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IMF warns India of economic risks as polls loom

By Victor Mallet in Hong Kong



P Chidambaram, India finance minister

The Indian economy, with growth set to fall to its lowest annual level in a decade, is vulnerable to the withdrawal of global liquidity and India's own shortcomings, according to the International Monetary Fund.

The IMF's warning, in one of its scheduled assessments of the country, highlights the challenges facing the new government that will emerge from a general election to be held in the next three months.

Gross domestic product growth is expected to decline to 4.6 per cent in the fiscal year to March – about half the level of three years ago – and then rise to 5.4 per cent the following year, the IMF said. It noted that Indian officials were more sanguine than the fund about the near-term growth prospects.

“India's growth slowdown is unusual among emerging markets both in its severity and the fact it has coincided with elevated inflation,” the IMF said, blaming domestic problems such as delayed infrastructure project approvals and uncertainty over government policy for two-thirds of the slowdown.

The main risk for India identified by the IMF is the likelihood of a further tightening of global liquidity as the US Federal Reserve “tapers” its bond-buying programme.

“With a still-significant external financing need, India is exposed to higher global interest rates and a reversal of capital flows. Such pressures could tighten domestic financial conditions, weaken corporate and bank balance sheets, curtail credit growth, and force a further procyclical tightening of monetary and fiscal policy,” said the IMF. “This could further raise borrowing costs, trigger portfolio outflows, and create the potential for disorderly adjustments in exchange rate and asset prices.”

India was shaken by a rapid decline of the rupee last summer, but has not suffered markedly in the latest bout of emerging market jitters.

Palaniappan Chidambaram, finance minister, has defended the record of the two Congress-led coalition governments that have been in power for the past 10 years.

In an interim budget on Monday to keep the country running over the election period, he boasted that he had cut the 2013-14 budget deficit to 4.6 per cent of GDP, below the targeted 4.8 per cent, while the current account deficit would fall to \$45bn, half the level of the previous year; the IMF forecast is \$61bn.

“I appeal to all political parties to join me in the pledge that we shall not, we shall never, do anything that will affect the stability of the foundations of the India's economy,” Mr Chidambaram said in parliament.

While his pre-election handouts were regarded in India as relatively restrained – they included cuts in excise duties on motorcycles, cars and trucks – economists were quick to question what Société Générale called the “suspect” budget calculations.

They said the government had artificially boosted revenues in the current year by forcing state-owned companies to pay hefty early dividends, while overestimating revenue for the year from other sources such as taxes and telecom spectrum auctions.

Furthermore, said SocGen, the government had chosen the easy way out by sharply curtailing capital expenditure and leaving current

spending barely touched. “Not surprisingly, India’s gross fixed capital formation for the current year is likely to be around 28.5 per cent [of GDP], the lowest in a decade.”

The IMF called for further interest rate rises to tackle inflation - which it predicted would stay at nearly 10 per cent - more steps to cut the fiscal deficit, enhanced supervision of banks, liberalisation of energy markets and greater investment in infrastructure.

“After the elections the first few months will be critical,” said Eswar Prasad, an economist and trade expert from Cornell University.

“There’s a big opportunity for the new government, because at least it looks like things have bottomed out.”

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