ISAS Brief
No. 689 – 15 August 2019

# South Asia Growth Prospects Amid Global Uncertainty

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## Summary

*Despite a slowdown of the global economy due to escalating trade tensions between the United States and China, South Asia as a region continues to grow fast and steadily. However, two diverging trends are noticed: on the one hand, India and Bangladesh are among the fastest growing economies in the world and are expected to remain on the high-growth track. On the other hand, Pakistan and Sri Lanka's economies have been slowing down, mainly because of domestic economic and political uncertainty.*

## South Asia Bright Spark

The World Bank has published in July 2019 its semi-annual Global Economic Prospects report. Global GDP growth slowed down to 2.6 per cent in 2019, 0.3 per cent lower than the Bank's previous estimates. Trade tensions between China and the United States, – with spill over effects on other major economies – a sharper than expected slowing down of economic activity in large economies and continuing financial stress in many emerging markets are among the most important factors behind the global slow down.

While not immune from these global trends, South Asia as a region has performed well and is expected to continue on this track. GDP growth in South Asia in 2018 is estimated at 7 per cent (up from 6.7 in 2017) and the Bank forecasts the same rate of growth for the next three years. The main factors underpinning solid economic growth in the region are strong domestic demand and robust investments. On the other hand, GDP growth is constrained by weak exports – that continue to be significantly lower than imports, thus negatively contributing to growth – and by financial uncertainty due to the large amount of non-performing assets across South Asian countries.

If we look at the single countries, however, it is clear that the major economies of the region are on two diverging trends. On the one hand, India and Bangladesh are amongst the fastest growing economies in the World; on the other hand, Pakistan and Sri Lanka are not only growing at a much slower pace, but domestic political and economic uncertainty will likely prevent them from catching up with their neighbours. Table 1 shows the estimated rates of growth of South Asia's largest economies.

**Table 1 – GDP Growth estimates and forecasts 2017-2021**

| | 2017 | 2018 | 2019 | 2020 | 2021 |
|---|---|---|---|---|---|
| India | 7.2 | 7.2 | 7.5 | 7.5 | 7.5 |
| Pakistan | 5.8 | 3.4 | 2.7 | 4.0 | 4.7 |
| Bangladesh | 7.9 | 7.3 | 7.4 | 7.3 | 7.3 |
| Sri Lanka | 3.3 | 3.2 | 3.5 | 3.6 | 3.7 |

Source: World Bank 2019 Global Economic Prospects, June 2019. Washington, DC: World Bank

## Divergent Growths

India is expected to keep growing fast, even though economic activity has slowed down in the last months of 2018 and in the first months of 2019. Also, as argued by former Chief Economic Advisor to the Indian government Arvind Subramaniam, there are serious concerns that the new methodology to calculate the GDP introduced by the government since 2015 might overestimate growth by as much as 3.5 percentage points. Leaving these caveats aside, the World Bank shows that domestic demand, solid investments (particularly in infrastructure) and credit growth have sustained economic activity, offsetting softening production in agriculture due to low rainfall.

Bangladesh has benefited from the global trade tensions between the United States and China. Exports towards both countries increased significantly (in particular for textiles and apparel), mirroring declining trade flows between the two major economies. Domestic demand was supported significantly by increasing remittances, which reflected higher growth in the source countries. The investment climate, particularly in the infrastructure sector, remains solid, also in light of the 2018 election results that ensured political continuity.

On the other side of the spectrum, Pakistan's GDP growth decelerated substantially, in particular because of the fiscal consolidation plan that the country adopted to address its macroeconomic imbalances. Internal demand suffered from tight monetary and fiscal policy and international reserves declined substantially to cover about three months of imports. Financial help from China, the International Monetary Fund (IMF) and some Gulf countries will mitigate financial uncertainty over the next years. However, currency depreciation also led to high inflation, which is another factor that separates Pakistan from the other South Asian economies, where inflation has remained low to moderate.

GDP growth slowed down in Sri Lanka too, partly as a consequence of political uncertainty in the wake of the 2018 constitutional crisis. Investment trends remain weak, while tight fiscal policies – adopted partly to address the downgrading of the country's sovereign debt by some credit agencies – translated into weak domestic demand. Political uncertainty is likely to continue affecting Sri Lanka's economy in the coming months, as the country goes through presidential (2019) and parliamentary elections (2020). Whereas investments, particularly in the infrastructure sector, are expected to pick up, recent security concerns in the wake of the 2019 Easter attacks are likely to moderate investors' confidence, particularly in the tourism sector.

## Challenges to Future Growth

One of the factors that might adversely affect South Asia's growth is tension between India and Pakistan in the wake of the decision by the Indian government to revoke Jammu and Kashmir's special status in August 2019. Jammu and Kashmir, now fully incorporated into India despite the fact that its territory is claimed by Pakistan, might re-ignite tension between India and Pakistan, as well as escalate tensions in the Kashmir Valley. Pakistan has in fact suspended trade relations with India. Furthermore, India's decision to declare the Ladakh region a Union Territory under the direct control of New Delhi, which has already provoked a strong reaction from Beijing, may impact India's relations with China, which claims part of Ladakh as its own territory.

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