IMF bats for ambitious fiscal consolidation path

But govt asserts public debt is sustainable

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India needs a more ambitious fiscal consolidation road map to ensure medium-term debt sustainability amid growing risks to its gross domestic product (GDP) growth outlook and shrinking fiscal space, the International Monetary Fund (IMF) said on Friday. The government, however, differed from the Fund, stressing public debt remained sustainable.

In its annual Article IV consultation report, the IMF said India's debt-to-GDP ratio, which peaked at 89 per cent in FY21, is projected to remain elevated over the medium term. It expects the ratio to rise to 83.9 per cent of GDP in FY24, from 83.4 per cent in FY23.

The Washington-based global lender said India's slow pace of fiscal consolidation means that debt is expected to remain around the current level, before gradually declining from FY26 onwards.

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WARNING SIGNS

IMF's risk assessment matrix for India

Source of risk/ **Likelihood**

Intensifying spillovers from Russia's war in Ukraine **High**

Commodity price shocks **High**

De-anchoring of inflation expectations and stagflation **Medium**

Cyberattacks on critical physical or digital infrastructure **Medium**

Abrupt global slowdown or recession **Medium**

Sharp tightening of global financial conditions **High**

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"A more ambitious and well-communicated fiscal consolidation is therefore needed to ensure medium-term fiscal sustainability. Announcing further deficit-reduction measures would reduce uncertainty and lower risk premia. In the short term, fiscal consolidation would also support the RBI's efforts to maintain price stability," it added.

The IMF's views come at a time when the FY24 Budget is under work. The government faces the dilemma whether to aggressively reduce the fiscal deficit or go for a moderate fiscal consolidation to support growth amid rising global uncertainties.

K V Subramanian, executive director for India at the IMF, representing the Indian government's point of view, disagreed with the assessment that India's fiscal space is at risk. "Authorities do not share the staff's view that India's fiscal space is at risk. Public debt remains very much sustainable given favourable growth dynamics and the strong commitment to consolidation," he maintained.

The finance ministry has indefinitely deferred amending the Fiscal Responsibility and Budget Management (FRBM) Act, even as it has reaffirmed its commitment to reduce the fiscal deficit to 4.5 per cent of GDP by FY26, from 6.4 per cent in FY23. The IMF has projected the fiscal deficit to reduce only marginally to 6.2 per cent in FY24.

"With growth slowing to 6 per cent of GDP and monetary tightening under the baseline, the interest rate and growth differential narrow over the projection period. Under a constant primary balance of -1.7 per cent of GDP (its projected level at the end of staff's medium-term horizon), and an interest rate-growth differential of 3.5 percentage points, debt would decline to 70 per cent of GDP (its average level before the pandemic) in about 17 years," the IMF said.

Subramanian argued that with real growth of about 7 per cent, and inflation of about 4 per cent expected during this decade (i.e., nominal growth of about 11 per cent), the debt-to-GDP ratio would reduce sharply with interest rate assumed at about 7 per cent.

The IMF cautioned that a sharp global growth slowdown in the near term would affect India through trade and financial channels. "Intensifying spillovers from the war in Ukraine can cause disruptions in the global food and energy markets, with significant impact on India. Over the medium term, reduced international cooperation can further disrupt trade and increase financial market volatility. Domestically, rising inflation can further dampen domestic demand and impact vulnerable groups. On the upside, however, successful implementation of wide-ranging reforms or greater-than-expected dividends from the remarkable advances in digitisation could increase India's medium-term growth potential," it added.

The multilateral lender has projected India's growth to ease to 6.1 per cent in FY24, from an estimated 6.8 per cent in FY23, reflecting the less favourable global outlook and tighter financial conditions. While it projected the current account deficit to increase to 3.5 per cent of GDP in FY23 as a result of higher commodity prices and strengthening import demand, the Indian authorities claimed it would remain within 3 per cent.

The IMF and the Indian authorities also differed over the Fund's assessment that rising food and fuel prices or the pursuit of difficult structural reforms could create social discontent, causing capital outflows and slowing of economic growth, and giving rise to economically damaging policies. "There is no such evidence of inflation causing social discontent in India, especially as India has not experienced hyperinflation. Even during the current pandemic, inflation has not increased abruptly, reflecting coordinated monetary-fiscal measures," Subramanian added.

Biz reforms...

Yet geopolitical turbulence nevertheless has significant implications for the Indian economy in 2023. The war and a delayed exit from the pandemic might reduce global growth in the coming year to under 2 per cent, a decrease of at least a percentage point from the ongoing year. This means that recent and welcome growth in India's exports, including of electronic goods, may face headwinds. Indeed,