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**Statement by Ms. Sitharaman
India**

On behalf of
Bangladesh, Bhutan, India, and Sri Lanka

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GLOBAL ECONOMY

Let me begin by sharing my concern about multiple downside risks that continue to overshadow the global economic outlook. Not only do the risks prominent at the time of the 2022 Annual Meetings continue to persist, but additional risks have also become evident with the recent bank failures in some advanced economies (AEs). Even though major central banks have shown their determination to act decisively by providing liquidity backstop to ease stress in global funding markets, the global economic outlook remains fragile, and the policy trade-offs have become even more complex for policymakers.

Despite some moderation in recent months, inflation continues to remain elevated amid stickiness in core inflation. Therefore, it may take more time to bring headline inflation within the target range of central banks. With major central banks going ahead with policy rate hikes to contain inflation expectations durably, the chances of the world economy achieving a soft landing have further dimmed, as can be ascertained from the downward revision of global growth by the IMF. Emerging markets and developing

economies (EMDEs) also face external demand shocks from lower growth prospects in AEs. Exports face greater risk, and tightening global financial conditions make the external financing environment more challenging for several EMDEs. This is discernible in several EMDEs facing sovereign debt distress in recent periods.

Given that monetary policy actions, especially in AEs, have implications for inflation and financial stability, clear communication highlighting central banks' policy actions' rationale and scope is important. As in the past, EMDEs should be vigilant against global monetary policy shocks. They would need to focus on strengthening their macroeconomic policy frameworks and remain prepared with adequate policy instruments to ease pressure and mitigate the spillovers in domestic financial markets.

In this era of high risks and uncertainty, policymakers must rely on credible risk-based fiscal frameworks to rebuild their fiscal buffers and strengthen the resilience to absorb economic shocks that may arise as they navigate the turbulence ahead. Fiscal policy must be in harmony with monetary policy. There would be social and political consequences of macroeconomic policies. We need strong leadership in this crisis and need to support multilateralism. In all this, however, our support to extend the social safety nets and our commitment to fight food insecurity, malnutrition, and hunger should not falter for want of resources.

Elevated global debt and its unsustainability might entail serious ramifications for the public finances of many Low-Income Countries (LICs) and some Middle-Income Countries (MICs). The G20-endorsed Common Framework is yet to deliver the expected results, although we have seen a successful round in the case of Chad. Under the G20 Presidency, India has sponsored the Global Sovereign Debt Round Table with the IMF and

the World Bank to foster a common understanding of debt issues among all stakeholders to strengthen the common framework. Enhanced creditor coordination with a strong commitment to transparency is the key to debt treatment, as we have seen in the case of Sri Lanka. In the days ahead, a successful conclusion of the debt treatment in the case of Zambia, Ethiopia and Ghana would certainly inspire greater confidence in the common framework.

INDIA

India has reasons to be pleased with the overall macroeconomic picture in a world of extreme uncertainty. Growth prospects are reasonably bright; inflation is not out of control, and the external sector is stable. Fiscal consolidation is gaining traction. Forex reserves are improving, and the banking sector remains healthy. Overall, macroeconomic stability is a matter of satisfaction, although now is scarcely a time to sit back on laurels.

According to India's National Statistical Office (NSO), India's GDP growth is 7% for 2022-23. As per the January update of WEO, India's contribution to global growth stood at 15% in 2022. The high GDP growth of 7% was attained on top of the high base of 9.1% growth in 2021-22, notwithstanding the monetary/liquidity normalisation in 2022-23.

The real GDP for 2022-23 has now exceeded the pre-pandemic level of 2019-20 by almost 10%. The growth performance was contributed mainly by the sharp increase of 13.2% in Q1:2022-23, followed by an average growth of 5.2% in the subsequent two quarters. The quarterly headline numbers, however, hide the fact that the growth momentum has steadily

increased from quarter to quarter. Hiring in the organised sector has also remained in the expansion zone month after month, per the PMI Composite employment sub-indices for 2022-23.

The Central Government adhered to the budgeted gross fiscal deficit target of 6.4% of GDP in 2022-23, now set lower at 5.9% for 2023-24, in line with the medium-term target below 4.5% by 2025-26. As in 2022-23, the focus now continues to be on infrastructure development and capital expenditure, which are expected to crowd in private investment and strengthen job creation and demand.

India has withdrawn lockdowns since April 2022. Total vaccination has crossed 2.20 billion. While precautionary doses, including for eligible children, are on, the number of persons vaccinated with more than one dose now exceeds 68%. The country's total number of active COVID cases stood at around 23,000 on 31st March 2023.

While private consumption has shot up by 9.5% during April-December 2022, its growth is estimated to decelerate to 7.3% in 2022-23 from 11.2% in 2021-22. Nonetheless, private consumption growth remains higher than in the pre-COVID years.

Gross fixed capital formation has sustained its double-digit growth tempo at 12.6% during April-December 2022, drawing strength from the government's thrust on infrastructure. This is also reflected in proximate indicators like cement production and steel consumption. Capacity utilisation in manufacturing is also above its long-term average. On the supply side, agriculture and services offered a silver lining against some moderation in the growth in industrial production amidst the intensification of input cost pressures.

While inflation at 6.4% in February is far lower than its recent peak, it remains above the upper tolerance limit of 6%. Undoubtedly, India is better placed than many other advanced economies or EMEs in this regard. However, core inflation remains sticky at around 6% even though it declined marginally in February. There have been successive rate hikes in every meeting of the Monetary Policy Committee of the Reserve Bank of India since May 2022, with a pause in the latest policy last week, the real policy rate is already in positive territory, and the surplus banking system liquidity has moderated. While it takes time for the past policy actions to work through the system, the central bank remains focused on withdrawing accommodation.

India recorded a current account deficit (CAD) of 2.7% of GDP during April-December 2022 compared with 1.1% during April-December 2021, mainly because of an increase in the merchandise trade deficit. With the surge in services exports and remittances far above the World Bank's projection, the CAD situation remains eminently manageable and within the parameters of viability. Given high growth in services exports, India is set to exceed its \$750 billion goods and services export target for 2022-23, up from actual exports of \$683.7 billion in 2021-22, notwithstanding the global headwinds.

The Indian rupee remained one of the least volatile currencies among its Asian peers in 2022-23. Similarly, the depreciation and the volatility of the Indian rupee during the current phase of multiple shocks is far lower than during the global financial crisis and the taper tantrum. In a fundamental sense, the movements of the rupee reflect the resilience of the Indian economy. Foreign exchange reserves have rebounded from US\$ 524.5 billion on October 21, 2022, to US\$ 578.8 billion on March 24, 2023,

covering around 9.8 months of projected imports for 2022-23. India's external debt ratios are low by international standards.

An EME like India typically runs a current account deficit (CAD) so that domestic saving is supplemented by foreign resources to achieve desired levels of investment. During the pandemic, the gap between investment and saving reversed from a deficit of 0.8% of GDP in 2019-20 to a surplus of 1.0% in 2020-21. It again flipped to a deficit of 1.2% in 2021-22. If this indicates the beginning of a new trend, as indicators for 2022-23 point, India's growth prospects are poised to improve.

While external demand is likely to be dented by a slowdown in global activity, the robust prospects for agricultural and allied activities are likely to boost rural demand. The rebound in contact-intensive sectors and discretionary spending is expected to support urban consumption. Given the sound health of corporates and banks, strong credit growth, resilient financial markets, and the government's continued thrust on capital spending and infrastructure, real GDP growth is expected at around 6.5% for 2023-24. While inflation is projected at 6.5% in 2022-23, it's expected to lie between 5.0% and 5.6% for 2023-24 on the assumption of a normal Monsoon.

India's per capita GDP in real terms grew by 5.9% in 2022-23, as against an average of 4.4% over the last decade (during 2012-13 to 2021-22). As a result, India's per capita GDP is estimated to cross US\$2,450, representing a step towards becoming a middle-income country.

SRI LANKA

1. In 2022, Sri Lanka experienced the worst socio-economic and political crisis in its post-independent history. Multiple external shocks, including the COVID-19 pandemic, considerably weakened the Sri Lankan economy, along with grave policy missteps. Sri Lanka had lost access to the conventional international financial markets with the onset of the pandemic, and had exhausted all fiscal, monetary, external sector and financial sector buffers by early 2022. Rising inflation and shortages of essentials resulted in a collapse of business confidence, severely affected the ongoing recovery in tourism, and triggered widespread public protests of an unprecedented scale that resulted in a change of key positions of the government over the next few months. The government made a request for a Fund-supported stabilization program and announced a debt service standstill in April 2022. The government commenced introducing necessary stabilization measures and embarked on discussions with creditors to seek support for an IMF-backed program to regain debt sustainability and restore macroeconomic stability. The government reached a Staff-Level Agreement with the IMF on September 1, 2022, and continued to introduce policy adjustments and reforms to stabilize the economy, while meeting the pre-requisites needed for program approval. Following the securing of financing assurances from major creditors, Sri Lanka's request for a US\$ 3 billion 4-year Extended Fund Facility arrangement was approved by the IMF Executive Board on March 20, 2023.

Real Sector developments and inflation

The Sri Lankan economy contracted by an unprecedented 7.8 percent in 2022, reflecting the magnitude of the crisis it faced during the year. All

three sectors of the economy, namely, Agriculture, Industry, and Services, were severely affected in 2022, and the impact of corrective policy measures is also having a dampening effect on economic activity in the near term. While the recovery in some agricultural sub-sectors, the rebound in tourism, and the gradual return of business confidence are expected to aid economic recovery, the economy is projected to contract by around 3 percent in 2023. Meanwhile, the unemployment rate in the first three quarters of 2022 remained at 4.6 percent on average, although poverty levels are expected to have increased. The immediate priority of the government remains stabilizing the economy, while pursuing growth-supportive reforms, and assisting the poor and the vulnerable through strengthened social safety net measures.

2. Inflation (Colombo Consumer Price Index (CCPI) based, year-on-year) accelerated from 5.7 percent in September 2021 to 69.8 percent in September 2022. Causes for this acceleration included the depreciation of the Sri Lanka rupee, disruptions to domestic food production, global fuel and food price shocks, price revisions of domestic fuel, electricity, and cooking gas supplies along with the associated increases in other prices, and unsustainable monetary financing of the fiscal deficits that de-anchored inflation expectations. Inflation has decelerated thereafter in response to policy tightening, measuring 50.6 percent in February 2023. A sharper deceleration is projected over the next few months. The behavior of inflation as measured by the movements of the National Consumer Price Index (NCPI) was similar, although the higher weight to food in the NCPI reflected higher overall inflation at the national level.

Monetary Policy, Monetary and Financial Sectors

3. The policy interest rate corridor of the Central Bank of Sri Lanka (CBSL) was increased from 5.00-6.00 percent at end 2021 to 15.50-16.50 percent by March 2023, with a decisive seven percentage-point hike in April 2022. The CBSL remains committed to a data-driven monetary policy-making process, and is confident of bringing down inflation to single digit levels by end-2023, and subsequently to the target range of 4-6 percent by 2024.

4. Most market interest rates increased, with the prime lending rate and yields on Sri Lanka Rupee-denominated Government securities peaking at 29.67 percent and 33.14 percent, respectively. The year-on-year growth of credit to the private sector by commercial banks decelerated from 20.3 percent in April 2022 to 6.2 percent at end 2022. Credit to the private sector, after adjusting its foreign currency-denominated component for exchange rate depreciation, contracted by 3.3 in 2022. In the absence of required foreign financing flows to the government, domestic financing has continued to expand. Within domestic financing, financing by the CBSL still accounts for a significant portion. Monetary financing of the fiscal deficit shall be prohibited under the new Central Bank bill. The enactment of the new Central Bank bill will also assist in firmly anchoring inflation expectations by prohibiting monetary financing, introducing institutional reforms that would enhance the independence of the CBSL, institutionalizing the flexible inflation targeting monetary policy framework with exchange rate flexibility, and increasing accountability of the CBSL in relation to price stability.

5. The impact of the economic crisis had severe implications on the financial system through various channels. Subdued economic activity, reduced disposable income, and lack of demand for credit resulted in a deceleration in asset growth in the banking sector and a deterioration in

the asset quality and profitability of the sector in 2022. The rest of the regulated financial sector is also experiencing similar developments. Amidst these risks, the government and the CBSL remain committed to ensuring the stability of the financial system by addressing any vulnerabilities in the system. The government is mindful of the significant impact on financial sector activity arising from the macroeconomic stabilization measures that have been put in place, as ensuring financial system stability is vitally important in facilitating economic recovery, and for effective monetary policy transmission.

External Sector

6. Sri Lanka faced severe balance of payments pressures over the past few years, with catastrophic effects in 2022. The Easter Sunday attacks, the COVID-pandemic and the uncertainties in 2022 significantly affected earnings from tourism. Worker remittances declined considerably in 2021 and 2022. While merchandise exports remained resilient, the expectation of an imminent exchange rate depreciation increased imports in late 2021, resulting in a large trade deficit of US\$ 8.1 billion in 2021, despite the imposition of import controls. After Sri Lanka lost access to the international conventional capital market, flows to the financial account dried up. This loss, combined with sizable debt service payments that were made until mid-April 2022, caused a significant loss of gross official reserves (GOR) in 2020, 2021 and 2022, and exhausted the usable reserves.

7. The sharp depreciation of the Sri Lanka Rupee in early 2022, the tight monetary policy stance, decline in real incomes and purchasing power, and tighter controls on imports resulted in a narrower trade deficit of US\$ 5.2 billion in 2022. Worker remittances are on an upward trend

while tourist arrivals have also begun to show signs of sustained recovery. The stability of the foreign exchange market also benefitted from the debt service standstill that is in place and the capital flow measures (CFM), as well as the quota system for fuel distribution. With positive sentiments in the domestic foreign exchange market rising, the CBSL eliminated the guidance given to the market on the exchange rate and allowed the exchange rate to be determined by market forces. The Sri Lanka Rupee has appreciated significantly thus far in 2023, with the CBSL purchasing foreign exchange from the market to bolster reserves.

Fiscal Policy

8. Sri Lanka recorded an overall fiscal deficit of 10.2 percent of GDP in 2022. At 8.3 percent of GDP in 2022, Sri Lanka's central government revenue collection is one of the lowest in the world. On the other hand, the rigid government expenditure, including wages and salaries, subsidies and transfers and interest payments, prevents any effective developmental activity without increasing the fiscal deficit and debt levels. To raise revenue collection to 15.0 percent of GDP by 2026, reduce the overall fiscal deficit to below 5.0 percent of GDP by 2025, and register a primary surplus of 2.3 percent of GDP by 2025, the government has introduced a series of decisive fiscal measures. In the near term, the primary balance is projected to improve to -0.7 percent of GDP in 2023 from -5.7 percent in 2021.

9. Key revenue measures implemented over the past few months include a) increasing the schedule of rates for marginal personal income tax (PIT), raising the top marginal rate, reducing tax-free threshold, and rationalizing incremental tax slabs, b) increasing the standard rate for corporate income tax (CIT), removing tax holidays as well as sector-

specific CIT exemptions, and unifying the rate structure for CIT, c) reinstating the value added tax (VAT) rate at 15 percent from 8 percent, lowering the VAT registration threshold, and removing some VAT exemptions, d) reinstating the mandatory withholding tax, and e) increasing rates for excise tax on alcohol and tobacco products, and on fuel. Going forward, the government expects to further revamp the VAT system to minimize exemptions, speed up valid VAT refunds, and abolish the Simplified VAT system that has created distortions. In addition, in 2024, the government plans to implement automatic indexation of excise taxes to inflation. In 2025, the government plans to revamp the property tax system and introduce a wealth transfer tax. The above measures are expected to make Sri Lanka's tax system more progressive, and gradually shift the focus of taxation from indirect to direct sources. The government has also embarked on revenue administration reforms to strengthen tax compliance, keeping in mind the relatively large size of the informal sector of the country.

10. Expenditure containment measures would complement the government's efforts towards fiscal consolidation. Measures have been introduced to reduce operational expenses of the government and increase accountability of spending. The government has proposed to limit the expansion of the wage and public sector pension bill, while ruling out pay cuts. Public investment, which has declined to unsustainably low levels, is expected to be raised over the medium term, with measures to enhance its efficiency and transparency. Expenditure rationalization is not expected to compromise spending on health, education, and social protection. The ongoing social safety net reforms are expected to improve coverage and targeting, thereby supporting the poor and the vulnerable, particularly during the ongoing adjustment phase. In the meantime,

measures are being introduced to mitigate fiscal risks arising from state-owned business enterprises (SOBEs) and to reform the SOBE sector.

11. The central government debt-to-GDP ratio remained high at 96.5 percent at end-2022. The government is expected to announce its proposed comprehensive debt restructuring framework by end-April 2023 and continue to engage with creditors with a view to regaining debt sustainability.

BANGLADESH

Bangladesh economy witnessed considerable external pressure in recent times, primarily due to shocks arising from the escalating Russia-Ukraine war, aggressive policy rate hikes by the US Fed and other advanced economies, and the lasting impact of the COVID-19 pandemic and global supply chain disruptions. These have led to a rapid depletion of foreign exchange reserves recently. High inflationary pressures were also observed due to high inflation in most trading partner countries, currency depreciation, and upward adjustments of fuel, gas, and electricity prices in the domestic market.

Despite these challenges, there has been a broad-based growth momentum across the economy during the first two-quarters of FY23, mainly driven by the agriculture and service-related sectors, and aided by supportive monetary and government measures. However, based on recent macroeconomic developments, the government has revised the GDP growth target downward from 7.50 percent to 6.50 percent for FY23. The Government and Bangladesh Bank have been extending the necessary policy measures to control demand while promoting supply-

and production-enhancing initiatives to address ongoing inflationary and exchange rate pressures.

Prudent fiscal and monetary policy measures helped the real GDP of Bangladesh grow by 7.10 percent in FY22 compared to 6.94 percent in the previous fiscal year. Bangladesh Bank (BB) has pursued a cautious policy stance with a tightening bias to contain inflation and exchange rate pressures while assisting the economic recovery process, ensuring the required flow of funds to the economy's productive and employment-generating activities for long-term economic growth. BB has resumed releasing its monetary policy statement on a half-yearly basis from the second half of FY23 (H2FY23), which was a regular practice of BB before June 2019.

Following the global trend, headline CPI inflation (p-t-p) rose to 8.78 percent (y-o-y) in February 2023, after falling since the peak of August 2022. This increase was mainly due to the global impact of commodity and fuel prices and exchange rate pass-through effects on the domestic market. Similarly, the twelve-month average CPI inflation rose to 8.14 percent (y-o-y) in February 2023 from 7.92 percent in January 2023, remaining above the revised budgetary target of 7.50 percent for FY23. The rise in inflation could be attributed to the non-food component, which kept mounting gradually, reflecting rising import costs impacted partly by the significant depreciation of the Bangladeshi Taka (BDT) against the US Dollar (USD).

The overall fiscal stance exhibited a slow momentum in Q2:FY23, as reflected in weak revenue mobilization and lower government expenditure compared to Q2:FY22. The budget deficit narrowed down in Q2:FY23 compared to the same quarter of the previous year, mainly due to the

government's spending cuts in the face of COVID-19 and the Russia-Ukraine war-led global economic crisis. Total revenue collection increased by 6.1 percent, while government expenditure decreased by 1.4 percent in Q2:FY23 compared to the same quarter of FY22. The fiscal deficit narrowed in Q2:FY23 compared to Q2:FY22 due to faster revenue collection growth over expenditure.

In addition to other challenges, Bangladesh faces significant resource constraints as it strives to attain its sustainable development goals and transition from its status as a least developed country (LDC). Realizing these goals will necessitate substantial financial resources, which may be difficult to obtain given the current economic challenges. Therefore, external funding from development partners and other sources is necessary to help bridge these funding gaps, and facilitate sustainable and environmentally friendly economic growth in Bangladesh. Consistent and continuous support from development partners and their subsidiaries will be crucial in mobilizing these resources and enabling Bangladesh to overcome these obstacles and achieve its development objectives.

BHUTAN

1. Macroeconomic Review

Growth rebounded moderately in 2021 as economic activities picked up, supported by expansionary fiscal policy, monetary support and progressive relaxation of containment measures. The economy grew at 4 percent in 2021, an increase of 14.1 percentage points compared to a decline of (-)10.0 percent in 2020. All the sectors exhibited a robust growth due to strong domestic demand, and in tandem with the global economic recovery. Industrial output grew by 1.9 percent after an all-time

low of -12.9 percent in 2020. The sub-sectors contributing to the industrial growth were mining & quarrying, and construction sector. Manufacturing production (cement, food, chemical and metal industries) also improved buoyed by government's countercyclical programs and monetary relief measures.

With the gradual easing of mobility restrictions and resumption of economic activities, service sector recorded a positive growth of 6.3 percent in 2021. Despite tourism industry being on a standstill, the revival in retail trade and other domestic businesses, steered the growth of the service sector, contributing around 44.0 percent to the GDP in 2021. Agriculture growth decelerated to 2.1 percent in 2021 compared to 4.6 percent in 2020 attributable to reduced production in livestock and forestry sector.

Economic growth of 4.9 percent anticipated in 2022, despite the two prolonged lockdowns from mid-January to March to contain the spread of the virus. With the nation achieving mass vaccination (almost 90 percent of its adult total population has received a booster dose by early March 2022) backed by robust policy measures and gradual opening up of tourism by September 2022, the economy is projected to sustain a growth of 4.9 percent. The growth trajectory is based on the assumption that there will be no emergence of new variants or mobility restrictions while government spending continues to boost aggregate demand and investments are implemented on time.

Inflation peaked at 8.2 percent by the end of FY 2021-22 mainly driven by increase in nonfood prices. For the last two years, inflation was mainly driven by increased food prices, which was on a higher end compared to non-food prices. However, starting from July 2021, increase

in non-food prices added to the inflationary pressure. Sudden hike in the fuel prices (petrol and diesel) due to limited supply and geopolitical tensions in the region caused drastic increase in the overall commodity prices. As of June 2022, inflation increased to 6.5 percent compared to June 2021 due to increase in both food prices by 5.1 percent and non-food prices by 7.8 percent.

Inflationary pressure will persist in the medium-term with the surge in both food and nonfood prices. Overall inflation for FY 2021-22 was recorded at 5.9 percent, a decrease of 2.3 percentage points compared to FY 2020-21. It was mainly attributable to slowdown in food inflation (primarily vegetables and meat) as prices were regulated by the concerned authority, and also due to rationalization of customs duties for the imports from COTI. Under the baseline scenario, annual inflation is estimated at 7.0 percent in current FY 2022-23 and 6.7 percent in FY 2023-24. However, as 80 percent of Bhutan's import is associated with India, any inflationary pressure in India is expected to transmit to domestic inflation, though with a time lag. Thus, estimates of inflation remains highly uncertain.

For the current FY 2022-23, fiscal deficit is estimated at 9.0 percent of GDP as government spending continues to accelerate economic recovery. The total expenditure is estimated to increase by 8.0 percent with capital budget of (Bhutanese Ngultrum) Nu. 38.5 billion, which is one of the highest, constituting 51.5 percent of the total outlay. Domestic revenue is revised from an estimated Nu. 36.4 billion to Nu. 41.3 billion, with the inclusion of royalty from tourism industry and broad-based improvement in the collection from both direct and indirect taxes. In terms of grant mobilization, residual amount of 12th Five Year Plan (FYP) amounting to Nu. 14.8 billion is estimated to be received in the current FY.

Total public debt is estimated to increase, although the overall risk is deemed manageable as the risk of debt distress is considered moderate. As major portion of external debt is in hydropower projects, which are commercially viable and deemed self-liquidating, increase in debt ratio may not be a cause of concern. For FY 2021-22, total public debt stock stood at Nu. 257.6 billion, accounting for 132.9 percent of GDP, of which external debt stock comprised of Nu. 229.6 billion. While the domestic debt stock stood at Nu. 28.1 billion, an increase of 64.4 percent due to issuance of government bonds of Nu.8.5 billion.

The current account balance (CAB) is expected to deteriorate from negative 12.1 percent of GDP in FY 2020-21 to negative 28.0 percent in the FY 2021-22, as a result of widening trade deficit. With the normalization in situation and resumption of economic activities, trade flows picked up surpassing the pre-pandemic threshold. However, the increase in imports were much higher compared to the exports leading to a huge trade deficit of 19.3 percent in the FY 2021-22 from 6.9 percent in the FY 2020-21. As a result, CAB is expected to remain elevated in the medium-term, with imports increasing exponentially and exports remaining subdued.

The recovery in trade performance has been immediate and widespread across all the sectors of the economy after a significant drop in 2020. The overall import in 2022 (January- June) increased by 52.0 percent as compared to the same period in the previous year, whereas exports increased by 24.3 percent only. If similar trade pattern continues in the upcoming months, the baseline scenario projects that by the end of 2022, overall import value will stand at Nu. 111.3 billion and export at Nu. 60.4 billion. As the magnitude of increase in imports is much higher compared to the export, trade deficit is expected to widen further.

The balance of payment situation is expected to worsen as current account balance deteriorates in the medium term. The net financial inflows which is used to finance the current account deficits over the period has been decreasing due to lower inflow of official grants, thereby impacting the gross international reserves. The gross international reserves stood at US\$ 839.6 million as on June 2022, and are estimated to remain around US\$ 845.2 million, sufficient to finance 12 months of essential imports.

Despite slowdown in the economy and high inflation, the monetary and credit situation remained favorable, supported by accommodative monetary and expansionary fiscal policies. Money supply (M2), measured by broad money, is estimated to grow at 7.5 percent in the FY 2021-22, owing to an increase in total deposits (7.2 %) held by the commercial banks, accounting for 93.1 percent of money supply components. On the asset side, growth in M2 is driven by improved performance in both net foreign assets (NFA) and net domestic assets (NDA). The money supply in FY 2022-23 is projected to grow by 10.1 percent.

Domestic credit growth is estimated to have slowed down to 4.8 percent in the FY 2021-22 compared to 6.5 percent in FY 2020-21. The slower growth was most accentuated in the manufacturing, construction, and service & tourism sector, reflecting an adverse impact of the pandemic, including delays in government spending on capital projects. Going forward, domestic credit is projected to grow at 10.8 percent in FY 2022-23 and 12.3 percent in FY 2023-24, in tandem with economic growth and supportive monetary measures.

In terms of soundness of the financial sector, the overall asset quality of the financial institutions weakened with the marginal increase in non-performing loans (NPL) by 2.1 percent in the FY 2021-22. In terms of sectoral NPL, the highest was recorded in the service & tourism sector at 29.3 percent, followed by trade & commerce sector at 19.5 percent, and manufacturing sector at 19.2 percent, as these sectors were severely affected by the pandemic.

Supported by various policy measures, overall banking liquidity remains adequate to facilitate credit growth in FY 2022-23. The excess liquidity in banking sector for FY 2021-22 was estimated at Nu. 19.9 billion (equivalent to 10.3 percent of money supply) compared to Nu. 32.2 billion in the FY 2020-21. The reduction was mainly on account of economic activities picking up and gradual fall in term deposits. However, the liquidity position in FY 2022-23 is expected to remain just adequate to meet the government's domestic borrowing. While continuity of expansionary monetary stance in the medium term is expected to pose risks in meeting the fiscal obligations, with crowding out of private credit.

2. Risks and Challenges

With the recent, on-going geopolitical conflict and high degree of uncertainty of the pandemic situation, risks to economic growth and recovery could emanate from both external and domestic environments. Besides the broad macroeconomic challenges, such as economic diversification, vulnerabilities from climate change, and unemployment, some of the possible risks and challenges to economic recovery based on the current update are listed below:

Widening current account deficit will put further strain on the overall reserve of the economy. As the economy returned to normalcy with the

relaxation of containment measures, economic activities including public infrastructure as well as hydropower projects resumed resulting in significant imports. The growth in imports were much stronger than exports, leading to deterioration of the trade balance and the current account balance.

As the financial inflows are not adequate to meet the current account deficit, the negative balance of payments will lead to depletion of overall reserve assets, posing risk to the constitutional mandate of meeting 12 months of essential imports. The macroeconomic imbalance emanating from the external sector is likely to spillover to other sectors of the economy eventually impacting growth prospects.

The rising geopolitical tension will aggravate the already existing inflationary pressure. Against the already turbulent backdrop of global inflationary pressures following the COVID-19 pandemic, the war between Russia and Ukraine has exacerbated supply chain disruptions leading to a spike in commodity prices, and broadening price pressures. The geopolitical conflict is likely to have a prolonged impact, especially on food and energy prices, leading to demand-supply imbalances.

With the war-induced commodity price increase, the impact will be felt mostly through higher cost-push inflation weighing on all the economic sectors including households, businesses and government. As an import dependent economy, higher energy and food prices will increase the import prices resulting in an increase in prices of domestic production. Therefore, surge in prices combined with low growth and high unemployment may lead to stagflation crippling the economy.
