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STATEMENT BY THE FINANCE MINISTER OF INDIA SHRI P. CHIDAMABARAM AT THE 26TH MEETING OF THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE (IMFC) IN TOKYO

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Please find below the **text of the Statement made by the Union Finance Minister and Leader of the Indian Delegation Shri P. Chidamabaram at the 26th Meeting of the International Monetary and Financial Committee (IMFC) in Tokyo yesterday** (Representing the Constituency consisting of Bangladesh, Bhutan, India and Sri Lanka)

Mr. Chairman,

We are meeting at a time when the global economy is facing heightened uncertainties.

Despite several measures by the authorities, financial market fragilities have increased and the global economic outlook is quite worrisome. Growth is faltering across regions, including in emerging market economies (EMEs). When we met in April last year we agreed that we would continue to act collectively to restore confidence, rekindle growth and create jobs. It is, therefore, appropriate to take stock of the progress made in realizing our goals so that we are better prepared to face the emerging challenges.

The Global Economy and Financial Markets

Uncertainties in major advanced economies have weighed on market confidence and sentiment. Consequently, the global economy has lost the upward momentum seen in the early part of the year and is now experiencing a synchronized slowdown. Many euro area economies are, in fact, in recession. By all indications, the global economy is likely to remain weak for a longer period than it was envisaged a few months back.

In the last few years, robust growth in the EMEs cushioned the slowdown in global growth to a significant extent. However, fragile financial market conditions have dented business confidence in many EMEs. Capital flows to emerging market economies remain volatile. Despite weak global recovery, global commodity prices, especially energy, have remained elevated and volatile. Although a major risk to global oil prices is on account of geo-political tensions, large liquidity being injected by major advanced economies may also exert further pressure on oil prices. This will threaten both growth and inflation in emerging market economies. The sharp rise in global food prices is another major challenge that many emerging market economies, especially those which are already facing inflationary pressures, may have to contend with.

Recent uncertainties have added to vulnerabilities in financial markets. Deleveraging by the banks has led to tightening of credit conditions for borrowers in many periphery economies. Large front-loaded fiscal adjustment by a number of euro area countries, including those that have fiscal space, has led to sharp slowdown in demand and growth. The adverse feedback loop of weak growth, weak fiscal position and weak banks remains a major risk to global financial stability.

Policy Challenges

The present state of the global economy poses huge challenges for policymakers in both advanced and emerging market economies. It is imperative for policy makers to bring some changes in the institutional and operational architecture to quell doubts about the long term sustainability of the monetary union. The immediate challenge is to prevent the adverse feedback loop between banks and sovereigns. However, in the absence of long-term measures, uncertainty will continue, which will pose risk to global macroeconomic and financial stability.

The issues of fiscal cliff and the lifting of the debt ceiling in the US also need to be resolved. The need is to put in place a medium-term fiscal plan while avoiding excessive fiscal correction in the short run. Should the economic situation in the US worsen, its impact on emerging market economies will be much more severe than in the case of the situation in the euro area.

Given the uncertain global macroeconomic environment, emerging market economies need to strengthen domestic demand to offset the decline in external demand. Emerging market economies are undergoing not only a cyclical slowdown, but also an erosion of their potential output. A major challenge for these economies, therefore, is to regain the losses in potential output by introducing structural reforms. Given the recent sharp increase in food prices, EMEs also need to formulate appropriate supply responses.

The IMF's Role– Architecture for Global Cooperation

Let me now touch upon some of overarching issues relating to global cooperation that need to be addressed in the context of safeguarding global economic and financial stability in the period ahead.

Quota and Governance Reform

We had hoped that the 2010 Quota and governance reform would be implemented by the target date of the Annual Meetings of 2012. There is an urgent need to complete this at the earliest. We have always taken the position that the best possible means to improve governance and legitimacy is to put crucial reforms on the quota formula upfront. Since the initiation of the work relating to the reform of the quota formula last year, the discussions at the G 20 Working Group or at the IMFC have revealed very little progress. We must not let the Quota Formula discussions meander into areas which are not part of the overall understanding reached at different G 20 and IMFC summits -- that there will be a clear shift of the quota shares in favour of the Emerging Market and Developing Countries, (EMDCs) to reflect more clearly the shifting global economic scenario and to make decision-making in the IMF more equitable. We must also adhere to the timeline for completing this reform by January 2013 so that it becomes the basis for the 15th General Review of quotas to be completed no later than January 2014.

GDP is the most important variable in the quota formula as it is the most robust measure of relative economic weight and stake in the global economy. Furthermore, the most appropriate way to measure the real size of an economy is in terms of purchasing power parity. It is therefore important that the weight of the blended GDP variable should be substantially increased in the formula through a simple formula with GDP blend as the predominant variable and with a higher share of GDP-PPP.

Adequacy of IMF Resources

At the Los Cabos summit of the G 20, leaders agreed to the proposal of the Managing Director for augmenting IMF resources. Several countries, including India, have announced their contributions. We welcome the recent judicial ratification of the European Stability Mechanism (ESM) and efforts by the EU to raise the size of its firewall and we continue to expect that EU/ ECB efforts should play the primary role with IMF assistance underpinning the EU's action. Largely any IMF assistance should play a catalytic role in order to provide confidence to investors and the amounts of the assistance required should inevitably require a fair burden sharing arrangement between the IMF, the EU and the country concerned, with full protection to the IMF as secured creditor.

We would once again stress that financial contributions made are voluntary in nature; these should not in any way be linked with future voice or governance reform. These contributions need to retain their temporary character; they should not be looked upon as a substitute to quota resources. At the same time it is important that innocent bystanders affected by the crisis, particularly low income countries, are adequately protected and there should be sufficient resources available for them.

Developments in the Constituency

I now turn to developments in my constituency.

Bangladesh

The Bangladesh economy has been one of the few economies in the world that posted more than 6 per cent growth in the recent past. The key drivers of this remarkable performance were the policy support for reducing supply bottlenecks in power, energy and infrastructure, sustained growth in agriculture and an improved performance in the manufacturing sector. Notable progress has also been made in improving various socioeconomic indicators including infant, child, and maternal mortality, gender equality and women empowerment, access to safe drinking water and sanitation. As regards recent macroeconomic situation, pressures that emerged in the latter part of FY11, eased in FY12 and this situation still persists. Restrained monetary policy supported by moderate fiscal consolidation has had a positive impact. On the fiscal front, revenue mobilization has demonstrated spectacular performance, posting about 20 per cent growth in FY12. The CPI inflation rate moderated to 7.93 per cent in August 2012 from the double digit level of March 2012. The exchange rate remained stable. Remittance growth picked up after currency depreciation in FY12 and also due to the robust outflow of new migrants. On the other hand, export and import growth rates slowed down following a record increase in FY11 primarily due to ongoing financial and economic strains experienced by major trading partners, particularly the EU countries. In effect, the positive current account balances coupled with stable capital and financial accounts led to a sizeable increase in foreign exchange reserves in recent months. The release of the first tranche of concessional financial support from the IMF under the Extended Credit Facility program also contributed towards raising foreign exchange reserves, which now stand over USD 11 billion. In addition, policy adjustments and reforms under the ECF program have had a useful impact on the balance of payments (BoP) position and the overall macroeconomic situation.

Bhutan

Real GDP increased by 11.8 per cent in 2010 benefiting from ongoing construction works on new hydropower projects. Medium-term growth prospects remain robust on the back of hydroelectric and construction activities. Bhutanese authorities expect real GDP growth to average 10.6 per cent till 2013/14. Inflationary pressures persisted during 2012; Consumer Price Inflation (y-o-y) increased to 13.5 per cent in 2012:Q2 from 8.3 per cent a year ago, reflecting both higher food and non-food inflation. To address structural liquidity deficit, the Royal Monetary Authority of Bhutan (RMA) reduced the cash reserve ratio (CRR) from 17 per cent in March 2012 to 5 per cent by June 2012 in two stages. To improve monetary transmission, the RMA introduced “RMA Short Term Liquidity Adjustment Window Facility” (RSTLAW) to provide short-term liquidity to deficient banks, while encouraging inter-bank market operations among financial institutions; the RMA also introduced a base rate system for banks effective September 2012. Current account deficit widened sharply to 25.7 per cent of GDP in 2010/11, largely reflecting imports relating to hydroelectric sector equipment. Overall balance of payments, nonetheless, remained in surplus reflecting buoyant capital grants and other capital flows. Fiscal deficit moved from a surplus of 1.8 per cent of GDP in 2009-10 to a deficit of 2.3 per cent in 2010-11.

India

Notwithstanding the sequential pick-up in Q1 of 2012-13, economic activity in India remained sluggish. The slowdown in growth was mainly due to sharp decelearation in industrial growth reflecting in part global uncertainties and domestic factors. To improve investment sentiment and put the economy on a sustainable higher growth path, the authorities have taken several measures in the recent period such as liberalizing FDI norms for aviation and multi-brand retail and significant pass through in fuel prices. While inflation rate has moderated, it still remains beyond the comfort zone of the Reserve Bank of India (RBI). The RBI has, therefore, kept the policy rate unchanged at 8 per cent since April 2012. However, in order to ensure that credit flows to productive sectors of the economy, the RBI has been managing liquidity actively. In the near-term, inflation is expected to remain sticky. Global commodity prices, particularly energy prices, pose a major risk to growth and inflation. The gross fiscal deficit of the Central Government is budgeted at 5.1 percent of GDP, which is lower than the 5.8 per cent of GDP achieved last year. In order to contain fiscal deficit, the authorities have decided to cap the subsidies to below 2 per cent of GDP. Recently, the authorities have also raised the domestic price of administered petroleum products to contain fuel subsidies. Public debt continues to follow a downward trajectory with the Central Government's gross debt expected to fall to 45.5 per cent of GDP during 2012-13. India's current account deficit has remained elevated during last few quarters due mainly to widening of trade deficit reflecting worsening global situation. However, with uncertain global macroeconomic environment and slowing domestic growth, the financing of CAD will continue to remain a challenge.

Sri Lanka

The Sri Lankan economy, despite difficult external and domestic challenges, grew by a commendable 7.1 per cent in the first half of 2012 following two years of robust growth of over 8 per cent. The moderation in the growth rate was due to a combination of global and domestic factors. The weakened global economy adversely affected the export demand, while on the domestic front, coordinated policy measures by the government and the central bank early 2012 to address imbalances in the external sector and possible inflationary pressures that would arise due to the high credit growth reduced the domestic demand. In addition, the drought conditions that prevailed in major cultivation areas had a negative impact on agriculture production. Inflation, which remained at single digit levels for over 3 years from 2009, gradually edged up during the year due to the upward adjustment of several administratively determined prices, including oil, currency depreciation and supply disruptions due to the drought. The Central Bank tightened its monetary policy stance by raising its policy interest rates as well as directing banks to limit their lending growth. The government is committed to maintain the overall fiscal deficit at 6.2 per cent of GDP in 2012 compared with 6.9 per cent in 2011 continuing the announced fiscal consolidation path, despite the challenging environment. The external sector improved during the first half of 2012 benefiting from the policy measures adopted during early 2012. Policy reforms were mainly aimed at reducing the widening trade deficit by curtailing non-essential imports and improving export competitiveness, while attracting capital inflows by enhancing investor confidence and relaxing exchange control regulations. The improvement in the trade account in response to policy measures, as well as increased receipts from workers' remittances and higher earnings from tourism led to a significant improvement in the current account. With increased inflows to the capital and finance account, the BOP turned to a surplus of US dollars 280 million by end August 2012, also supported by the proceeds of the fifth International Sovereign Bond and the final tranche of the IMF SBA facility. Accordingly, gross official reserves increased to US dollars 7.1 billion by end August 2012 from US dollars 6.0 billion at end 2011.

Conclusion

The global economy is facing several critical challenges at this juncture. Unless the uncertainties facing the global economy are addressed, the global economy cannot be put on a sustainable growth path. Actions by central banks by providing liquidity may have helped calmed the markets and averted aggravation of the crisis, but they cannot be a substitute for a longer-term solution. Policy uncertainties in the advanced economies are also impacting the growth prospects of emerging market economies. The authorities, therefore, need to move swiftly to find a long-term solution to the problem. Problems in advanced economies with their spillover to other economies require coordinated policy responses. We maintain that the IMF is ideally placed for anchoring global policy coordination so as to remove the vulnerabilities and revive growth in the global economy on a sustainable basis.

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