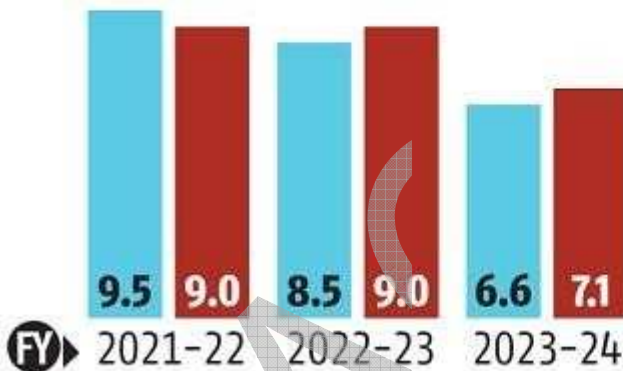




Bumps ahead: On IMF's India growth forecast

IMF'S INDIA GDP ESTIMATE: OCTOBER 2021 VS JANUARY 2022

Oct '21 forecast Jan '22 forecast



Source: IMF World Economic Outlook

FY23 FORECASTS BY VARIOUS AGENCIES

Agency	FY23 real GDP forecast (in %)
RBI	7.3
IMF	9.0
World Bank	8.7
India Ratings	7.6
SBI Research	8.0
Moody's	7.9
Barclays	7.3

Source: Various Agencies

Context:

In its latest **World Economic Outlook report**, the IMF has pared global growth hopes for 2022 from 4.4% projected in January, to just 3.6%, a sharp decline from the estimate of 6.1% for 2021.

The International Monetary Fund projected a **“fairly robust” growth** of 8.2 per cent for India in 2022, making it the **fastest-growing major economy** in the world, almost twice faster than China’s 4.4 per cent.

Global GDP Growth:

1. The **global growth** has been projected at 3.6 per cent in 2022, down from 6.1 per cent in 2021.

2. The **IMF's projection of global growth** at 3.6 per cent in 2022 and 2023 is 0.8 and 0.2 per cent lower than in the January forecast, respectively.
3. The downgrade largely reflects the war's direct impacts on Russia and Ukraine and global spillovers.
4. For other countries, **IMF has projected GDP growth** for Brazil at 0.8 per cent, Mexico at 2 per cent, Germany at 2.1 per cent, Italy at 2.3 per cent, France at 2.9 per cent, Japan at 3.3 per cent, UK at 3.7 per cent, Canada at 3.9 per cent, and Spain at 4.8 per cent.
5. Observing that the overall risks to economic prospects have risen sharply and policy trade-offs have become even more challenging.
6. This crisis unfolds at a time when the global economy was on a mending path and was recovering from the Covid-19 pandemic.

Volatile yet sharp commodity prices and supply chain disruptions:

1. The **invasion of Ukraine** has significantly dampened post-COVID recovery prospects, with the IMF highlighting volatile yet sharp commodity prices and supply chain disruptions.
2. Fresh pandemic-driven lockdowns in China's key manufacturing and trade hubs also compound supply worries and could slow its own growth from 4.8% to 4.4% this calendar year.
3. India's growth through 2022-23, which the IMF had pegged at 9% in January, has now been projected at 8.2% – lowered by the same extent as overall global growth.
4. This headline number is more optimistic than projections from the World Bank (8%), the ADB (7.5%) and the RBI (7.2%).
5. In 2023-24, however, the IMF expects growth to slip to 6.9%, while the World Bank expects it to be at 7.1%.
6. The IMF has emphasized that these projections are much more uncertain than usual due to the 'unprecedented nature of the shock' to the world economy.
7. Growth could slow much more while inflation could turn out higher than expected.
8. The multilateral lender expects India's retail inflation to now **average above the RBI's tolerance threshold at 6.1%** and the **current account deficit to touch 3.1% this fiscal year.**

India's Economy to Rebound as Pandemic Prompts Reforms:

India's economy is poised for a rebound after enduring a second wave of COVID-19 infections this year that further constrained activity and took a heavy toll on its people.

India's broad range of fiscal, monetary and health responses to the crisis supported its recovery and, along with economic reforms, are helping to mitigate a longer-lasting adverse impact of the crisis, according to the latest annual review.

Though policy steps helped mitigate the pandemic, it's still likely to result in **greater poverty and inequality**. And the path of recovery will follow the path of the virus.

New infections have fallen significantly and vaccination rates have risen to surpass a billion doses, although another resurgence is not impossible even if it seems unlikely today.

There's a lot of uncertainty about COVID. We cannot rule out future waves.

Factors for lowering of India's growth trajectory:

1. The chief factors cited by the IMF for lowering India's growth trajectory include higher oil prices, inflation that would exacerbate weak domestic demand, and the likelihood of a drag on net exports.
2. The World Trade Organisation has lowered its 2022 global merchandise trade growth forecast to just 3% from 4.7% projected earlier.
3. This means a critical operating growth engine, which manifested in the record \$420 billion exports in 2021-22, could sputter.
4. A corollary risk from higher food and fuel prices in emerging economies is heightened social unrest, and the IMF has noted that ordinary families' budgets are being strained to the breaking point.
5. While IMF has mooted decisive actions from central banks to stem inflation worries, IMF has also warned that **monetary policy tightening** would raise debt servicing costs and put many low-income countries in distress.

Way Ahead: Need to focus on supply side reforms:

Another distinguishing feature of India's economic response has been an emphasis on supply-side reforms rather than a total reliance on demand management.

These **supply-side reforms** include deregulation of numerous sectors, simplification of processes, removal of legacy issues like 'retrospective tax', privatization, production-linked incentives and so on.

Even the sharp increase in capital spending by the Government can be seen as both demand and supply response as it creates infrastructure capacity for future growth.

Two common themes in India's supply-side strategy:

Reforms that **improve flexibility and innovation** in order to deal with the long-term unpredictability of the post-Covid world.

1. This includes **factor market reforms**; deregulation of sectors like space, drones, geo-spatial mapping, trade finance factoring;
2. **Process reforms** like those in government procurement and in telecommunications sector; removal of legacy issues like retrospective tax; privatization and monetization, creation of physical infrastructure, and so on.

Reforms aimed at improving the resilience of the Indian economy. These range from climate/environment related policies;

Social infrastructure such as public provision of tap water, toilets, basic housing, insurance for the poor, and so on;

1. Support for key industries under Atmanirbhar Bharat; a strong emphasis on reciprocity in foreign trade agreements, and so on.
2. Some commentators have likened the Atmanirbhar Bharat approach to a return to old school protectionism.
3. Far from it, the **focus on economic resilience** is a **pragmatic recognition** of the vagaries of international supply-chains.

Conclusion:

Indian policy makers **need all hands-on deck and undivided attention** to cope with the **multiple headwinds**, which include the need to smoothen interest rate hikes, spur consumption, manage fragile fiscal math and currency fluctuations amid volatile foreign capital flows.

It would be equally critical to devise a **medium-term action plan** to minimize the scarring effects of this '**crisis upon a crisis**', as the IMF expects employment and output to persist below pre-COVID trends till as far as 2026, amid a further dip in global growth after 2023.

A Pros and Cons Analysis of the CBDC

Since many of the securities traded in the market have been digitised in the last decade, the next in the pipeline is the **Central Bank Digital Currency (CBDC)**.

There is an increasing appetite for CBDC across the world. With private digital currencies – **cryptocurrencies** – making rapid inroads, threatening the stability of the financial system with possible money laundering and illicit financing, **governments have to act fast to manage their risks.**

What is the Scenario of CBDC?

- CBDCs are a **digital form of a paper currency** and unlike cryptocurrencies that operate in a regulatory vacuum, these are **legal tender issued and backed by a central bank.**
- Many countries have decided to have their own CBDC to provide more reliable digital currencies to work as legal tender, prompting displacement of private digital currencies.
 - **Bahamas** has been the **first economy to launch its nationwide CBDC – Sand Dollar.**
 - **Nigeria** is another country to have rolled out **eNaira** in 2020.
 - China became the world's first major economy to pilot a digital currency **e-CNY** in April 2020.
 - **Korea, Sweden, Jamaica, and Ukraine** are some of the countries to have begun testing its digital currency and many more may soon follow.
- Recently, in its **Budget 2022-23**, the Government of India announced that its **central bank will issue a digital currency** as early as 2022-23.
- The main objective is to **mitigate the risks and trim costs in handling physical currency**, costs of **phasing out soiled notes**, transportation, insurance and logistics.
- It will also **wean people away from cryptocurrencies** as a means for money transfer.

What are the Merits of CBDC?

- **A Combination of Traditional and Innovative:** CBDC can gradually bring a **cultural shift towards virtual currency** by reducing currency handling costs.

- CBDC is envisaged to **bring in the best of both worlds** - the **convenience and security of digital forms** like cryptocurrencies, and the regulated, **reserved-backed money circulation of the traditional banking system**.
- **Easier Cross-Border Payments:** CBDC can provide an easy means to **speed up a reliable sovereign backed domestic payment** and settlement system partly replacing paper currency.
 - It could also be **used for cross-border payments**; it could **eliminate the need for an expensive network** of correspondent banks to settle cross-border payments.
- **Financial Inclusion:** The increased use of CBDC could be **explored for many other financial activities to push the informal economy into the formal zone to ensure better tax and regulatory compliance**.
 - It can also pave the way for furthering **financial inclusion**.
- There is a need to **enforce strict compliance of Know Your Customer (KYC) norms** to prevent the currency's use for **terror financing** or **money laundering**.

What are the Risks Associated with CBDC?

- **Privacy Concerns:** The first issue to tackle is the heightened risk to the privacy of users—given that the **central bank could potentially end up handling an enormous amount** of data regarding user transactions. This has serious implications given that **digital currencies will not offer users the level of privacy** and anonymity offered by transacting in cash.
 - Compromise of credentials is another major issue.
- **Disintermediation of Banks:** If sufficiently large and broad-based, the shift to CBDC can **impinge upon the bank's ability to plough back funds** into credit intermediation.
 - If e-cash becomes popular and the **Reserve Bank of India (RBI)** places no limit on the amount that can be stored in mobile wallets, **weaker banks may struggle to retain low-cost deposits**.
- **Other risks are:**
 - **Faster obsolescence of technology** could pose a threat to the CBDC ecosystem calling for **higher costs of upgradation**.

- Operational risks of intermediaries as the **staff will have to be retrained** and groomed to work in the CBDC environment.
- **Elevated cyber security risks**, vulnerability testing and **costs of protecting the firewalls**
- **Operational burden** and costs for the central bank in managing CBDC.

How to Overcome the Risks of CBDC?

- In order to obviate some weaknesses of CBDCs, the **usage should be payment-focused** to improve the payment and settlement system. Then it can steer away from serving as a store of value to avoid the risks of disintermediation and its major monetary policy implications.
- The data stored with the central bank in a centralised system will hold grave security risks, and **robust data security systems** will have to be set up to prevent data breaches. Thus, it is important to **employ the right technology that will back the issue of CBDCs**.
- The sizing for the infrastructure required for the CBDC will remain tricky if payment transactions are carried out using the same system. The RBI will have to map the technology landscape thoroughly and **proceed cautiously with picking the correct technology for introducing CBDCs**.
- The financial data collected on digital currency transactions will be sensitive in nature, and the government will have to carefully think through the **regulatory design**. This would require close interaction between the banking and data protection regulators.
 - Also, the institutional mechanisms would need to **ensure that there is no overlap between different regulators** and chart out a clear course of action in case there is a data breach of digital currencies.