deceleration in economic growth in 2002 has had a major negative impact on the Government's fiscal position. As a result of disruptions to manufacturing, a fall in imports, and a sharp downturn in tourism, revenue collections were less than 12% of GDP, below the budget target of about

13%. While recurrent expenditures and the fiscal deficit were maintained in line with budget targets, development spending fell sharply and domestic borrowing increased significantly.

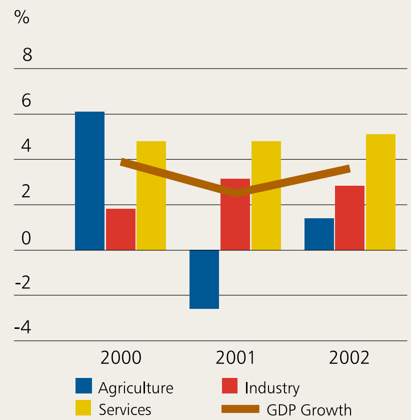
Security concerns also had large fiscal implications for Pakistan. Consolidated expenditures of the federal and provincial governments rose by 20%, while revenues improved by only 12%. As a result, the fiscal deficit in 2002 is estimated to be 7% of GDP (or 5.7% after adjusting for one-off expenditures incurred in 2002, including bonds issued to public sector banks to settle past income-tax refund claims and an equity injection into the Karachi Electric Supply Corporation). Development expenditures showed a large increase of 35% over 2001, but fell still short of the budget target. Current expenditures increased by 6.2%, mainly due to higher defense spending. Government revenues strengthened in 2002, mainly on account of large rises in nontax revenues and surcharges on petroleum and gas. Nontax revenues surged by 52%, due to large payments received for the use of the country's civil aviation facilities by the coalition forces for operations in Afghanistan, while receipts from surcharges increased by 47%. In Sri Lanka, the fiscal deficit target of 8.5% of GDP is unlikely to be achieved due to the shortfall in tax revenues occurring as a result of the sharp decline in imports and price reduction measures introduced by the Government in July 2002.

Monetary policy has remained generally accommodative in South Asia, to facilitate economic expansion. However, lack of confidence among investors has also failed to lead to significant growth in private sector borrowing. In Bangladesh, although monetary conditions remained loose, the rate of money supply (M2) growth declined to 13.1% in June 2002 from 16.6% in June 2001. Notwithstanding a recent increase in government borrowing from the banking sector, this decline in growth was due to a sharp deceleration in credit growth to the public sector, reflecting greater efforts to contain the public sector deficit. The main contributor to the growth in broad money during this period was a sharp rise in net foreign assets of the banking system, reflecting an upward trend in foreign reserves. Credit growth to the private sector also picked up marginally during this period. Money supply (M3) in India grew by 14.3% in 2001, down from 16.8% a year earlier. Deposits of commercial banks grew by 14.6%, while currency in circulation grew by 15.2%, mainly on account of higher agricultural activity and larger procurement of foodgrains. Money supply growth rose to 17% during the first quarter of 2002 (April–June 2002). Excess liquidity stemming from slack demand conditions relative to monetary growth led to a decline in interest rates. Nevertheless, the prime lending rate has been changed little because of inflationary expectations arising from the recent setback in agriculture. In Pakistan, the large accumulation of foreign exchange reserves in 2002 led to a substantial expansion in the money supply, as the State Bank of Pakistan adopted an easy monetary policy to revive growth. Money supply increased by 15.2% in 2002 compared to 9.0% in 2001, as the discount rate was lowered from 14% in June 2001 to 9% by January 2002 and kept unchanged at that level for the next 5 months. However, this did not result in an expansion of demand for credit by the private sector, as security concerns dampened the investment climate. In Sri Lanka too, despite growth in broad money supply of 16%, credit to the private sector has been low. The Central Bank has reduced the repurchase and reverse repurchase rates by 150 basis points during the year, and the yield for short-term credit has shifted downward.

Price levels have displayed a varied performance throughout the subregion. The annual average rate of inflation in Bangladesh edged up to 2.3% in May 2002 from 1.6% in December 2001. While low food prices depressed the overall index, prices of nonfood items accelerated more sharply due to a rise in administered

Improvement in Pakistan's GDP growth was mainly due to agriculture, despite continuing drought.

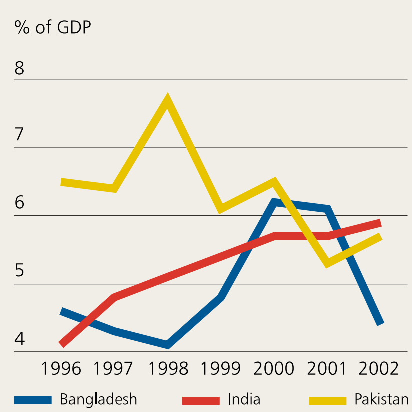
GDP Growth by Sector, Pakistan 2000-2002



Sources: ADO database; *Pakistan Economic Survey 2001-02*.

The fiscal arena remains a major area of concern, with large deficits commonplace.

Fiscal Deficit, Selected South Asian Countries, 1996-2002



Sources: ADO database; Bangladesh Resident Mission, *Quarterly Economic Update*; Reserve Bank of India, 2002, *RBI Bulletin*, August; *Pakistan Economic Survey 2001-02*.

Selected Economic Indicators, South Asia, 1999–2003

	1999	2000	2001	2002		2003	
				ADO 2002	*Update*	*ADO 2002*	*Update*
GDP Growth (%)							
Average	5.7	4.2	4.8	5.4	3.9	6.4	5.7
Afghanistan	—	—	—	—	—	—	—
Bangladesh	4.9	5.9	5.2	4.5	4.2	5.7	5.4
Bhutan	7.3	5.7	6.0	6.5	6.0	6.5	6.5[a]
India	6.1	4.0	5.4	6.0	4.0	6.8	6.0
Maldives	7.4	4.6	2.1	2.0	2.0	—	4.0
Nepal	4.5	6.1	4.7	3.5	0.8	5.0	3.5
Pakistan	4.2	3.9	2.5	3.0	3.6	5.0	4.5
Sri Lanka	4.3	6.0	-1.3	3.5	2.8	5.5	5.5[a]
Inflation (%)							
Average	4.2	6.2	3.7	4.1	5.4	4.8	4.8
Afghanistan	—	—	—	—	—	—	—
Bangladesh	8.9	3.9	1.6	2.4	2.4	2.6	2.9
Bhutan	9.2	3.6	3.6	4.5	4.5[a]	5.2	5.2[a]
India	3.3	7.1	3.6	4.0	6.0	5.0	5.0
Maldives	3.0	-1.2	0.7	—	—	—	—
Nepal	11.3	3.5	2.4	5.0	3.0	5.0	5.0
Pakistan	5.7	3.6	4.4	5.0	2.8	5.0	5.0
Sri Lanka	5.9	1.2	11.0	8.5	8.5[a]	6.0	6.0[a]
Current Account (% of GDP)							
Average	-1.6	-1.0	-0.2	-1.7	-0.4	-1.9	-0.6
Afghanistan	—	—	—	—	—	—	—
Bangladesh	-1.4	-1.0	-2.1	-2.5	0.6	-2.1	-0.2
Bhutan	-25.9	-30.6	-27.5	—	—	—	—
India	-1.1	-0.6	0.3	-1.0	-0.9	-1.5	-0.9
Maldives	-14.6	-9.5	-10.9	—	—	—	—
Nepal	-3.3	-4.5	-4.4	-5.0	-7.0	-5.0	-5.0
Pakistan	-4.1	-1.9	-0.9	-3.6	2.2	-3.1	1.0
Sri Lanka	-3.6	-6.5	-3.4	-6.5	-6.5[a]	-7.5	-7.5[a]

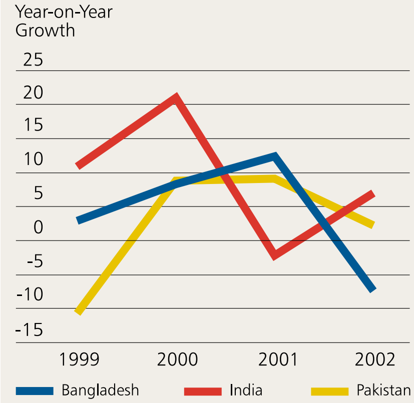
— Not available.
[a] *ADO 2002* forecast.
Sources: ADO database; staff estimates.

prices from the beginning of this year. Annual inflation in India, as measured by changes in the CPI for industrial workers, was higher at 4.7% in May 2002 compared to 2.5% in May 2001. The annual inflation rate based on the wholesale price index declined from 5.3% in June 2001 to 2.2% in June 2002, but a recent hike in prices of petrol and diesel is pushing this index back up. In Nepal, the inflation rate recorded a slight increase to 3% in 2002 from the 2001 rate of 2.4%. In contrast, the trend of declining inflation in recent years in Pakistan was sustained in 2002. The inflation rate fell to 2.8% from 4.4% in 2001, due to a comfortable supply of essential commodities, weaker international prices for petroleum in the first half of the year, lower prices of cotton, and appreciation of the Pakistan rupee. In Sri Lanka, inflation continues to be high despite lower petroleum prices in the first half of the year. Average inflation for the 12-month period ending in June 2002 was 12.3% compared with 11% in December 2001.

Export growth in South Asia has slowed to an annual pace of 4.7% (reflecting mainly the second half of 2001), affected by slower economic growth in major export markets and in the subregion itself. In some South Asian countries, it was negative. In Bangladesh, notwithstanding a brief upturn during the middle and end of 2002, year-on-year export earnings declined by 7.4%, mainly on account of the global downturn, the economic fallout from the September 11 attacks, and growing infrastructure constraints. The decline in export earnings was broad based, affecting all major export categories except jute goods and agricultural products. India's exports have also slumped recently, largely due to the global slowdown: they were up by 18.2% in April 2002 compared to April 2001, but in the following month growth had declined sharply to only 3.9% over May 2001. Though exports are likely to grow faster this year than last year, the recovery is likely to fall short of the 11% export growth projected in *ADO 2002*, mainly because of a weaker than expected recovery in the global economy. Exports from Nepal are estimated to have declined by 15% in 2002 after having grown, on average, by above 20% over the last 3 years. Exports of key merchandise items such as woolen carpets, ready-made garments, and *pashmina* products (to countries other than India) have declined significantly due to supply disruptions as well as to the slowdown in demand abroad. Export growth to India also slowed in 2002 from the levels of previous years, due to the delay in the renewal of the Nepal-India Trade Treaty of 1996. Tourist arrivals in Nepal declined by about 40%, resulting in an estimated 33% decline in tourism receipts. Pakistan's exports grew by a small margin of 2.2% (from $8.9 billion to $9.1 billion in 2002) in contrast to an increase of 9.1% in 2001. Sri Lanka's exports continued to decline during the first half of 2002. Exports fell to $2.0 billion compared with $2.4 billion during the first half of 2001. The poor performance was due to lower industrial imports in the country's main export markets, the US and EU, where the recovery has been slower than expected.

Export growth has slowed.

Export Growth, Selected South Asian Countries, 1999-2002



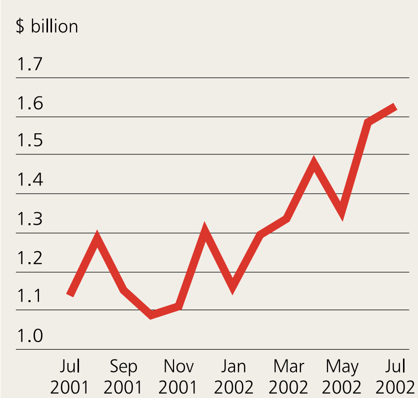
Sources: *ADO* database; Reserve Bank of India, 2002, *RBI Bulletin,* August; www.sbp.org.pk; Bangladesh Bank 2002, *Monthly Current Economic Trends*, June.

Import growth in the subregion has also been lower, or its decline sharper, than previously expected. Available data in Bangladesh indicate that during the first 10 months of fiscal 2002, year-on-year imports declined by 7.1%, as exporters' demand for industrial raw materials and intermediate goods dropped. However, reflecting the pickup in exports during May and June 2002, imports in terms of letters of credit opened for the whole year declined by only 4.1%. In India, imports are unlikely to grow as rapidly as earlier projected, since the recovery of domestic economic activity noted in early calendar year 2002 may not be sustained. Nepalese imports are estimated to have declined by about 8% in 2002 due to weaker demand for industrial raw materials, lower oil prices, and reduced aid-related imports. In Pakistan, total imports declined by 7% in 2002 (from $10.2 billion to $9.5 billion), in contrast to an increase of 6.3% in 2001. In Sri Lanka, imports declined as well, falling by 10% to $2.9 billion in the first half of 2002.

Subregional improvement in the balance of payments has generally pushed up holdings of foreign reserves.

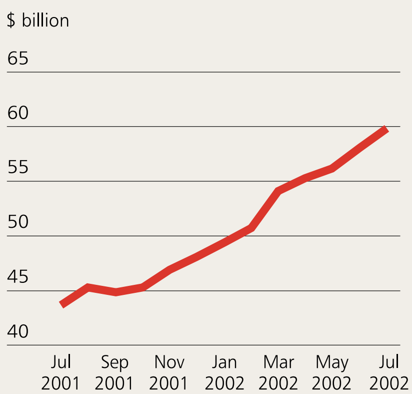
The expected sharper contraction in imports than exports has improved the picture for the subregion's current account balances. In Bangladesh, the decline in imports somewhat offset the decline in exports and led to a narrowing of the trade deficit to $2.1 billion during the first 10 months of 2002 from $2.2 billion during the corresponding period of 2001. The lower trade deficit was accompanied by a substantial 34% increase in overseas workers' remittances due, in large measure, to efforts taken by the Government to encourage the flow of remittances through official channels. As a result, the current account balance (excluding official grants) for the first 10 months of 2002 moved to a surplus of $139 million from a deficit of $766 million in the corresponding period of the preceding year. In India, a surge in inflows of invisibles during 2001 resulted in a small surplus on the current account. In Nepal, the fall in exports and tourism income was not offset by a drop in imports and steady growth of workers' remittances from abroad. The current account balance, therefore, remained in deficit at about 7% of GDP. Pakistan's net current transfers increased to $5.7 billion in

Foreign Exchange Reserves, Bangladesh, July 2001-July 2002



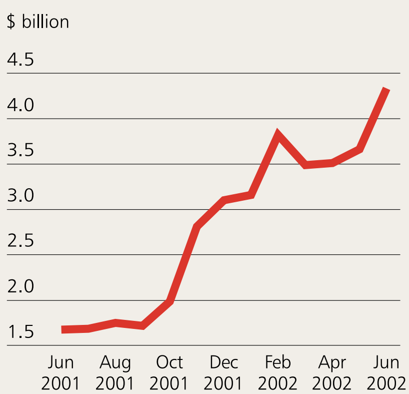
Source: www.bangladesh-bank.org.

Foreign Exchange Reserves, India, July 2001-July 2002



Source: www.rbi.org.in.

Foreign Exchange Reserves, Pakistan, June 2001-June 2002



Source: www.sbp.org.pk.

2002 due to a sharp rise in workers' remittances and official transfers in the post-September 2001 period. The balance of payments improved significantly during 2002 due to these remittances, larger inflows of foreign grants, and receipts for the use of civil aviation facilities by the coalition forces. Excluding official transfers, the current account posted a surplus of $1.3 billion compared to a deficit of $0.5 billion in 2001. There was also a substantial reduction of 16.6% in the deficit on the services account, mainly reflecting receipts of about $350 million for logistics support provided for operations in Afghanistan. As exports declined at a much faster rate than imports in Sri Lanka, the trade deficit there widened by about 11% to $863 billion in the first half of 2002.

The general improvement in the balance of payments in the subregion in 2001 has pushed up holdings of foreign reserves in most countries. In Bangladesh, the substantially higher current account more than offset a somewhat lower financial account balance resulting from lower FDI inflows and a sharp increase in short-term capital outflows. This led to an overall balance-of-payments surplus of $81 million in 2002, compared to a deficit of $368 million in 2001. Following improvement in the overall balance, foreign exchange reserves climbed to $1.6 billion at the end of July 2002 from $1.3 billion at the end of December 2001. India's foreign exchange reserves have been increasing steadily from $42 billion in March 2001 to $60 billion in July 2002. Despite the large rise in reserves, the nominal exchange rate of the Indian rupee depreciated by about 4% from April 2001 through March 2002 and by a further 2.4% by 1 August 2002. In Nepal, despite the deterioration in the external accounts, gross official reserves, as of mid-July 2002, remained at a comfortable level of about $1.1 billion, equivalent to about 7 months of imports. Pakistan's overall surplus on the balance of payments made possible a substantial increase in the foreign exchange reserves so that, as of end-June 2002, central bank reserves stood at $4.3 billion compared to $1.7 billion on 30 June 2001.[2] Sri Lanka's gross official reserves position strengthened to $1.4 billion in June 2002 from $1.3 billion at end-2001.

POLICY DEVELOPMENTS

Throughout South Asia, governments continue to grapple with the problems of fiscal deficits and of trade growth that is lower than targeted to achieve sustainable poverty-reducing economic growth. During the second half of 2002, the Government of Bangladesh made concerted efforts to address the imbalances caused by the pursuit of expansionary fiscal and monetary policies in the past, and to remove some of the trade-distorting administrative measures introduced to stem the decline in international reserves earlier in the year. In addition to steps taken to instill budgetary discipline, the Government revoked the right of commercial banks to meet their reserve requirements in foreign exchange in an attempt to improve the effectiveness of monetary operations. Foreign exchange and trade restrictions—such as enhanced margin requirements on letters of credit and increased import duties and surcharges introduced earlier in the year to restrict imports—have also been eased. Following the Government's success in reducing the fiscal deficit in 2002, the deficit for 2003 has been targeted to within sustainable limits (4% of GDP) so that it would no longer be a source of instability in the economy. With this end in view, an Expenditure Review Commission and a Revenue Reform Commission have been set up. The 2003 budget also introduces major reforms in the import duty structure, restarting the tariff liberalization process that had been stalled since the mid-1990s. During the second half

[2] The country's total foreign exchange reserves, including reserves held by commercial banks, stood at $6.3 billion as of end-June 2002 compared to $3.3 billion a year earlier.

of 2002, the Government also made significant efforts to prepare, on the basis of broad public consensus, a National Strategy for Economic Growth and Poverty Reduction that would provide the basis for future development planning. Notwithstanding these reform measures, progress has been slow on much-needed governance and structural reforms in the SOE and banking sectors. The more recent closure of a major state-owned jute mill could, however, signify a willingness on the part of the Government to address the problems posed by nonviable state-owned enterprises.

In India, the medium-term economic outlook is also mixed. The 10th Plan Approach Paper for 2002–2007 sets a target growth rate of 8% to ensure rapid and continuing poverty reduction. However, the current lower growth rate indicates that it could be difficult to achieve the 8% growth target without significant structural adjustments, especially fiscal adjustments, over the medium term. The state governments are now implementing a program of fiscal consolidation. However, fiscal reform in the central Government has slackened with the introduction of VAT having been postponed to April 2003 from April 2002.

On the trade front, the Government of India announced several measures in its Export-Import Policy for 2002–2007 aimed at augmenting exports. Transaction costs have been significantly reduced because numerous procedures have been simplified. Important policy initiatives included the removal of quantitative restrictions on most exports, permission for overseas banking units to set up in special economic zones, and other export promotion schemes. The abolition of the licensing regime for rough diamonds should help India emerge as a major international center for diamond cutting and trading. The introduction of a new eight-digit commodity classification for imports will go a long way to eliminating classification inconsistencies and should, therefore, reduce rent-seeking opportunities and improve tariff administration efficiency.

Lack of reforms in the Indian power sector has received major attention in recent years. The central Government is now implementing the Accelerated Power Development and Reform Program, which has begun yielding results. Twelve states have set up electricity regulatory commissions and many of them have started rationalizing tariffs.

On the monetary front, the Reserve Bank of India (RBI) announced its monetary and credit policy for 2002, adopting a cautious expansionary stance that progressively reduces interest rates. Toward this end, the cash-reserve ratio has been reduced further from 5.5% to 5.0% and the RBI has indicated that it may also reduce the bank rate if necessary. To introduce flexibility in the interest rate structure, commercial banks are being encouraged to introduce a flexible interest rate system for all new deposits, with rates reset at 6-monthly intervals, and to keep the fixed rate option open. Thus, banks may offer longer-term deposits with 6-monthly reset conditions and at the same time offer a fixed rate for similar maturities, the interest rate on which may be higher or lower depending on the period of deposit and the banks' perceptions of the outlook for inflation and interest rates over the longer term. Banks have been advised to put such a flexible rate system in practice as early as possible, and devise schemes for encouraging depositors to convert their existing long-term fixed rate deposits into variable rate deposits. Furthermore, the ceiling rate on export credit in foreign currency is being reduced from the present LIBOR plus 1.0 percentage point to LIBOR plus 0.75 percentage point. The RBI has also expressed its concern over the excessive variation in commercial bank lending rates for prime borrowers and others. Banks are now required to declare their prime lending rate and the maximum spread.

In response to the current political and fiscal difficulties, the Government of Nepal has begun to implement an Immediate Action Plan. A key element of the Plan is prioritization of public investments, including discontinuation of low priority projects or programs, ensuring adequate and timely flow of resources to priority projects. The Plan also includes measures to improve public service delivery and enhance transparency and accountability of the public sector. The 2003 (July 2002–June 2003) budget focuses on addressing the security situation (with increased budget allocation) and implementation of the Plan, and the Government is now finalizing the 10th Five-Year Plan, which embodies its poverty reduction strategy.

The Government of Pakistan continued with tax reforms aimed at bringing about a more rational tax regime; the structure of taxes has significantly changed in recent years. Reforms include reducing corporate tax rates, introducing a self-assessment scheme for income tax, reducing or eliminating withholding taxes, reducing import tariffs, and extending the base of the general sales tax. The Government also circulated for comments a fiscal responsibility law, which requires the Government to progressively reduce its borrowing, so that after 5 years it will meet all its current expenditures from revenue receipts. Also, it will be bound to bring down the level of public debt to 60% of GDP in 10 years, from 111% in 2001, aided in part by recent Paris Club rescheduling. The Government's fiscal stabilization efforts have so far relied mostly on cutting expenditures, which has had detrimental effects on economic growth. Efforts for better revenue mobilization have not been very successful because of problems with the tax administration systems. Initial steps in this area have recently been taken, such as setting up a Large Taxpayers Unit in Karachi and constituting the high-level Supervisory Council to determine the policies of the Central Board of Revenue.

The Government of Sri Lanka is undertaking several reform measures, including revision of labor legislation which has been a bottleneck to attracting foreign investors. The intention of the Government is to present the amendments to various items of legislation to Parliament in the latter part of 2002.

OUTLOOK FOR 2002–2003

For the rest of this year and next, South Asian economic performance should continue to improve, although at a more subdued pace than predicted in *ADO 2002*, with expectations of mild global recovery and more favorable weather. In Bangladesh, the GDP growth rate in 2003 (year ending June 2003) is expected to improve to 5.4%, due to a measured recovery in both external and domestic demand. This is, however, slightly lower than the growth forecast in *ADO 2002* due to the reduced pace of recovery in the global economy. The current account balance is likely to move marginally into deficit in 2003, from a small surplus of around 0.6% of GDP in 2002, as stronger export growth is likely to be accompanied by a pickup in imports due to the import-dependent domestic and export-oriented manufacturing sectors. A higher trade deficit is also likely to be accompanied on the current account by more subdued growth in worker remittances due to a decline in the number of registered workers leaving to work abroad. The annual rate of inflation is likely to accelerate from around 2.4% in 2002 to around 2.9% in 2003 due to higher domestic demand, a further increase in administered utility prices, and the one-off impact of higher rates and fees introduced in the 2003 budget. In India, with reduced agricultural production and only moderate growth in major export markets, real GDP is expected to grow by 4% in 2002 (year ending March 2003) and 6% in 2003. Inflation is likely to be around 6% and 5% in those years, and the current account deficit is projected at 0.9% of GDP.

Macroeconomic prospects in Nepal in the short to medium term depend on how the security and political scenarios develop. On the assumption of an improved security situation and normal weather conditions, the economy is expected to grow by 3.5% in 2003 (year ending July 2003). Exports are expected to increase only slowly because of the continued security problems and uncertainties about external demand in third countries. This in turn will adversely affect the output of the manufacturing sector. A major upturn in tourism in the short term is also unlikely unless the security and political environment significantly improves. Though the expected recovery of exports in 2003 will be matched by import growth, the current account deficit is forecast to improve slightly to 5% of GDP. Inflation will remain moderate at 5%.

If current trends are sustained in Pakistan, the economy should be able to realize the growth target of 4.5% in 2003 (year ending June 2003). Recent rains have improved the outlook for the agriculture sector and have replenished the major water reservoirs for the first time in 3 years. It is estimated that agricultural growth will increase to 3% in 2003. The upturn observed in large-scale manufacturing in the last quarter of 2002 (April–June) is expected to continue and growth in the industry sector is expected to strengthen to 5%. The services sector may also get a boost from election spending. Inflation is expected to accelerate to 5%, as economic activity picks up. The fiscal deficit in 2003 should decline significantly, but the budgetary deficit target of 4.4% for 2003 seems very ambitious and may not be achieved. Both exports and imports seem to have bottomed out and to have experienced a significant upturn in the last quarter of 2002, which is likely to continue in 2003. With anticipated revival of domestic economic activity, imports will also increase. However, the trade deficit is likely to remain at around $1 billion, or 1.5% of GDP. Remittances are likely to be sustained at the high level achieved in 2002, as these have mostly resulted from a shift from informal to regular banking channels. Overall, the surplus in the current account in 2003 is likely to be lower than it was in 2002.

Growth for 2002 in Sri Lanka will likely be about 2.5–3%, lower than the initial estimate of 3.5% in *ADO 2002*. The fiscal balance is expected to worsen by about 1% of GDP due to lower tariff collections from reduced imports and the July price-reduction measures, unless significant expenditure cuts are made in the latter part of the year. A major concern is the financing of the budget deficit due to the delay in realization of foreign loans and privatization proceeds. Hence the Government will have to adopt domestic financing, which will have an impact on interest rates in the future. Peace talks on the conflict in the northeast of the island are likely to raise confidence and provide a mild stimulus to the economy. Depending on the outcome of these talks and political stability, the economy is expected to pick up significantly in early 2003.