

# SOUTH ASIA

Subregional economic growth is forecast to slow in 2023 slightly more than projected in *ADO April 2023*. It will likely reaccelerate in 2024 as previously forecast. Current growth outlooks for individual economies in the subregion largely confirm earlier projections, except for Nepal, where growth will be significantly lower in 2023. Inflation will be higher than forecast in April, especially in 2024, as domestic demand recovers.

## Subregional assessment and prospects

**Economic developments in the first half (H1) of 2023 were broadly similar to those expected in April.** India's economy grew by 7.8% year on year in the first quarter of fiscal year 2023 (FY2023, ending 31 March 2024), reflecting strong growth in services and rising investment fueled by public investment and bank credit to the private sector. The Afghan economy showed some signs of recovery in H1 2023, following 3 successive years of recession. Growth in Bangladesh, though higher than forecast earlier, decelerated in FY2023 (ended 30 June 2023) as industry growth moderated because of high input prices and energy shortages, agriculture suffered from floods and cyclones, and domestic and external demand faltered on account of rising prices, a slowdown in the US and Europe, and import restrictions. Growth in Maldives was kept robust by strong tourism and public investment. In Pakistan, growth is estimated to have slowed to 0.3% in FY2023 (ended 30 June 2023), halting gains made in post-pandemic recovery. Massive floods at the outset of FY2023 damaged cotton and rice crops, cutting expansion in agriculture to one-third of sector growth in FY2022. The other economies of the subregion did not do well either.

Sri Lanka's economy contracted in the first quarter of 2023 as both industry and services contracted, though economic conditions have since stabilized with food and fuel becoming more readily available. In Nepal, contractionary monetary and fiscal policies and import restrictions pushed growth markedly lower in FY2023 (ended mid-July 2023) than was forecast in April, though agricultural output rose thanks to normal weather patterns. In Bhutan, services showed steady recovery as tourist arrivals picked up, but erratic monsoon rains undermined crop production and a shortfall in hydropower production hurt industrial output.

**Aggregate subregional GDP is forecast to expand by 5.4% in 2023 and 6.1% in 2024, much as projected in April (Figure 2.3.1).** The outlook excludes Afghanistan because meaningful forecasts are precluded by the unsettled situation there and lack of credible data. The subregional growth shadows the pattern of growth in India, which accounts for 80% of the subregional economy. Indian growth in the rest of this fiscal year and next will be propelled by robust domestic consumption as consumer confidence improves, and by investment, including large increases in government capital expenditure. However, as slowing exports could foment headwinds for the economy, and erratic rainfall patterns are likely to undermine

---

The section on Bangladesh was written by Soon Chan Hong, Barun K. Dey, and Mahbub Rabbani; India by Chinmaya Goyal and Kriti Jain; Pakistan by Khadija Ali and Farzana Noshab. The sections on other economies were written by Dinuk de Silva, Lakshini Fernando, Elisabetta Gentile, Abdul Hares Halimi, Manbar Singh Khadka, Sonam Lhendup, Ahmad K. Miraj, and Neelina Nakarmi, Milan Thomas, and consultants Abdulla Ali and Macrina Mallari. The subregional assessment and prospects was written by Reza Vaez-Zadeh and Trisha Chandra, consultants. ADB placed on hold its regular assistance in Afghanistan effective 15 August 2021.

**Figure 2.3.1 GDP Growth in South Asia**

South Asia will grow at a brisk pace in 2023 and see growth accelerate in 2024.



Note: Lighter colored bars are *Asian Development Outlook April 2023* forecasts.  
Source: *Asian Development Outlook* database.

agricultural output, the growth forecast for FY2023 is revised down marginally to 6.3%. The forecast is retained at 6.7% for FY2024, when rising private investment and industrial output are expected to drive growth.

**Growth prospects in the rest of South Asia are mixed.** In Afghanistan, economic expansion will be constrained by governance issues, policy uncertainties, ongoing drought, and the exclusion of women from the labor force. However, if humanitarian assistance to the country continues at the 2022 level, modest growth can be expected there this year and next. In Pakistan, growth is forecast at 1.9% in FY2024, slightly below the April projection, assuming continued implementation of reforms and supportive macroeconomic policies, recovery from flood-induced supply shocks, and improving external conditions. Political stability following general elections later this year, if achieved, will boost business confidence, as will a new standby arrangement agreed with the

International Monetary Fund to support economic stabilization and rebuild fiscal buffers. Sri Lanka's economy will remain in recession again in 2023, as forecast in April. However, indications are still for modest recovery in 2024, as supply conditions have improved, official international reserves have risen, and consumer and investor confidence are expected to rise with the implementation of a program agreed with the International Monetary Fund. In Nepal, continued restrictive macroeconomic policies, lower external demand, and delayed monsoon rains will moderate growth in FY2024 below the previous projection. Bangladesh's growth forecast for FY2024 remains unchanged from April. Growth will be sustained there by rising exports, higher consumption as remittances grow, and higher government investment. The growth forecast for Bhutan is revised down for 2023 from April projections, owing to disappointing growth in agriculture and industry. The forecast for 2024 is revised up slightly, however, as energy output is expected to expand with the opening of new hydropower plants next year. In Maldives, April growth forecasts are retained for both this year and next.

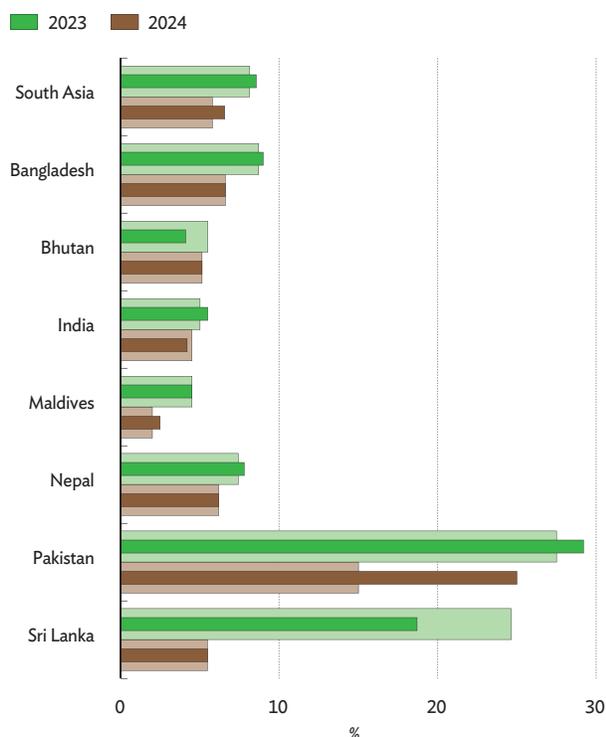
**Forecasts for subregional inflation are revised up from April to 8.6% in 2023 and 6.6% in 2024 (Figure 2.3.2).** The revision for this year mainly reflects higher expected inflation in Pakistan and India. Average inflation in Pakistan will soar from 12.2% in FY2022 to 29.2% on higher food prices caused by supply shortages, continued currency depreciation, import restrictions, and fiscal stimulus for post-pandemic recovery. Normalized food supplies and lower inflation expectations, albeit tempered by higher power and gas tariffs and likely currency depreciation, could ease inflation somewhat in FY2024, but Pakistan's inflation rate is now expected to remain at 25.0% in FY2024, substantially higher than forecast in April. Headline inflation in India will moderate from 6.7% in 2022 to 5.5% in 2023. The forecast is higher than the ADO April 2023 forecast because of unexpectedly high food prices. Inflation is expected to moderate to 4.2% in FY2024, slightly lower than previously forecast, due to core inflation becoming more subdued.

**Inflation forecasts for the rest of the subregion are broadly unchanged from April projections.**

Inflation in Sri Lanka moderated more than expected in H1 2023 on subdued demand. The downward trend is expected to continue, with inflation sharply lower

**Figure 2.3.2 Inflation in South Asia**

Soaring prices in Pakistan will push South Asia's inflation higher.



Note: Lighter colored bars are Asian Development Outlook April 2023 forecasts.  
Source: Asian Development Outlook database.

in 2023 than previously forecast and in single digits in 2024. In Bangladesh, inflation exceeded the April forecast in FY2023 on rising energy and food prices, but it will ease in FY2024 to the rate projected in April as global nonfuel commodity prices fall, monetary policy gradually tightens and crop production improves. The inflation forecast for Bhutan is revised down for this year from April owing to a midyear drop in fuel prices and low food inflation. The April forecast for 2024 is retained. Inflation in Nepal was slightly higher in FY2023 than the April projection, reflecting a broad-based increase in prices, but the forecast is retained for FY2024 in anticipation of subdued increases for oil and moderating inflation in India, Nepal's dominant source of imports. Inflation in Maldives is likely to be lower in 2023 than forecast in April as the hike in goods and services tax is now expected to have a more moderate impact on prices. In 2024, inflation will rise slightly higher than forecast in April owing to a base effect.

**The economic outlook for South Asia is subject to significant risks.** They include extreme weather conditions under climate change that may bring erratic rainfall, energy and food security challenges posed by the Russian invasion of Ukraine that could intensify inflationary pressures, and slippage in needed policy reform implementation that could dampen consumer and investor confidence.

## Bangladesh

### Growth, though higher than expected, moderated in fiscal year 2023 (FY2023, ended 30 June 2023).

This was in the face of the sharp decline in growth in major advanced countries that provide the external demand propelling the country's export-oriented economy. Inflation intensified on high commodity prices and shortfalls in meeting fuel and energy demands. Exports continued to grow, and a marked fall in imports sharply reduced the current account deficit. Growth in FY2024 is expected to edge up and inflation to ease.

## Updated Assessment

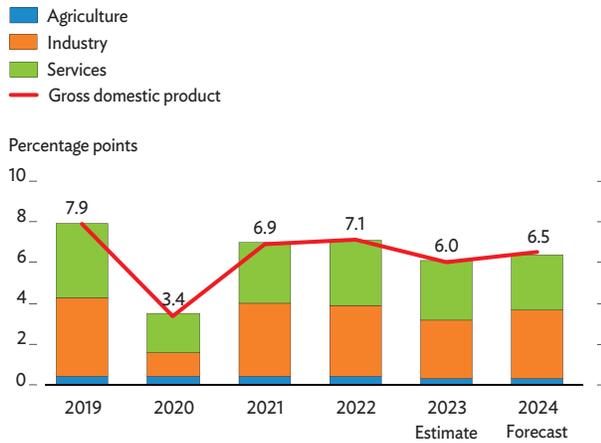
### GDP growth is estimated at 6.0% in FY2023.

Growth outperformed the projection of 5.3% in ADO April 2023 but moderated from actual growth of 7.1% in FY2022 (Figure 2.3.3). On the supply side, the decline was mainly due to lower industrial activities. Industry sector growth declined to 8.2% in FY2023 from 9.9% in FY2022, mainly reflecting reduced export demand from advanced countries and domestic power and energy shortages. Large-scale manufacturing production growth fell from 15.7% to only 8.5% in FY2023. Growth in agriculture declined to 2.6% from 3.1% a year earlier as a result of inclement weather including floods, cyclones, and droughts. Services growth also declined to 5.8% from 6.3% following the trend in agriculture and industry, as domestic demand weakened due to erosion in incomes.

**On the demand-side, lower growth in private consumption and investment contributed to the dip in GDP growth.** Decline in consumer purchasing power with rising inflation significantly affected private consumption, while public consumption expanded on higher recurrent expenditure. Private investment was constrained by higher input costs and restrictions on

**Figure 2.3.3 Supply-Side Contributions to Growth**

Growth slowed on weak external demand in 2023, but will turn higher in 2024.



Note: Years are fiscal years ending on 30 June of that year.

Sources: Bangladesh Bureau of Statistics; Asian Development Bank estimates.

the issuance of import letters of credit to ration foreign exchange. Growth in public investment also decreased as only 84.2% of the annual development program was implemented in FY2023, compared to 92.7% in FY2022. With a sharp decline in imports, net exports added to growth.

**Inflation surged to an average of 9.0% in FY2023 from 6.2% in FY2022 (Figure 2.3.4).**

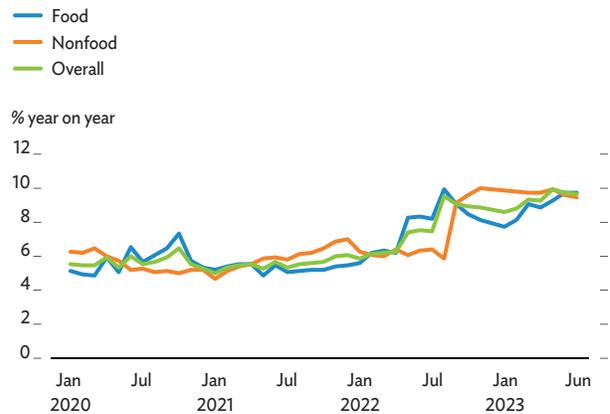
Food inflation increased to 8.7% in FY2023 from 6.1% in FY2022 and nonfood inflation to 9.4% from 6.3%. Weaker agricultural production, some upward adjustments in administered domestic fuel and energy prices, although subsidies prevented a full pass-through of energy price increases, and the marked depreciation of the taka against the US dollar were the main causes of the sharp updraft in inflation and its stickiness through the end of the fiscal year.

**Broad money growth increased to 10.5% in FY2023 from 9.4% in FY2022.**

Growth in credit to the public sector rose to 35.0% with a sharp increase in credit utilization by the government and other public sector organizations amid a decrease in the issuance of national savings certificates (Figure 2.3.5). Private sector credit in the same period grew by 10.6%, down from 13.7%, on lower investment amid import restrictions. To restrict credit growth and

**Figure 2.3.4 Monthly Inflation**

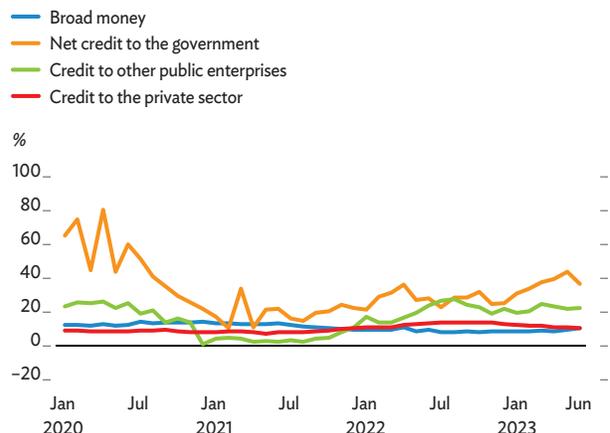
Price pressures intensified in 2023.



Source: Bangladesh Bank. 2023. *Monthly Economic Trends*. August.

**Figure 2.3.5 Growth of Monetary Indicators**

Government borrowing from the banking system soared.



Source: Bangladesh Bank. 2023. *Major Economic Indicators: Monthly Update*. July.

contain inflationary pressure, Bangladesh Bank, the central bank, raised its policy rate, the repo rate, by 1 percentage point to 6.0% in FY2023.

**The government’s revised budget targets for FY2023 remained ambitious.**

The FY2023 revised budget targeted revenue collection and spending to grow by 29.4% and 27.5% over that in FY2022, equivalent to 9.8% of GDP and 14.9% of GDP, respectively. However, actual revenue collection by the National Board of Revenue expanded by only 10.2% in FY2023, while public spending rose by only 16.7%

in the first 9 months. On balance these shortfalls are expected to be largely offsetting, and the FY2023 fiscal deficit is expected to widen to 5.1% of GDP, in line with the revised budget target and up from 4.6% in FY2022.

**Exports grew by only 6.3% in FY2023, decelerating sharply from 33.4% expansion in FY2022.** Export growth was entirely due to expansion in garment exports, which grew by 10.3%, as other exports fell sharply by 9.5%. The marked economic slowdown in the European Union and the US was mainly responsible for the sharp deceleration of export growth. Continued domestic energy and electricity shortages in factories also played a role.

**Imports contracted by 15.8% to \$69.5 billion in FY2023 from the marked 36.0% expansion in FY2022.** Imports of intermediate goods decreased sharply by 19.8%, driven by decline in both garment-related intermediates and other intermediate goods for manufacturing. Capital goods imports decreased by 17.4%. Petroleum-related goods imports also declined. However, fertilizer and rice imports increased, driven by the government efforts to ensure food security. Import restriction measures taken by the central bank to limit a marked decline in its foreign exchange reserves played a significant role in the contraction along with slower growth.

**The trade deficit narrowed to \$17.2 billion in FY2023 as imports were sharply reduced while exports expanded moderately (Figure 2.3.6).** Remittances increased to \$21.6 billion, helped by a sharply depreciated Bangladesh taka, government cash incentives, and increased ease of transfer through mobile financial services. Because of the lower trade deficit and higher remittances, the current account deficit narrowed sharply to \$3.3 billion or 0.7% of GDP in FY2023, from \$18.6 billion or 4.1% of GDP in FY2022 (Figure 2.3.7). Even with a significantly reduced current account, sharply reduced financial inflows including a decline in medium- and long-term loans and other short-term loans of the private sector led to gross foreign exchange reserves falling by \$10.6 billion, about 25%, to \$31.2 billion. This level provided cover for over 4 months of imports of goods and services (Figure 2.3.8).

**Figure 2.3.6 Monthly Exports and Imports**

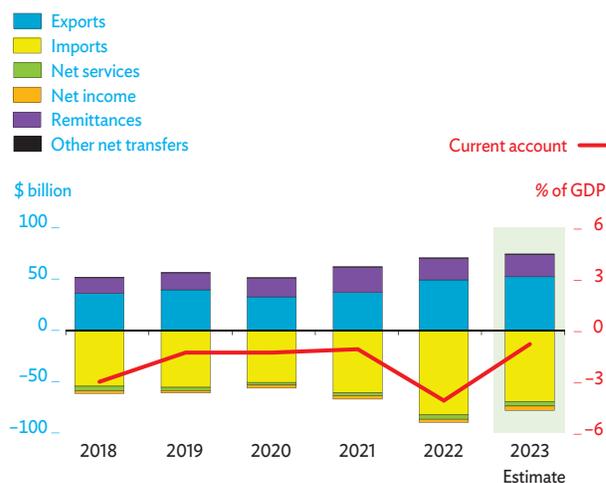
The trade deficit narrowed on a decline in imports.



Source: Bangladesh Bank, 2023. *Major Economic Indicators: Monthly Update*. July.

**Figure 2.3.7 Current Account Components**

The current account deficit sharply narrowed on a fall in the trade deficit and growth in remittances in 2023.



GDP = gross domestic product.

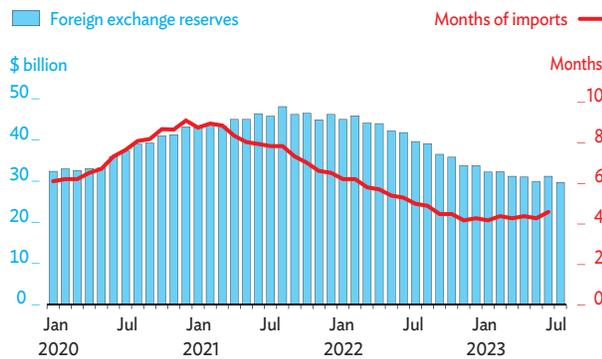
Note: Years are fiscal years ending on 30 June of that year.

Source: Bangladesh Bank.

**The taka depreciated by 13.8% against the US dollar at the end of June in FY2023 from a year earlier (Figure 2.3.9).** Bangladesh Bank followed a path of gradual adjustment of US dollar exchange rate towards a market-driven rate as it sold net \$13.4 billion during the year to commercial banks to curb excessive exchange rate volatility. The taka depreciated in real effective terms by 8.6% in June 2023 from a year earlier.

**Figure 2.3.8 Gross Foreign Exchange Reserves**

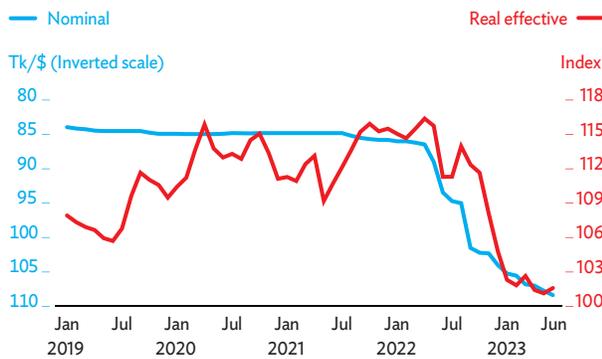
Foreign exchange reserves have declined markedly since January 2022.



Source: Bangladesh Bank.

**Figure 2.3.9 Exchange Rates**

The taka depreciated sharply against the US dollar and in real effective terms.



Source: Bangladesh Bank. 2023. *Monthly Economic Trends*. August.

## Prospects

**The economy is expected to grow slightly faster in FY2024 with easing inflation and some improvement in export growth.** GDP growth projection in FY2024 is retained at 6.5%, higher than 6.0% in FY2023, due to continued export growth supported by economic recovery in the euro area (Table 2.3.1). Import growth is expected to return to positive territory due to an increase in demand for export-related intermediates and government imports. Moderate inflation and an increase in remittances will contribute to reviving private consumption, while completion of a number of major government infrastructure

**Table 2.3.1 Selected Economic Indicators in Bangladesh, %**

Growth slowed somewhat less than expected on weak global demand but will meet the ADO April 2023 forecast in 2024.

|            | 2022 | 2023 |     | 2024 |     |
|------------|------|------|-----|------|-----|
|            |      | Apr  | Sep | Apr  | Sep |
| GDP growth | 7.1  | 5.3  | 6.0 | 6.5  | 6.5 |
| Inflation  | 6.2  | 8.7  | 9.0 | 6.6  | 6.6 |

GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

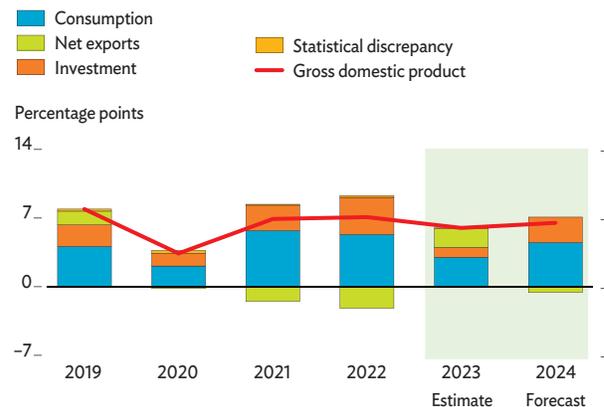
Sources: Bangladesh Bureau of Statistics; Asian Development Bank estimates.

projects will increase investment (Figure 2.3.10). Private investment, however, may be dampened by the initial higher interest rates resulting from a revision in the country’s monetary policy framework.

**On the supply side, industry is expected to contribute most to growth.** Agriculture sector growth is projected to increase to 2.9% in FY2024 assuming normal weather and government policy support including distribution of quality seed, fertilizers, and training to farmers. Growth in the industry sector is expected to rise to 9.3% in FY2024, driven by improvement in power supply and better access to imports. However, growth in the services sector is expected to be slower at 5.5%, with expected lower growth in real estate and human health and social work activities.

**Figure 2.3.10 Demand-Side Contributions to Growth**

Subdued consumption and investment pulls down growth in 2023.



Note: Years are fiscal years ending on 30 June of that year.

Sources: Bangladesh Bureau of Statistics; Asian Development Bank estimates.

**Inflation is projected to decline to 6.6% in FY2024.**

Though high inflation may persist in the first months of the fiscal year, it is expected that it will come down with some fall in global nonfuel commodity prices, expected higher agricultural production, and the initial tightening of monetary policy under the new framework.

**Monetary policy is expected to be tightened in FY2024.**

It will feature a transition from a monetary aggregate targeting framework to an interest rate-targeting framework. Bangladesh Bank has increased the policy interest rate from 6.0% to 6.5% accompanied by a symmetric corridor of 200 basis points for the standing loan and deposit facilities. Bangladesh Bank also replaced the cap lending rate with a market-driven lending rate for bank loans based on a reference lending rate called SMART (6-month moving average rate of treasury bills). In FY2024, applicable lending rates will be SMART plus a margin of up to 3% for banks, and SMART plus a margin of up to 5% for nonbank financial institutions. Loans to cottage, micro, small, and medium-sized enterprises, and consumers could be charged an additional fee of up to 1 percentage point on top of above margin to cover supervision costs. Bangladesh Bank is also adopting a single market-driven exchange rate and calculating gross foreign exchange reserves in accordance with the sixth edition of the International Monetary Fund's Balance of Payments and International Investment Position Manual.

**The government's FY2024 budget is ambitious.** It aims to achieve a ratio of revenue to GDP at 10.0% and of expenditure to GDP at 15.2% with a resulting fiscal deficit of 5.2% of GDP, marginally higher than FY2023 revised budget target of 5.1%. The policy is directed at slimming current expenditure and expanding capital expenditure. It is expected that 60.0% of the deficit will be financed domestically: 85.2% from banks and the remaining 14.8% from nonbank sources, mostly the sale of national saving certificates.

**As part of the government's ongoing structural reform program, the Income Tax Act, 2023 was passed in Parliament.**

The new law includes changes to accounting methods, depreciation and amortization rules, provisions related to capital gains, income from intangible assets, transfer pricing, and alternative dispute resolution provisions. To facilitate business and investment, instead of filing 29 returns and statements related to tax deduction at source in the existing law, only 12 are required in the new law. The new tax law will help enhance domestic resource mobilization by ensuring tax compliance, greater tax return filing under self-assessment, better return process and audit provisions, and international standardization.

**Export growth is projected to slightly accelerate to 9.0% in FY2024.**

Improved electricity and energy supply and a fully market-oriented exchange rate are expected to support higher growth, especially for non-garment exports, which sharply declined in FY2023. Imports are expected to rebound and grow at 7.0% with an increase in import demand for intermediates and capital goods.

**The trade deficit is forecast to slightly widen to \$17.3 billion in FY2024 as the increase in imports surpasses that of exports in nominal terms.**

Remittances growth will accelerate to 8.4% as a market-driven exchange rate and cash incentives are expected to encourage increased transfer through official channels. With increased remittances, the current account deficit is forecast to narrow slightly to 0.5% of GDP in FY2024.

**However, there are some downside risks to growth.** These include the effects of any adverse weather events and further deterioration in the balance of payments situation if global demand is weaker than expected.

## India

**Despite global uncertainties, the economy showed robust growth in the first quarter (Q1) of fiscal year 2023 (FY2023, ending 31 March 2024), driven by strong government and private investment and private consumption.** The growth forecast for FY2023 is modestly lowered from the projection in *ADO April 2023* due to lower-than-expected agricultural output but retained for FY2024 as corporate profitability and strong bank credit buoy private investment. Inflation has moderated broadly, but the forecast for FY2023 is raised owing to a spike in food prices, and the forecast for FY2024 is marginally lowered as core inflation moderates.

### Updated Assessment

**Robust domestic demand pushed GDP growth to 7.8% year on year in Q1 FY2023.** Investment growth was above 8% for the past 5 quarters on rising government infrastructure and private investment outlays. Private consumption growth rose to 6% in Q1 FY2023 after tepid growth in the previous 2 quarters. The recovery was expected, given improving consumer sentiment and labor market conditions, but was dampened by subdued rural demand. Public consumption remained weak as the government's focus has been on raising capital expenditure. The contribution of net exports to growth was negative as exports fell by 7.7% in real terms on weak external demand (Figure 2.3.11).

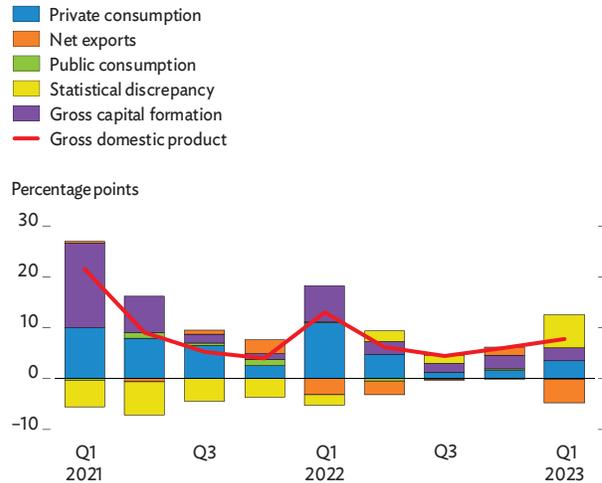
**On the supply side, the services sector was the main contributor to GDP growth, rising by 10.3%.**

Financial, real estate, and business services grew by 12.2% year on year in Q1 FY2023, and trade and hotel and communication services by 9.2%. The manufacturing and electricity sectors grew moderately by 4.7% and 2.9%, respectively, and the agriculture sector by 3.5% (Figure 2.3.12).

**Inflationary pressures broadly moderated, but food prices spiked.** Consumer inflation averaged 5.3% during April-July FY2023, much lower than 7.1% in the corresponding period of FY2022. The broad moderation in inflation was led by cooling global energy prices, particularly for crude oil and coal, which has helped lower fuel inflation and input costs. Core inflation, which was sticky at around 5.8% in July 2022, was down to 4.9% year on year in July 2023 (Figure 2.3.13).

**Figure 2.3.11 Demand-Side Contributions to Growth**

*Investment and private consumption drove growth in Q1 2023.*



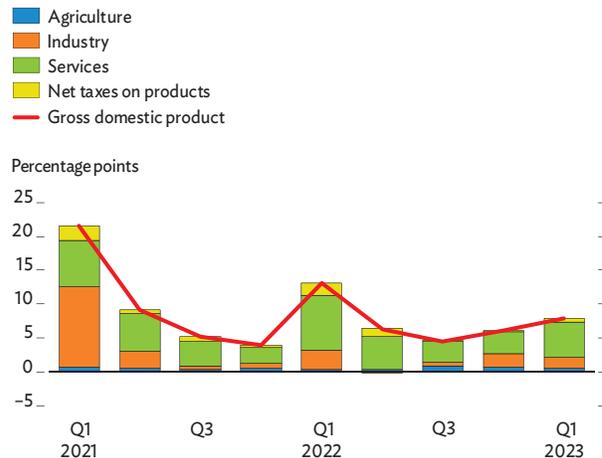
Q = quarter.

Note: Years are fiscal years ending on 31 March of the next year.

Source: Ministry of Statistics and Programme Implementation.

**Figure 2.3.12 Supply-Side Contributions to Growth**

*The services sector was the main contributor to growth in Q1 FY2023.*



FY = fiscal year, Q = quarter.

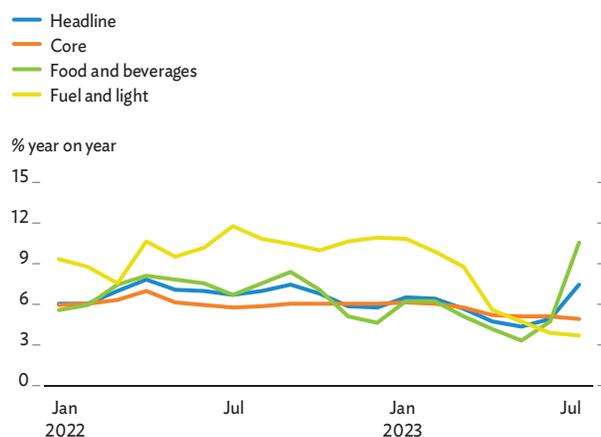
Note: Years are fiscal years ending on 31 March of the next year.

Source: Ministry of Statistics and Programme Implementation.

However, food prices have risen sharply, led by high inflation in cereals, pulses, and vegetables. While vegetable price inflation is likely short term, resulting from supply volatility, the erratic rainfall patterns across regions could result in lower crop production in the summer (*kharif*) cropping season, putting further pressure on food prices (Figure 2.3.14).

**Figure 2.3.13 Consumer Inflation**

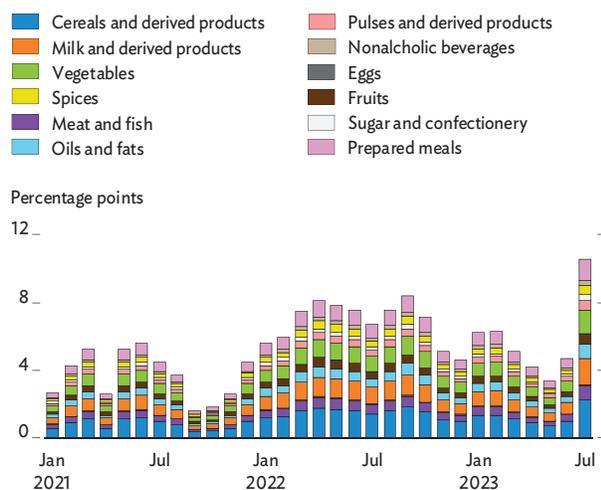
*Inflation rose in July 2023 on a spike in food prices.*



Source: Reserve Bank of India.

**Figure 2.3.14 Contributions to Food Price Inflation**

*Food prices spiked from higher prices for many categories.*

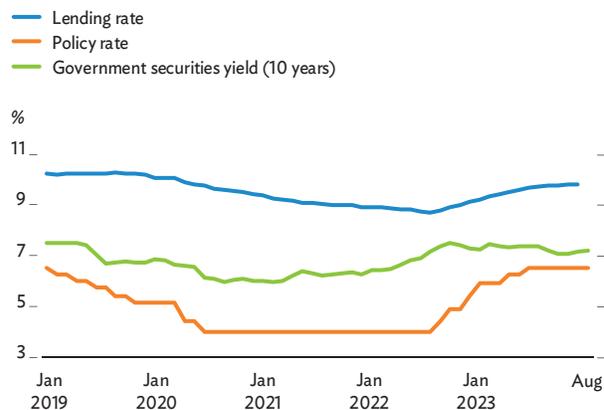


Source: Reserve Bank of India.

**The monetary policy rate has remained stable since February 2023 as inflation moderated.** To combat inflation, the Reserve Bank of India, the central bank, raised its policy (repo) rate from 4.0% to 6.5% from April 2022 to February 2023. Since then, the policy rate has been unchanged. However, broader monetary policy remains focused on bringing consumer inflation closer to the medium-term target of 4%, while supporting economic growth. It is important to note that, while the policy rate has risen by 250 basis points since April 2022, the average bank lending rate has increased by only 106 basis points, indicating incomplete monetary policy transmission (Figure 2.3.15).

**Figure 2.3.15 Interest Rates**

*Lending rates have edged up but less than the policy rate.*



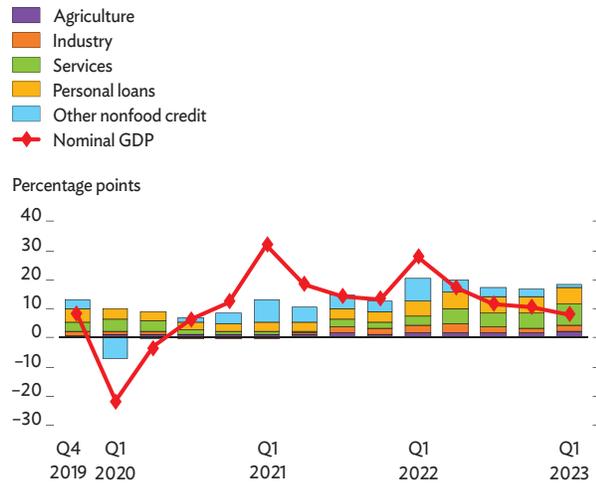
Source: Reserve Bank of India.

**Bank credit growth remains robust and nonperforming loans remain low.** Nonfood bank credit (excluding working capital loans for public food purchases) grew by 19.8% year on year in July 2023, compared to 13.8% in July 2022, faster than nominal GDP growth (Figure 2.3.16). The services sector and personal loans were major contributors to faster growth, while credit flow to large industrial firms was muted. High personal loan growth is driven by housing and vehicle purchases and consumer durables loans. India's banking sector has been relatively insulated from the global financial turmoil, helped by low nonperforming loans, an improved capital base, and a stronger regulatory regime to deal with delinquencies. At the end of March 2023, gross nonperforming assets in the banking sector were at their lowest point in the past 10 years, amounting to 3.9% of total loans compared to 5.0% in September 2022. Financial sector stress in India has sometimes emerged from the vulnerabilities of the nonbanking financial corporations. However, reflecting greater regulatory oversight by the central bank, the gross nonperforming assets of nonbanking financial corporations have remained low, falling to 3.8% of their loans in March 2023 from 5.8% in March 2022.

**Government investment is growing at a fast rate, but revenue collections have been slow.** In the first 4 months of FY2023, central government revenues (net of states' share) grew by 0.7%, affected by dampened collections from corporate tax and taxes on petroleum sales, despite income tax and goods and services tax

**Figure 2.3.16 Growth in Nonfood Bank Credit**

Nonfood bank credit has grown steadily.



GDP = gross domestic product, Q = quarter.

Source: Haver Analytics.

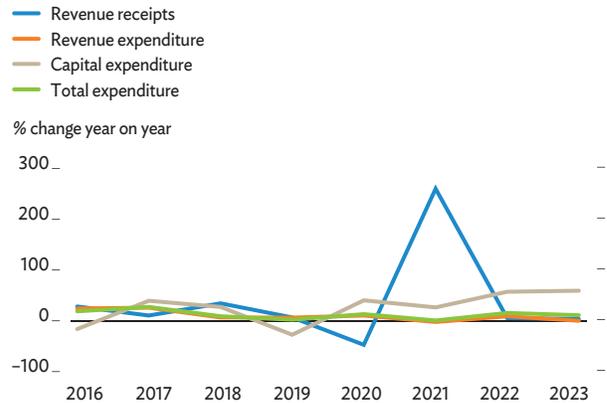
collections growing by 6.4% and 11.4% respectively. The gap in revenue collection has been partly mitigated by the flow of central bank dividend payments to the central government, which increased to ₹874 billion from ₹303 billion in Q1 FY2022. Central government capital expenditure increased by 52% year on year during April-July FY2023, putting the government on track to meet its budget target of a 35% increase in capital spending in FY2023. Current expenditure also increased by 15.9% in the first 4 months of FY2023, leading to total expenditure increasing by 22.5%. As a consequence of larger capital expenditure and low revenue growth, the central government’s fiscal deficit reached 35% of the annual target by July 2023, in comparison to 21% in the previous year. The state governments have also ramped up their capital expenditure in Q1 FY2023, with data for 23 states showing an increase in capital expenditure by 74%. (Figure 2.3.17).

**The trade deficit shrank during the first 4 months of FY2023 as both imports and exports contracted.**

Goods imports declined by 14% year on year during April to July 2023. Low crude oil prices lowered petroleum imports. Most major categories of nonpetroleum imports also saw contraction, including gold, fertilizers, pearls and precious stones, coal, coke and briquettes, and vegetable oil. Goods exports contracted by 14.5% year on year during April-July 2023 due to muted demand in

**Figure 2.3.17 Central Government Revenue and Expenditure**

Total government spending has fallen as its capital expenditure has risen.



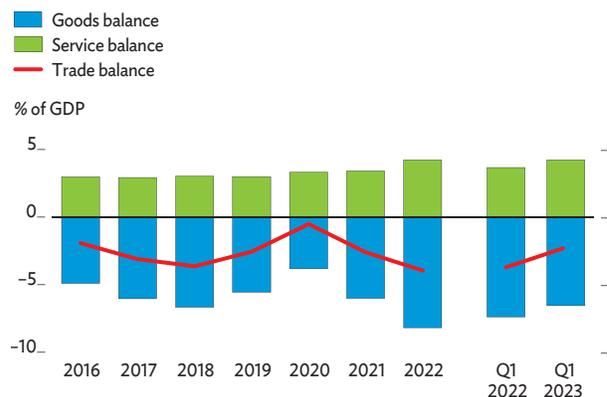
Note: Data show growth in the April-July period over the corresponding period of the previous year.

Source: Comptroller General of Accounts.

advanced nations and lower commodity prices, although electronic goods continued to show double-digit growth. During Q1 FY2023, service exports and imports growth also slowed year on year to 7.6% and 0.2% respectively (Figure 2.3.18).

**Figure 2.3.18 Trade Balance**

The trade deficit shrank as balances for both services and goods improved.



GDP = gross domestic product, Q = quarter.

Note: Years are fiscal years ending on 31 March of the next year.

Source: CEIC Data Company.

### Foreign direct investment declined during the first 2 months of FY2023, but foreign portfolio investment flows were strong.

Net foreign direct investment declined to \$5 billion in Q1 FY2023 from \$13.4 billion in Q1 FY2022. This was balanced by a strong increase in net portfolio investment despite tighter monetary policy globally, from net outflows of \$14.0 billion in Q1 FY2022 to net inflows of \$15 billion. Due to a lower trade deficit and high growth in personal remittances, the current account deficit decreased from 2.0% of GDP in Q3 FY2022 to 0.2% of GDP in Q4 FY2022. Foreign exchange reserves remained robust and covered 11 months of imports at the end of July 2023. The rupee-dollar exchange rate was relatively stable in the first 4 months of FY2023 at an average value of ₹82.19 per dollar, almost unchanged from the end of FY2022.

## Prospects

### The growth trajectory is broadly consistent with expectations in ADO April 2023 (Table 2.3.2).

An exception is lower growth of the agriculture sector. Since ADO April 2023, monsoon rainfall under the influence of a developing El Niño has led to erratic weather patterns, including flooding in certain regions and deficient rains, particularly in August. The erratic rainfall patterns have resulted in damage to the rice crop in particular and lower sowing in 2023 for pulses in the *kharif* season. The ADO April 2023 forecast of robust growth of the sector in FY2023 had assumed no extreme weather shocks. However, given the current rain patterns, agriculture growth projection is revised down by almost a percentage point for FY2023, with FY2024 growth remaining the same under the assumption of normal rainfall next year.

**Table 2.3.2 Selected Economic Indicators in India, %**

The growth forecast is lowered marginally for FY2023 and retained for FY2024, while forecast inflation is raised for this fiscal year and lowered for next year.

|            | 2022 | 2023 |     | 2024 |     |
|------------|------|------|-----|------|-----|
|            |      | Apr  | Sep | Apr  | Sep |
| GDP growth | 7.2  | 6.4  | 6.3 | 6.7  | 6.7 |
| Inflation  | 6.7  | 5.0  | 5.5 | 4.5  | 4.2 |

GDP = gross domestic product.

Note: Years are fiscal years ending on 31 March of the next year.

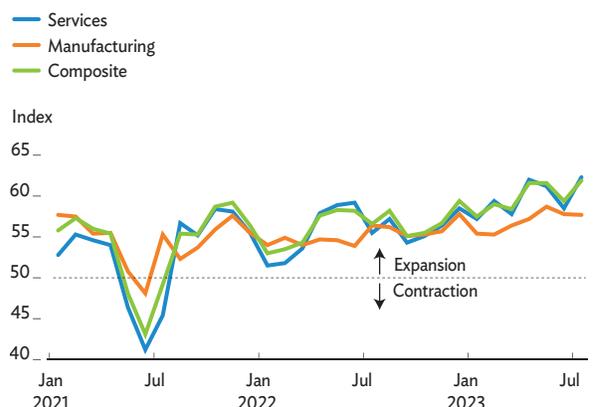
Sources: Ministry of Statistics and Programme Implementation, Government of India; Reserve Bank of India; Asian Development Bank estimates.

### Growth in services is forecast higher, while the industry outlook remains the same.

The services sector will continue to grow strongly in FY2023 and FY2024, supported by a high-performing banking sector, as well as professional services and real estate. Purchasing managers' indexes for manufacturing and services remain high (Figure 2.3.19), as does the industrial business outlook (Figure 2.3.20). Manufacturing sector growth will be slower than services in FY2023 but will improve in FY2024 on the back of a more optimistic industrial outlook and the government's policy efforts to boost manufacturing output.

**Figure 2.3.19 Purchasing Managers' Indexes**

Purchasing managers' indexes remain high.



Source: CEIC Data Company.

**Figure 2.3.20 Industrial Business Outlook**

The business outlook remains healthy.



Note: Net response is the difference between the percentage of respondents reporting optimism and those reporting pessimism. A value >0 indicates optimism for expansion, <0 pessimism about contraction.

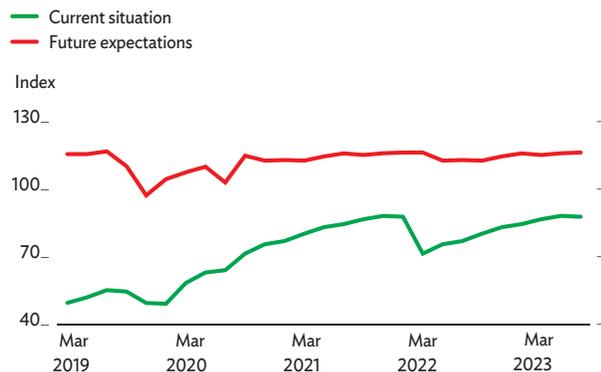
Source: Reserve Bank of India.

### Consumption will be robust in FY2023 with an improving labor market, especially formal sector employment.

The gradual lowering of consumer price inflation will further fuel consumption growth. Consumer confidence is improving, as expected, with the index increasing from 84.8 in January 2023 to 88.1 in July 2023 (Figure 2.3.21). Consumer sentiment is expected to further improve in 2024. Nevertheless, consumption growth in 2023 would be lower than expected in *ADO April 2023* due to expected weakness in rural consumption. As the agriculture sector contributes majorly to the rural economy, erratic rainfall patterns affecting *khari* crop output will likely lower agricultural income, thus affecting consumption. Export restrictions on certain varieties of rice and onions and other measures to contain prices may also impact farmer incomes.

### Figure 2.3.21 Consumer Confidence Survey

Consumer confidence is rising.



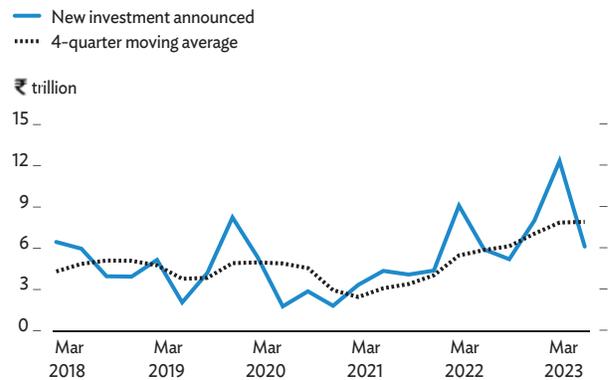
Note: The consumer confidence index is based on the responses of respondents on the economic situation, income, spending, employment, and prices. A value >100 indicates net optimism, <100 net pessimism. Source: Reserve Bank of India.

### Prospects for investment are getting better steadily despite the rise in interest rates.

Both central and state government capital expenditure growth is expected to continue to be strong in FY2023 and FY2024. Further, there is a continued uptick in the new investment project announcements, including by the private sector (Figure 2.3.22). Infrastructure sectors like roads and energy projects account for the majority of the increase in new projects, due to policy emphasis in these sectors. Private sector investment growth is driven by improving business outlook owing to rising corporate profitability, as input price increases have cooled off, and bank credit flows have been strong.

### Figure 2.3.22 New Investment Projects Announced

Rising project announcements point to robust investment growth.



Source: Centre for Monitoring of Indian Economy.

This is expected to continue in 2024 as well, along with a pickup in large manufacturing investments, driven by the implementation of private sector projects announced under the government production-linked incentives scheme. Household investment in real estate will also continue to grow strongly, fueled by improvement in housing affordability and improving urban incomes.

### External demand is muted, and lower commodity prices will lower imports.

The contraction in goods exports and slowing of services exports will continue in the remaining part of FY2023 due to weak demand in global markets, as expected in *ADO April 2023*. However, falling prices for imported energy relative to 2022 will help improve economic growth in FY2023. Both exports and imports are expected to improve in FY2024. On balance, net exports' contribution to growth will be negligible in FY2023 and FY2024.

### Monetary and fiscal policies are expected to broadly support economic growth.

Risks to growth from further monetary policy tightening are diminishing as core inflation and inflationary expectations have started to moderate, as indicated by central bank surveys. Given the current inflation outlook, the central bank is not expected to raise its policy rate in FY2023 and may lower it in FY2024. Fiscal policy is expected to be supportive of growth, by maintaining high government investment levels, and also with further fiscal consolidation, greater financial space will be available for the private sector borrowings to fund investment.

**GDP growth forecast is revised down from the ADO April 2023 projection to 6.3% in FY2023 and maintained at 6.7% for FY2024.**

On balance, India's economic growth will be resilient and strong. The lower FY2023 growth forecast takes into account the impact of extreme rainfall spatial patterns on *kharif* output, while the forecast for FY2024 assumes that rising private investments and industrial expansion will propel growth.

**Inflation is expected to moderate to 5.5% in FY2023 and 4.2% in FY2024.**

The forecast for FY2023 is higher than that in *ADO April 2023* on account of expectations of higher food prices. This forecast takes into account the effect of various government policy actions to reduce inflation, including export prohibition on non-basmati varieties of rice, export duties on other rice varieties, the maintenance of buffer stocks of pulses and onions, the removal of import duties on pulse imports, and a new fuel subsidy for cooking gas. On the other hand, core inflation is moderating at a faster-than-expected rate, which will dampen overall consumer inflation in FY2024 to 4.2%, lower than projected in *ADO April 2023*.

**The current account deficit is forecast at the equivalent of 1.8% of GDP in FY2023, lower than projected in ADO April 2023.**

A shrinking trade deficit, robust growth in service exports and improving remittances are key factors for improving external balances. The current account deficit is expected to be equivalent to 1.7% of GDP in FY2024. While foreign direct investment is expected to continue to be tepid, portfolio inflows can be expected to improve further, leading to stronger balance of payment position for India going forward.

**The outlook is subject to both upside and downside risks.**

The downside risks arise from global geopolitical tensions, which may further create economic uncertainty and/or lead to a rapid rise in the global food prices. Further weather-related shocks either at the time of harvesting of *kharif* season (July–October) or during the October–April *rabi* season may further affect agriculture growth. On the upside, economic growth could be higher in FY2024 than expected if foreign direct investment inflows are larger, particularly in the manufacturing sector, as a result of multinational corporations diversifying their supply chains by including India as a production location.

## Pakistan

**In fiscal year 2023 (FY2023, ended 30 June 2023), the economy was buffeted by severe floods, global price shocks, and political instability.**

Expansionary fiscal and monetary policy hit their limits. Growth fell, inflation jumped, the Pakistan rupee weakened, and international reserves shrank. In response, fiscal and monetary policy have been tightened. Adherence to an economic adjustment program through April 2024 will be critical for restoring stability and the gradual recovery of growth, which is projected to reach a moderate 1.9% in FY2024, with price pressures remaining elevated. Downside risks to the outlook remain exceptionally high.

### Updated Assessment

**Before FY2023, Pakistan had 2 years of strong growth but with rising imbalances.**

In FY2021 and FY2022, growth averaged 6.0%. Domestic demand was robust, stoked by fiscal deficits averaging 7.0% of GDP, negative real policy rates, and concessionary lending schemes. The current account deficit swelled from 0.8% of GDP in FY2021 to 4.7% in FY2022, driven by large trade deficits. Average inflation rose from 8.9% to 12.2% in FY2022.

**Severe shocks and policy slippage raised economic volatility in FY2023.**

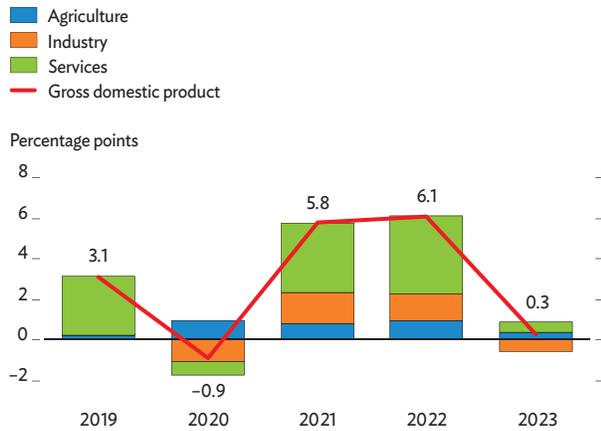
Massive floods hurt farm output and food stocks, jacking up food prices. Political unrest reduced investor confidence and consumer spending. High global prices for food and fuel cut purchasing power and raised import costs. Slower global growth curbed exports, and global monetary tightening reduced financing flows. Nevertheless, expansionary policies were continued, including large fuel and electricity subsidies. Due to missed targets under an International Monetary Fund (IMF) extended fund facility, IMF financing ceased, and flows from bilateral and multilateral sources also slowed. Tight foreign exchange controls reduced imports, which curtailed production due to the scarcity of critical inputs.

**Consequently, real GDP stagnated, and inflation jumped.**

Growth is provisionally estimated to have reached only 0.3% in FY2023 after 6.1% in FY2022 (Figure 2.3.23). Headline inflation averaged 29.2% in FY2023, a 5-decade high, largely reflecting higher food prices.

**Figure 2.3.23 Supply-Side Contributions to Growth**

Growth slowed significantly in 2023 across all productive sectors.



Note: Years are fiscal years ending on 30 June of that year. GDP at basic prices excludes indirect taxes less subsidies.

Source: Pakistan Bureau of Statistics, *National Accounts Tables Base FY2016*.

But core inflation, which excludes food and energy prices, was also high, at 16.1% for urban areas and 20.5% for rural (Figure 2.3.24).

**The slowdown spanned the main productive sectors.**

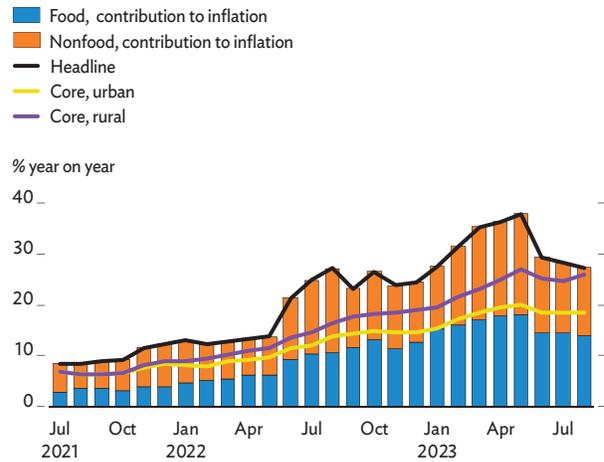
Agricultural output grew by only 1.6%, compared to 4.3% the previous year. Cotton and rice production fell, offsetting higher output of sugarcane, wheat, and livestock. Industrial production declined by 2.9%, against growth of 6.8% in FY2022. Manufacturing output shrank by 3.9%, with especially large declines in textiles (18.7%), autos (50.0%), and pharmaceuticals (28.8%) (Figure 2.3.25). Construction decreased by 5.5%. Service output grew by only 0.9%, compared to 6.6% in FY2022. Strong increases in education and in information and communication services barely overcame contraction in trade, finance and insurance services, and general government services.

**The slowdown was similarly broad across demand categories.**

Private consumption, which represents 88% of GDP, grew by 1.6%, compared to 6.8% in FY2022. Gross fixed capital formation fell by 17.8%, reflecting declines both in private and public sector investment. Exports shrank to 9.2% of GDP from 10.2% in FY2022 in national income account terms due to the supply shock from floods and ad hoc import controls.

**Figure 2.3.24 Inflation**

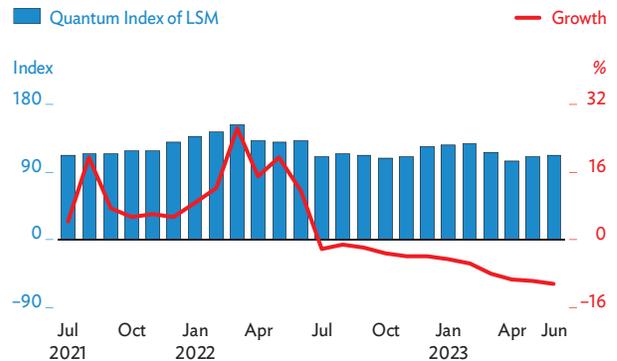
Inflation jumped to a 5-decade high due to high food and fuel prices.



Source: Pakistan Bureau of Statistics, *Monthly Review on Price Indices, July 2023*.

**Figure 2.3.25 Large-Scale Manufacturing**

Manufacturing output shrank in key sectors from high global fuel prices and import controls.



LSM = large-scale manufacturing.

Note: Years are fiscal years ending on 30 June of that year.

Source: Pakistan Bureau of Statistics. *Quantum Index Numbers of Large-Scale Manufacturing Industries*. June 2023.

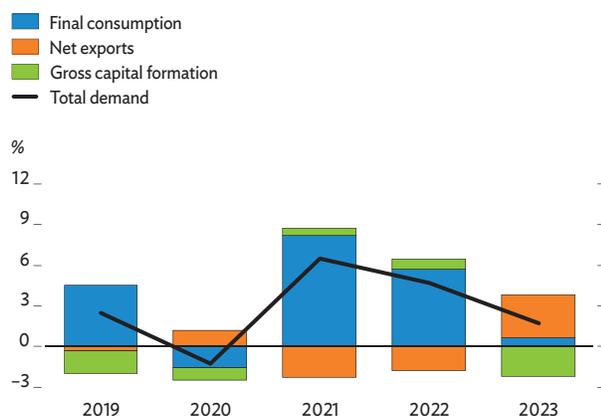
But because imports fell much more than exports, net exports contributed 3.4 percentage points to GDP growth (Figure 2.3.26).

**Lending stagnated on reduced activity, lower confidence, and higher interest rates.**

Loans to the private sector in FY2023 barely grew, compared to a rise of 21.1% in the previous year. While lending for fixed investment expanded by 6.6%, lending for working capital and consumer financing declined by 3.6%,

**Figure 2.3.26 Components of Demand Growth**

Private consumption stagnated, while investment fell sharply



Notes: Years are fiscal years ending on 30 June of that year. Total demand is gross domestic product at market prices, which includes indirect taxes less subsidies.

Source: Pakistan Bureau of Statistics, *National Accounts Tables Base FY2016*.

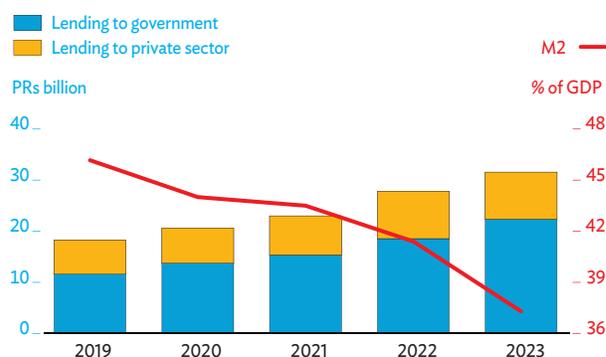
reversing a 20.9% increase in FY2022. However, strong capital and liquidity buffers kept the banking sector stable in FY2023. At the end of June 2023, banks' capital adequacy and liquidity coverage ratios stood at 17.8% and 107.9%, respectively, well above the statutory requirements. Gross nonperforming loans as a percentage of all loans fell from 7.8% in March 2023 to 7.4% in June 2023. However, provisioning against nonperforming loans continued its rise since December 2022, reaching 94.4% at the end of June 2023 (Figure 2.3.27).

#### Ad hoc import controls cut the current account deficit but at some cost.

The current account deficit shrank by 85% in FY2023 to \$2.6 billion (or 0.7% of GDP) from \$17.5 billion (or 4.7% of GDP) in FY2022 (Figure 2.3.28). Imports of goods and services fell by 29.0% in FY2023 to \$60.0 billion. Imports of key merchandise, including petroleum, machinery, and metals, declined, although food imports rose because of higher edible oil prices and imports of wheat to rebuild stocks. Import controls raised production costs, made critical inputs scarce, and thus hurt exports, with textiles and agriculture most affected. Exports of goods and services slipped by 11.1% to \$35.2 billion (Figure 2.3.29).

**Figure 2.3.27 Bank Lending**

Lending to the private sector stagnated, on low confidence and high interest rates.

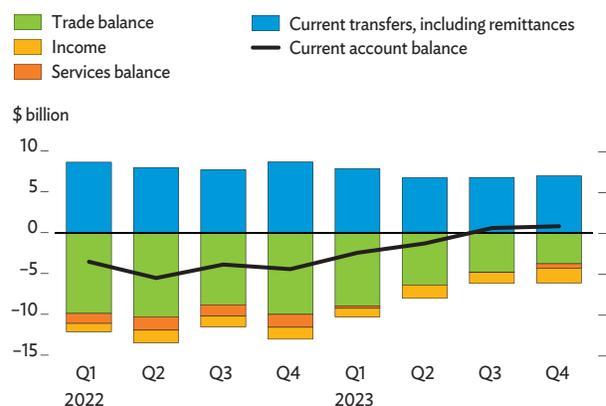


Notes: Years are fiscal years ending on 30 June of that year. Lending to government is net government borrowing for budgetary support.

Source: State Bank of Pakistan. Monetary Policy Compendium. July 2023.

**Figure 2.3.28 Current Account Balance**

The current account deficit shrank after strict import controls were imposed.



Q = quarter.

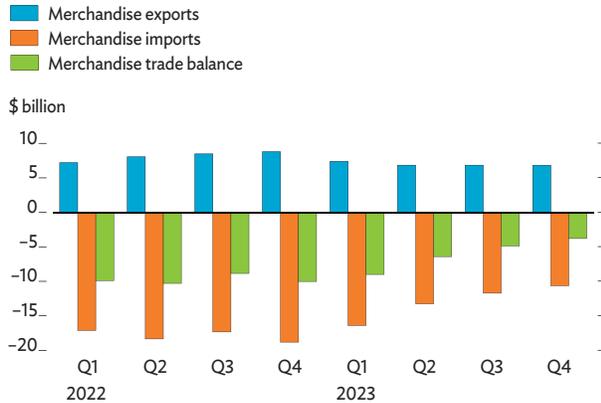
Note: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan. *Economic Data: External Sector*. Summary Balance of Payments as per BPM6—August 2023.

Administrative efforts to control the exchange rate led to the emergence of a parallel foreign exchange market with a substantial premium over the official exchange rate (Figure 2.3.30). This, in turn, led to a further tightening of foreign currency liquidity in the interbank market by encouraging the use of the parallel market for inward remittances and proceeds from service exports. Consequently, recorded workers' remittances fell by \$4.3 billion to \$27.0 billion in FY2023.

**Figure 2.3.29 Balance of Trade**

The trade deficit narrowed, though cuts in imports also reduced exports.



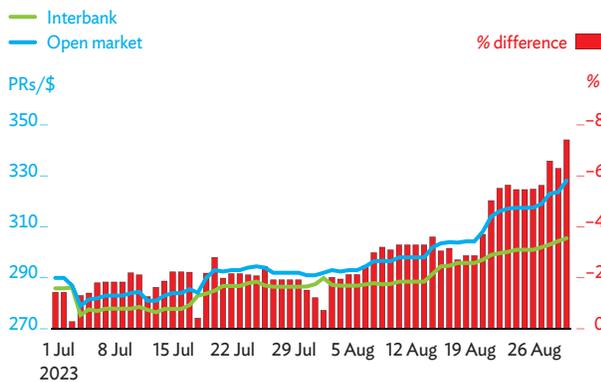
Q = quarter.

Note: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan. *Economic Data: External Sector*. Summary Balance of Payments as per BPM6—August 2023.

**Figure 2.3.30 Interbank and Open Market Foreign Exchange Rates**

Exchange rate controls led to a substantial difference between the official interbank and open market rates

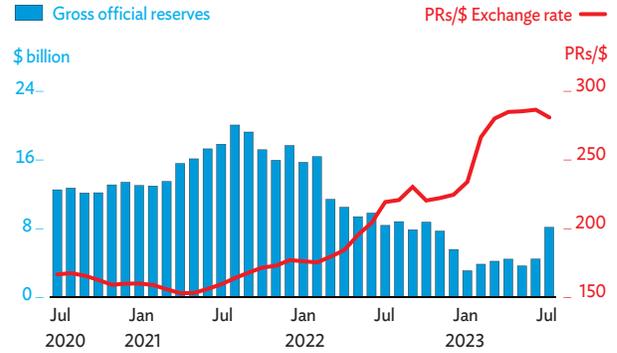


Source: State Bank of Pakistan. *Economic Data*.

**Despite a sharply narrowed current account deficit, international reserves plunged.** Net international reserves fell by more than half during FY2023, to \$4.5 billion from \$9.8 billion at the end of FY2022, reflecting a 40% larger outflow for external debt repayments (Figure 2.3.31). Official inflows declined by 12% from FY2022 as multilateral and bilateral flows diminished with the suspension of the previous IMF program. Pakistan could not issue bonds in international capital markets, while inflows of foreign

**Figure 2.3.31 Gross Official Reserves and Exchange Rate**

Foreign reserves plunged with the suspension of the previous International Monetary Fund program.



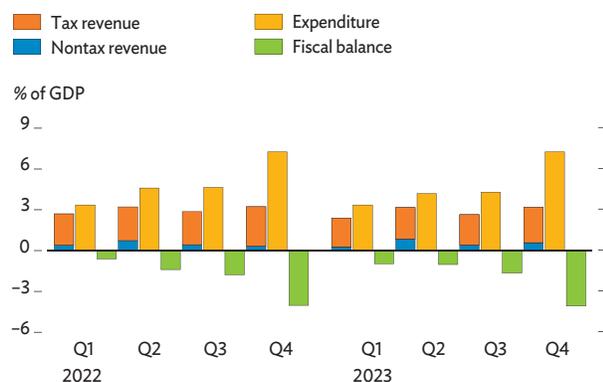
Source: State Bank of Pakistan. *Economic Data*.

direct investment declined by 33% to \$1.5 billion in FY2023, less than in each of the previous 3 years, reflecting low confidence from economic volatility and political uncertainty. Portfolio investment saw a net outflow of \$1.0 billion, as the Sukuk (Islamic) dollar bond came due for repayment in December 2022. In July 2023, after Pakistan reached agreement with the IMF, the IMF disbursed \$1.2 billion while Saudi Arabia and the United Arab Emirates lent a total of \$3.0 billion, raising foreign reserves to \$8.2 billion.

**The fiscal deficit remained high, on weak tax collection and higher interest outlays.** The target FY2023 budget deficit was raised from 4.5% of GDP to 6.9% of GDP, to allow for flood relief and rehabilitation. The actual deficit was higher, 7.7% of GDP, little changed from 7.9% in FY2022 (Figure 2.3.32). The primary balance registered a deficit of 0.8% of GDP, also above the revised target, although less than the 3.1% deficit in FY2022. Although tax revenues grew by 15.7%, they fell to 9.2% of GDP in FY2023 from 10.1% of GDP in FY2022, reflecting poor collections of sales taxes and customs duties from the economic slowdown and contraction in imports and industrial output. The decline would have been even larger if direct taxes had not risen by 0.4% of GDP, thanks to tax policy measures enacted through a mini budget revision in February 2023. Nontax revenues increased to 2.1% of GDP from 1.9% a year earlier, helped by an increase in the petroleum development levy to the statutory upper limit. Interest payments equaled 6.9% of GDP, 0.6 percentage points above

**Figure 2.3.32 Fiscal Indicators**

The fiscal deficit persisted on weak tax collection and high interest payments.



Q= quarter, GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

Source: Ministry of Finance, Pakistan Summary of Consolidated Federal & Provincial Fiscal Operations, July–June FY2023.

the revised estimate and absorbing three-fourths of all tax revenues. To contain the deficit, the government cut development and noninterest current spending, restricting total expenditures to the revised estimate of 19.1% of GDP.

**Debt vulnerabilities rose significantly.** Because of the large fiscal deficit, the weaker rupee, and slow growth, public debt rose to 74.3% of GDP in FY2023, above the 73.9% of GDP in FY2022. External debt, despite a decline in dollar terms due to scarce external finance, increased to about 32.1% of GDP from 30.5% of GDP in FY2022, reflecting the large exchange rate depreciation (Figure 2.3.33). Credit rating agencies downgraded the country's sovereign ratings to just above the default threshold. Nevertheless, the IMF's latest assessment concluded that public debt remains sustainable, assuming steadfast implementation of the adjustment program.

## Prospects

**The economy's near-term prospects will heavily rely on progress under the economic adjustment program.** The program aims to stabilize the economy and rebuild buffers for domestic and external balance, thereby providing a foundation for a possible successor program under the new government expected to be elected in the first quarter of calendar year 2024. The program involves fiscal consolidation, monetary

**Figure 2.3.33 Government Domestic and External Debt**

External debt remained high in 2023.



Notes: Years are fiscal years ending on 30 June of that year. External debt includes government and other external liabilities and public corporations.

Source: State Bank of Pakistan, *Economic Data*.

tightening, and a return to a market-determined exchange rate, as well as structural reforms in energy, state-owned enterprises, banking, and climate resilience.

**The economy is projected to recover modestly in FY2024 with base effects from the post-flood recovery.** Uncertainty will linger, though, and stabilization measures will limit the growth of demand. Growth in FY2024 is projected to be 1.9%, slightly lower than the *ADO April 2023* forecast (Table 2.3.3). The revised projection assumes a modest rebound in demand, with private consumption and private investment growing by about 3% and 5%, respectively. Fiscal and monetary tightening will crimp demand, as will inflation staying in double digits. On the other hand, implementation of the economic adjustment program and a likely smooth general election should boost confidence, while the easing of import controls should support investment as fiscal tightening restrains public consumption. On the output side, better weather conditions will enable an increase in the area under cultivation and in yields, supporting recovery in agriculture. The government's relief package of free seeds, subsidized credit, and fertilizer will also help. In turn, the recovery of farm output will feed through to industry, which will also benefit from the increased availability of critical imported inputs. The recovery of output will enable exports to pick up, although imports will grow much faster, due to pent-up demand. However, the downside risks are significant, including from global price shocks and slower global growth.

**Table 2.3.3 Selected Economic Indicators in Pakistan, %**

Growth in FY2023 proved lower, and inflation higher, than in ADO April 2023, while the forecast inflation for FY2024 has been raised in light of the high inflation in FY2023.

|            | 2022 | 2023 |      | 2024 |      |
|------------|------|------|------|------|------|
|            |      | Apr  | Sep  | Apr  | Sep  |
| GDP growth | 6.1  | 0.6  | 0.3  | 2.0  | 1.9  |
| Inflation  | 12.2 | 27.5 | 29.2 | 15.0 | 25.0 |

FY = fiscal year, GDP = gross domestic product.

Note: Years are fiscal years ending on 30 June of that year.

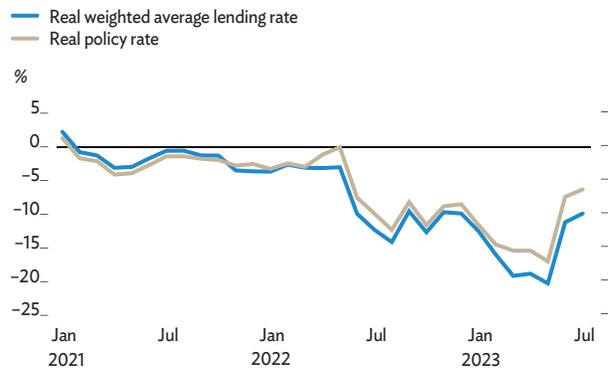
Sources: Pakistan Bureau of Statistics; Asian Development Bank estimates.

**Fiscal tightening will come from raising revenues and containing spending.** The FY2024 budget targets a primary surplus of 0.4% of GDP and an overall deficit of 7.5% of GDP, gradually declining over the medium term. Tax revenues are programmed to hit 10.3% of GDP in FY2024. Provincial spending will be cut by 0.4% of GDP and spending on defense and energy subsidies will be limited, while protecting priority social and development outlays. The government has committed to granting no further tax amnesties or issuing new tax preferences or exemptions.

**Despite continued monetary tightening, disinflation faces headwinds.** Inflation is expected to ease in FY2024, as base-year effects set in, food supply normalizes, and inflation expectations moderate. In addition, the central bank will likely raise the policy rate from the 22% it set in July 2023 to gradually reduce inflation to its medium-term target of 5%–7% (Figure 2.3.34). The central bank has agreed to achieve positive real interest rates, refrain from introducing new refinancing schemes, and contain refinancing credits. However, significant inflationary pressures remain. Sharp increases in petroleum, electricity, and gas tariffs are envisaged under the program. As import and exchange rate controls are eased, the rupee could further weaken, raising the cost of imported goods. (Figure 2.3.35). El Niño and the continuing Russian invasion of Ukraine could disrupt supplies and raise prices of wheat, rice, and other basic foodstuffs. Hence, inflation will likely remain high at about 25% in FY2024, significantly higher than projected earlier in ADO April 2023.

**Figure 2.3.34 Interest Rates**

The central bank raised interest rates, but rates remained negative in real terms.

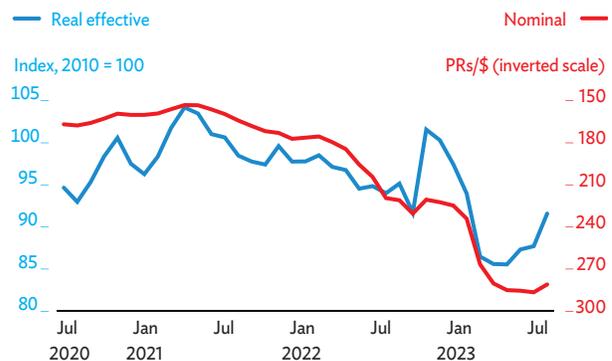


Note: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan, *Economic Data*.

**Figure 2.3.35 Exchange Rates**

The rupee weakened through FY2023.



Note: Years are fiscal years ending on 30 June of that year.

Source: State Bank of Pakistan, *Economic Data*.

**Easing import and exchange rate controls will have competing effects on the current account balance and reserves.** Imports should increase as economic activity recovers and as businesses find it easier to import inputs. But exports should also recover, despite slower global growth, on greater availability of inputs, improved farm output, and a more competitive rupee. On balance, the current account deficit is projected to increase to about 1.5% of GDP in FY2024. Despite the larger deficit, international reserves should grow. The new program with the IMF has improved the prospects for multilateral and bilateral financing, while a more market-determined exchange rate is expected to stabilize the currency market and encourage remittance inflows through official channels.

**Downside risks to the outlook remain exceptionally high.** On the external front, tighter global financial conditions and potential supply chain disruptions from any escalation of the Russian invasion of Ukraine will weigh on the economy. Amid the upcoming election season, persistent political instability will remain a key risk to implementing reform toward growth stabilization, the restoration of confidence, and sustainable debt. Disbursement from multilateral and bilateral partners would remain crucial for reserve accumulation, exchange rate stability, and improved market sentiment.

## Other Economies

### Afghanistan

**In the first half (H1) of 2023, the economy showed some signs of recovery following 3 successive years of recession.** Exports and revenue collection rose, banks became slightly more liquid, the afghani exchange rate and inflation stabilized, and work availability for both skilled and unskilled labor improved following a seasonal slump from November 2022 to February 2023. These developments were mainly due to continued international humanitarian and basic needs support, lower global food and oil prices, and better security. However, recovery remains fragile, particularly with tightening restrictions on women's education and their employment in nongovernment organizations and United Nations agencies, and exclusion of women from other economic activities such as closure of beauty salons. Officially excluding women from the workforce has complicated the delivery of humanitarian assistance, degraded women's skills, and negated their economic potential. Less directly, it has intensified instability, outward migration, and the consequent loss of trained professionals and other experts.

**While mining showed some improvement in H1 2023, industry, services, and agriculture remained subdued.** Business confidence was weak because of governance issues, policy uncertainty, and the risk of macroeconomic instability. Agriculture, already suffering from drought, could weaken further under a threatened locust outbreak in H2 2023, with potential wheat losses forecast at 0.7–1.2 million tons.

Moreover, the successful suppression of opium—without, so far, any announcement of an official effort to supply alternative livelihoods—could eliminate more than \$1 billion in rural earnings annually, hitting trade, transport, exports, and construction.

**Inflation has turned around this year.** After global oil and food price shocks caused sharp spikes in the first 3 quarters of 2022, with average inflation reaching 15.0% year on year in January–April 2022, inflation braked to 2.0% in the same period of 2023, with 1.0% deflation year on year in April, the deepest in 5 years, as food prices declined by 3.3% and prices for other goods by 1.8%. The main reasons for lower inflation were falling import prices and afghani appreciation against the Pakistan rupee, the Iranian rial, and major international currencies, including the US dollar.

**Afghanistan's trade deficit widened to \$2.4 billion in the period from January to May 2023.** Imports soared by 36% over the same 5-month period in 2022 to \$3.1 billion, while exports grew by only 9% to \$0.73 billion, reflecting mainly increases in textiles, coal, and vegetables. With the formal banking system crippled, informal money service providers have thrived and facilitated import financing and remittances.

**Revenue collection reached AF63 billion in the first 4 months of fiscal year 2023 (FY2023, ending on 20 March 2024).** This was a 16% increase over the same period of FY2022. Growth came mainly from the surge in imports, which increased revenue collection at the border by 23%. Inland revenue collection rose by 7% on higher mining royalties.

**Afghanistan's economic outlook is challenging.** Humanitarian assistance is critical to the economy, which lacks other drivers for a rebound. If humanitarian assistance continues at the 2022 level, modest growth is expected in FY2023, with annual average inflation in the middle single digits in calendar year 2023. Inflation relief could bolster real household income and possibly improve food security. However, further economic contraction and high inflation could come from any decline in humanitarian assistance or as spillover from economic and political difficulties in neighboring countries.

## Bhutan

**Adverse weather has diminished Bhutan's growth prospects in 2023, hitting both agriculture and industry.** Summer monsoon rains have been erratic this year, undermining crop production in every part of the country. The growth forecast for agriculture is thus revised down from 3.2% in ADO April 2023 to 2.8%. Projected growth in industry is similarly revised down from 3.2% to 2.8% in response to a 7.4% fall in hydropower output year on year in the first 5 months of 2023. After adjusting for a low base because the Tala hydropower plant was shut down in January–February 2022, the shortfall in hydropower output approaches 19%, caused by subpar hydrological flows. In addition, projected growth in construction is revised down by 2.0 percentage points following the suspension in June of credit for building commercial housing projects and hotels. The suspension aimed to address concerns about nonperforming loans and conserve foreign exchange reserves. With developments in manufacturing and mining unfolding as expected, manufacturing is still projected to grow by 3.3% and mining to contract by 1.5%. Growth in services is now forecast 0.3 percentage points higher, with improvement in tourist arrivals expected to continue under a new government incentive from 1 September that cut the prevailing daily sustainable development fee of \$200 by half. Tourist arrivals picked up from 22% of the pre-pandemic number in the first quarter of 2023 to 46% in April.

**The growth forecast is downgraded for 2023 but upgraded for 2024 (Table 2.3.4).** The 2023 downgrade follows adverse developments affecting hydropower and construction, which together provided 26.0% of GDP in 2022. The 2024 growth forecast is revised marginally higher because of the lower base now projected for 2023. Major factors behind 2024 projections made in April are unchanged, notably the opening of the Nikachhu hydropower plant by the end of 2023 and the Punatsangchhu II plant by the end of 2024.

**Risks to growth derive mainly from energy, especially the schedule for commissioning new hydropower plants.** Further delays affecting Nikachhu and Punatsangchhu II would derail growth prospects, but none are expected as both projects

**Table 2.3.4 Selected Economic Indicators in Bhutan, %**

*Projections now see slightly slower growth and significantly slower inflation in 2023, with forecast growth improvement in 2024 mostly from a base effect.*

|            | 2022 | 2023 |     | 2024 |     |
|------------|------|------|-----|------|-----|
|            |      | Apr  | Sep | Apr  | Sep |
| GDP growth | 4.7  | 4.6  | 4.3 | 4.2  | 4.4 |
| Inflation  | 5.6  | 5.5  | 4.1 | 5.1  | 5.1 |

GDP = gross domestic product.

Sources: Royal Government of Bhutan, Ministry of Finance; Royal Monetary Authority, Bhutan; Asian Development Bank estimates.

are close to completion. Another domestic risk to growth is continued deterioration in Bhutan's foreign reserve position, which declined from \$766.6 million in December 2022 to \$549.1 million in May 2023 as the nominal value of imports, as reported by Bhutan Trade Statistics, grew by 30% quarter on quarter in the first quarter of 2023 while exports held steady. This continues a steady decline in reserves from \$1.5 billion in March 2021. In addition to high commodity prices in 2022, a contributing factor has been the import of over \$200 million in information technology equipment since mid-2021, a significant part of which is likely to support digital asset mining, mostly Bitcoin. Other risks to growth include constrained fiscal space and skilled workers' steady emigration to advanced economies.

**Headline inflation in the first 5 months of 2023 averaged 3.7% year on year.** This was much lower than expected, thanks to a midyear drop in fuel prices and low food inflation at only 1.8%. Inflation in the second half of the year is projected to rise to 4.5% as food price pressure results from the impact of the erratic monsoon on domestic agriculture, export restrictions imposed by neighboring countries on food commodities, and expected increases in global prices. The 2024 inflation forecast is maintained.

## Maldives

**Robust tourism was sustained in the first half (H1) of 2023 as arrivals grew by an impressive 14.3% year on year.** Expansion mainly reflected restored tourism from the People's Republic of China (PRC) beginning in the first quarter and recovery in

the Russian market from a weakened 2022. With the resumption in flights from the PRC, arrivals from the country surged in H1 2023, accounting for 51.3% of the growth in arrivals and 6.8% of total arrivals. In the same period, arrivals from the Russian Federation rebounded by 33.0% year on year, to provide 23.2% of growth in arrivals. Despite arrivals growing by only 6.1%, Europe continued to be the dominant regional tourist market with a 58.6% share. And, though arrivals declined by 8.5% year on year, India remained the largest single country tourist market, accounting for 11.9% of tourist arrivals. Bed-nights sold, a proxy for tourism income, grew by 9.8%. Growth in construction and investment was also strong, as evidenced by a 16.8% increase year on year in imports of construction materials in H1 2023, largely reflecting higher public investment.

**Projections for 2023 and 2024 are for continued strong growth, though falling short of sizable expansion in 2022.** High growth that year reflected continued recovery from an enormous 33.5% GDP contraction in 2020 because of COVID-19. With 929,607 tourists arriving in H1 2023, the ADO April 2023 projection of 1.8 million tourists in the whole year is attainable, especially as the fourth quarter is the peak tourism season. Strong travel demand is likely to carry over into 2024 as more airlines recommence direct flights with the PRC. Construction is also poised to remain expansive, thanks to substantial public investment scheduled for H2 2023 and 2024. On balance, ADO April 2023 forecasts for GDP growth in 2023 and 2024 are retained (Table 2.3.5).

**The main downside risk to the outlook would be a major shortfall from forecast global growth, disrupting tourism.** In addition, global interest rates substantially higher than expected would further deteriorate fiscal and debt sustainability in Maldives, considering the country's scant foreign exchange reserves.

**Inflation will remain low, though with adjustments to forecasts in 2023 and 2024.** Average inflation in H1 2023 climbed to 3.5% year on year, reflecting a hike in goods and services taxes from 1 January that exerted upward pressure on local prices. Inflation in H2 2023 appears likely to average 3.5% as well, with the impact of the tax hike less than expected in ADO April 2023. In 2024, inflation will rise slightly higher than forecast in April due to the lower base now projected for 2023.

**Table 2.3.5 Selected Economic Indicators in Maldives, %**

ADO April 2023 growth projections are retained, while the inflation forecast for 2023 is trimmed and that for 2024 is raised.

|            | 2022 | 2023 |     | 2024 |     |
|------------|------|------|-----|------|-----|
|            |      | Apr  | Sep | Apr  | Sep |
| GDP growth | 13.9 | 7.1  | 7.1 | 6.9  | 6.9 |
| Inflation  | 2.3  | 4.5  | 3.5 | 2.0  | 2.5 |

GDP = gross domestic product.

Sources: Maldives Monetary Authority. Monthly Statistics. July 2023; Asian Development Bank estimates.

In view of the foregoing, the 2023 inflation forecast is lowered, while that for 2024 is revised slightly higher.

**The merchandise trade deficit improved from \$1.5 billion in H1 2022 to \$1.3 billion a year later as exports grew and imports contracted.** The services balance weakened in January–April 2023, however, because advance travel sales for 2023 were booked in the fourth quarter of 2022 to avoid the hike in goods and services taxes. Developments to date are within expectations in ADO April 2023, which projected trade and current deficits narrowing in 2023 on moderating prices for oil and other commodities and improved travel receipts, then widening marginally in 2024 as global oil prices pick up.

## Nepal

**Following 2 years of strong expansion since the pandemic shock, growth fell more than expected in fiscal year 2023 (FY2023 ending mid-July 2023).** This update lowers the growth projection for FY2023 to align with the preliminary estimate (Table 2.3.6). Significant growth moderation reflects tight monetary policy and fiscal consolidation used by the authorities to address rising inflation and pressure on foreign exchange reserves. The overnight repo policy rate was raised from 5.5% to 7.0% in August 2022. Affected by higher interest rates, import restrictions in the first 5 months of FY2023, and sharply lower growth in external demand, industry grew by only 0.6% as manufacturing and construction contracted. Growth in services fell by half to 2.3% as wholesale and retail trade contracted. Agriculture, however, expanded by 2.7% as a normal monsoon boosted rice

**Table 2.3.6 Selected Economic Indicators in Nepal, %**

*Growth will accelerate from a low base in fiscal 2024 as the authorities revise macroeconomic policies.*

|            | 2022 | 2023 |     | 2024 |     |
|------------|------|------|-----|------|-----|
|            |      | Apr  | Sep | Apr  | Sep |
| GDP growth | 5.6  | 4.1  | 1.9 | 5.0  | 4.3 |
| Inflation  | 6.3  | 7.4  | 7.7 | 6.2  | 6.2 |

GDP = gross domestic product.

Note: Years are fiscal years ending in mid-July of that year.

Sources: Asian Development Bank estimates.

yields. On the demand side, 4.1% expansion in private consumption underpinned growth as fixed investment contracted by 10.9%—with private investment down by 7.6% and public investment by 20.2%—subtracting 3.9 percentage points from GDP growth. Moreover, a steep drop in stocks reduced overall capital formation by 13.0%. Net exports were the major contributor to growth in FY2023 as imports contracted by 17.2%.

**The growth forecast for FY2024 is revised down from the ADO April 2023 projection.** This reflects weaker projected growth in the major advanced economies than in April baseline forecasts and the need to continue guarded macroeconomic policies and strengthen structural reform. While notable progress in restoring external balance has been made, fiscal challenges persist. On balance, economic activity in FY2024 will be curtailed by low domestic and external demand, continued weakness in investor confidence, high interest rates, and deficient rainfall in June that will likely suppress agricultural output. Considering these developments, Nepal Rastra Bank, the central bank, adjusted its monetary stance by lowering the policy rate by 50 basis points to 6.5% and by relaxing provisions on working capital loans to revive investor confidence, while the government has prioritized capital budget execution with the issuance of guidelines for its effective implementation. Fixed investment will provide the main impetus to growth in FY2024, reversing the drag it exerted in FY2023. With foreign exchange reserves rebuilt, there is little risk to external balance.

**Inflation in FY2023 averaged 7.7%, a bit higher than ADO April 2023 projected.** Annual food inflation averaged 6.6% as prices rose for cereal grains, spices, dairy products, and eggs. Nonfood inflation averaged 8.6%, despite a sizable decline in global fuel

charges, as prices rose for transportation, health, education, and housing and utilities. The inflation forecast for FY2024 is retained in anticipation of a subdued increase for oil and lower inflation in India, Nepal's main source of imports.

**The current account deficit in FY2023 narrowed by a massive 89.2% to \$557.1 million, equal to 1.4% of estimated GDP.** This reflected a 22.2% decline in the trade deficit and a 12.1% increase in remittance inflow, the traditional offset to the trade deficit, which brought foreign exchange reserves to \$11.7 billion in FY2023, providing import cover for 10.0 months. This was a marked improvement from \$9.5 billion in FY2022, which covered only 6.9 months. The current account deficit is expected to widen to 1.8% of GDP in FY2024 as growth revives, albeit less than projected in ADO April 2023.

## Sri Lanka

**Economic conditions have gradually stabilized.**

Increased food and fuel availability signals better supply conditions since ADO April 2023. Official reserves, which include a People's Bank of China swap, have strengthened but still languish below 3 months of import cover. Better foreign currency liquidity has allowed most import controls to be lifted. The government has made progress on reforms envisaged under the International Monetary Fund program, having enacted an anticorruption bill and legislation that enhances the independence of the Central Bank of Sri Lanka and its powers to manage financial crises.

**In the first quarter of 2023, the economy contracted by 11.5% year on year.** Industry shrank by 23.4%, constrained by higher production costs, higher taxes, and lackluster demand. Services contracted by 5.0%, mostly from declining financial and insurance services and real estate, but agriculture grew by 0.8%. Constrained economic conditions and fiscal austerity lowered both private and government consumption, and gross capital formation continued to decline. Net exports contributed positively to GDP as imports remained constrained.

**Leading indicators remain muted.** The manufacturing purchasing managers' index remained below 50 in July, indicating contraction for a fourth consecutive month, and the index of industrial production contracted by

10.9% in the first half of 2023. However, the services purchasing managers' index surpassed 50 in April and every month since. With developments since April in line with expectations, growth forecasts for 2023 and 2024 are unchanged (Table 2.3.7).

**Table 2.3.7 Selected Economic Indicators in Sri Lanka, %**

*Growth forecasts remain unchanged, but lower inflation is now projected for 2023.*

|            | 2022 | 2023 |      | 2024 |     |
|------------|------|------|------|------|-----|
|            |      | Apr  | Sep  | Apr  | Sep |
| GDP growth | -7.8 | -3.0 | -3.0 | 1.3  | 1.3 |
| Inflation  | 46.4 | 24.6 | 18.7 | 5.5  | 5.5 |

GDP = gross domestic product.

Sources: Central Bank of Sri Lanka; Asian Development Bank estimates.

#### **Inflation has decelerated more than expected.**

Subdued demand and better supply conditions drove down inflation, as measured by the Colombo consumer price index, from 69.8% year on year in September 2022 to 6.3% in July 2023. The central bank reduced its policy rate by 2.5 percentage points in June and a further 2.0 points in July, and cut the statutory reserve ratio by 2.0 percentage points in August amid muted demand for private sector credit. Market interest rates have declined but remain in double digits. Given these developments, the inflation forecast for this year is revised down from the April projection.

#### **Weak global demand and higher production costs lowered export earnings, but imports also declined.**

In the first half of 2023, export earnings fell by 10.0% year on year, but imports plunged by 18.6%, shrinking the trade deficit from \$3.5 billion a year earlier to \$2.3 billion.

With gradual relaxation of import restrictions and continued weak exports, the trade deficit is expected to widen in 2023. Remittances in January–July 2023 soared by 78.0% year on year, and tourist arrivals improved by 67.4%. The current account flipped from \$1.3 billion deficit in the first quarter of 2022 to \$644 million surplus a year later.

#### **Official reserves doubled to \$3.8 billion in the 7 months to the end of July.**

The rebuilding of reserves reflected support from international financial institutions, inflow into government securities, and central bank net dollar purchases of \$1.5 billion in the period, during which the local currency appreciated by 10.2% against the US dollar.

#### **Parliament approved in July a framework to optimize domestic debt.**

This allows the reprofiling of Treasury bills held by the central bank and bonds held by superannuation funds through step-down coupons and maturity extensions, the conversion of provisional advances to the government into Treasury bonds, and the restructuring of dollar-denominated local debt. However, to minimize impact on the financial system, these provisions exclude government securities owned by banks. Government bond yields have dropped as uncertainty has eased.

#### **Economic conditions have improved, but risks remain.**

Sri Lanka needs to implement structural benchmarks and meet quantitative performance criteria under the International Monetary Fund program and ensure the timely completion of debt restructuring. Adverse weather could have a prolonged impact on agriculture. Also, outward labor migration, particularly by highly skilled workers, may constrain recovery.