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TO MAINTAIN COMFORTABLE EXTERNAL SECTOR BALANCE

India needs to roll back monetary, fiscal stimulus gradually, says IMF

Structural reforms could deepen integration in global value chains and attract FDI

FE BUREAU
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POLICY PRESCRIPTIONS

- Intervention on exchange rate should be limited to **'addressing disorderly market conditions'**
- RBI has **enough forex reserves**, no need for further accummulation
- India's CAD to worsen to **3.1% of GDP in FY23 from 1.2% in the last fiscal**
- New Delhi should get into more **FTAs, further liberalise investment regime and cut import tariff**
- The Fund acknowledged that **India's external debt liabilities** are 'moderate' compared with its peers

THE INTERNATIONAL MONETARY Fund (IMF) on Thursday suggested that India withdraw fiscal and monetary policy stimulus gradually, develop export infrastructure and scale up shipments by getting into free trade agreements with key trading partners, in a bid to maintain comfortable external sector balance over the medium term.

These steps, the Fund said, should also be accompanied by further liberalisation of the investment regime and a reduction in tariffs, especially on intermediate goods.

Amid a depreciation of the rupee against the dollar, the Fund suggested that interventions in the forex market be limited to "addressing disorderly market conditions". Given that the Reserve Bank of India (RBI) already has comfortable level of foreign exchange reserves despite recent drop (these are still enough to cover eight months of imports), accumulation of additional reserves is less warranted, it said. The rupee settled at 79.54 against the dollar on Thursday, a near 40 paise loss from the previous session.

In its 2022 External Sector Report, the IMF also said: "Structural reforms could deepen integration in global value chains and attract FDI, hence mitigating external vulnerabilities. Exchange rate flexibility should act as the main shock absorber, with intervention limited to addressing disorderly market conditions."

The Fund has forecast India's current account deficit (CAD) to worsen to $108 billion (3.1% of its GDP) in FY23 from $38 billion (1.2% of GDP) in the last fiscal. The spike in the CAD this year partly reflects the impact of the war in Ukraine on oil prices. However, the CAD will stabilise over the medium term, said the IMF. "The authorities have made some progress in external trade promotion and the liberalisation of FDI and portfolio flows, but the existing tariff structure remains broadly unchanged," it said.

Reversing a slide witnessed in 2020, India's average applied import tariff rose to 18.3% in 2021 from 15% in the previous year, although it's still way below the permissible limit set for the country by the World Trade Organization.

As for the Fund's suggestion on withdrawal of fiscal and monetary measures, the RBI has already raised the interest rate by 90 basis points since May and is widely expected to hike the rate by another 35-50 bps on Friday. It has also ended some of the liquidity measures initiated in the wake of the pandemic. The fiscal measures were mostly aimed at boosting the supply side, and not so much the demand side.

India's CAD, however, is "broadly consistent" with its per capita income level, favourable growth prospects, demographic trends, and development needs, said the IMF. "External vulnerabilities stem from volatile global financial conditions and significant increases in commodity prices," it added.

The Fund acknowledged that India's external debt liabilities are "moderate" compared with its peers, and short-term rollover risks are limited. "The moderate level of foreign liabilities reflects India's incremental approach to capital account liberalisation, which has focused primarily on attracting FDI. While FDI inflows covered the CAD in FY22, structural reforms and improvement of the investment regime to promote FDI are needed," the Fund said.

It added that volatile portfolio investments are very sensitive to changes in global financial conditions and country risk premia. "Expected inclusion of India in international bond indices should increase portfolio investment inflows for financing the CA deficit over the medium term," it said.

The country's net international investment position — typically the difference between its external financial assets and liabilities — improved to −11.1% of GDP at the end of 2021 from −13.5% a year before. "This reflected a relatively low CAD (amid the Covid-19 pandemic) and the accumulation of reserve assets. Gross foreign assets and liabilities were 30.5% of GDP and 41.7% of GDP, respectively. The bulk of assets were in the form of official reserves and (outward) FDI, whereas liabilities included mostly FDI and other investments," it added.