IMF report

What is the issue?

- The Article IV Consultation document of the IMF released recently is much more optimistic than the recent commentaries on Indian economy.
- This is partly due to its analysis of the slowdown of the Indian economy.

What is the analysis?

- The policy prescriptions are based on the data available until October, 2019 and do not include the estimates of the second quarter GDP.
- While noting that the first quarter growth was low at 5%, it expects growth to rebound in the remaining quarters.
- This is based on the presumption that investment and private consumption will firm up in the second half of the year.
- This is supposed to transpire due to the lagged effects of accommodative monetary policy, actions to facilitate its transmission, ensuring liquidity, and support by the government to augment rural consumption.

What does the report present?

- The IMF report presents two scenarios for the future - one **baseline** and another with **reforms**.
- **Baseline** - Under this scenario, growth is expected to accelerate to a medium term potential of 7.3%
- This can be achieved by continued commitment to inflation targeting, gradual macro-financial and structural reforms, including the lagged effect of earlier reforms.
- These reforms include implementation of the Goods and Services Tax (GST) and the Insolvency and Bankruptcy Code (IBC) and measures to liberalise FDI flows, and further improve the ease of doing business.
- **Reforms** - In this scenario, it recommends many reforms to boost inclusive growth which will help spur productivity and employment.

What are the three pillars of reform?

- Ongoing **clean-up of bank balance sheets** complemented by strengthening of PSB governance and regulation, and oversight of NBFCs.
- A **fiscal consolidation** anchored to reduce general government debt toward 60% of GDP as recommended by the FRBM Review Committee.
- **Reform of the markets** to enhance labour market flexibility, formalising the economy, improving employment opportunities, enhancing competition and reducing the scope for corruption.

What are the risks?

- The IMF report states that the downside risks to growth can arise.
- They may arise from the inability to undertake structural reforms, shortfalls in revenue collections, slowness in cleaning up the balance sheets of the PSBs and corporate.
- **Subdued credit growth** arising from risk aversion from the banks and external factors like rising protectionism and the possibility of oil price increase are other factors.
- Even so, the IMF team did not foresee the sharp decline in the second quarter growth of GDP to 4.5%, the lowest in 26 quarters, and it won't be long before it allows a downward revision of growth for the year.

What should the government do?

- The report stated that the government should continue to **pursue the medium-term fiscal consolidation** towards reducing general government debt to 60% of GDP.
- It states that fiscal stimulus should be avoided at the present juncture to reduce fiscal dominance which has led to financial repression.
- Immediate focus should be to make more realistic revenue projections, enhance fiscal transparency and make the budgetary coverage more comprehensive to avoid off-budget borrowings.

What are the constraints?

- Some of the downside risks reviewed in the IMF report have already been realised as the growth rate in the second quarter plunged to 4.5%
- Both the investment and private consumption as ratio of GDP, declining, and exports are virtually stagnant.
- So, the only way to trigger a virtuous cycle of investment and growth, in the present juncture, may have to come from public investments.
- The cleaning up of the balance sheets of the banks and corporate have been a slow process.
- A clear reading of the report indicates that IMF is not likely to recommend

any slippage in fiscal consolidation path even if it recognises the constraints pointed above.
- The report is categorical in stating that the **“fiscal space is at risk”** and there is no scope to provide fiscal stimulus at this juncture.
- The only concession it seems is that the Central government’s extended deficit should be held constant at 5.4% of GDP.

What is the forecast?

- According to the report, the growth impetus should essentially come from monetary policy and structural reforms.
- There is space for further monetary policy actions depending on the inflation risk, and the unlikely immediate impact of both monetary policy and structural reforms.
- Due to this, the forecast is that we are not likely to see a quick turnaround, and returning to the medium-term potential growth rate of 7.3% is not likely.
- Even the much promised **strategic disinvestment** has not been forthcoming.

What is next?

- The government should speed up this process to **accelerate public investments**.
- It is important to bring out the actual fiscal deficit, taking that as the base, lay down a credible consolidation path to reduce debt.
- The experience shows that the government, does not seem to care for realism in projections nor bother about transparency and comprehensiveness in coverage.
- For this reason, the time is opportune to think of an institutional monitoring mechanism by establishing an independent **Fiscal Council** reporting to the Parliament by amending the **FRBM Act as recommended by the 14th Finance Commission.**
- The Fiscal Council can focus on three important issues namely,
    1. Evaluating the realism of the forecasts,
    2. Bring out off-budget transactions to ensure greater transparency,
    3. Realistically estimating cost of various schemes and programmes announced by the government from time to time.

Source: Financial Express

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