India should gradually withdraw fiscal, monetary stimulus: IMF

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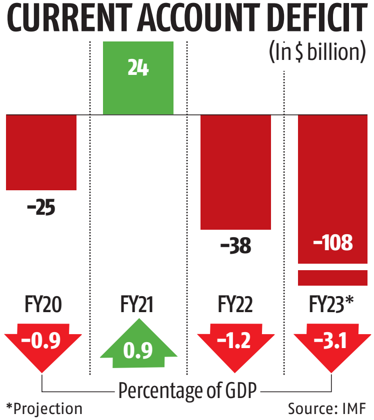
To maintain external sector balance at a comfortable level over the medium term, the International Monetary Fund (IMF) has recommended that India should gradually withdraw its fiscal and monetary policy stimulus, develop export infrastructure, and negotiate free-trade pacts with key trading partners to provide a sustainable boost to exports.

In its latest External Sector Report released on Thursday, IMF said India should further liberslise its investment regime accompanying it with reduction in tariffs, especially on intermediate goods. "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," IMF said.

The IMF said India's external position in FY22 was broadly in line with the level implied by medium-term fundamentals and desirable policies. "Running current account deficits is broadly consistent with India's level of per capita income, favourable growth prospects, demographic trends, and development needs. External vulnerabilities stem from volatile global financial conditions and significant increases in commodity prices," it said.



The multilateral lending agency projected India's current account deficit (CAD) to widen to 3.1 per cent of GDP in FY23 from 1.2 per cent of GDP in FY22. "In part reflecting the impact of the war in Ukraine on oil prices, the CAD is projected to widen in fiscal year 2022-23 but then stabilise over the medium term. The authorities have made some progress in external trade promotion and the liberalization of FDI and portfolio flows, but the existing tariff structure remains broadly unchanged," it said.

As of the end of 2021, IMF said India's net international investment position (NIIP), which is the difference of the country's external financial assets and liabilities, had improved to –11.1 per cent of GDP from –13.5 per cent of GDP at the end of 2020. "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 per cent of GDP and 41.7 per cent 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 said.

India's external debt liabilities are moderate compared with peers, and short-term rollover risks are limited, IMF said. "The moderate level of foreign liabilities reflects India's incremental approach to capital account liberalization, 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. 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 added.

The IMF said an unusual period of current account surpluses in 2020 and early 2021 allowed the Reserve Bank of India to replenish official forex reserves, which reached a record high of about $638.5 billion at the end of 2021. The reserves decreased in subsequent months but remained at a comfortable level of about eight months of import coverage.

"Various criteria confirm that official forex reserves are adequate for precautionary purposes. As of the end of 2021, they represented about 223 per cent of short-term debt (on residual maturity) and 195 per cent of the IMF's composite metric. Consequently, accumulation of additional reserves is less warranted, and forex interventions should be limited to addressing disorderly market conditions," it said.