



# Executive Summary

The uneven recovery from the pandemic has left countries in South Asia with multiple policy challenges, which are exacerbated by the impact of the war in Ukraine. While several countries are navigating rising inflation and growing difficulties to finance fiscal deficits and trade deficits, the region must also chart a new way forward to address rising inequality, unleash new growth potential, and accommodate an energy transition. To reshape their economies, the region cannot avoid redesigning tax systems, increasing competition, and challenging vested interests and existing gender norms. This issue of the *South Asia Economic Focus* describes recent economic developments, analyzes the economic impact on South Asia of the war in Ukraine, presents growth forecasts, provides risk scenarios, and concludes that reshaping economies goes hand in hand with reshaping norms.

## Chapter 1. Stronger headwinds during recovery

**Although the region's economy is growing again, the recoveries have been uneven across sectors, countries, and groups of people.** While production and exports of digital services have risen, other sectors like construction, transportation, and tourism have not fully recovered in most countries. While some countries experience a solid rebound in GDP growth, Afghanistan faces a humanitarian crisis, Pakistan a political crisis, and Sri Lanka a balance-of-payments crisis. While high-skilled workers retained jobs during the pandemic, or found new opportunities, only some unskilled migrant workers have returned to jobs in the cities. Moreover, men have been able to find new job opportunities more quickly than women.

**South Asian economies are emerging from the deep COVID-19 recession, burdened by high inflation, rising current account deficits, and deteriorated fiscal balances, which are exacerbated by the impact of war in Ukraine.** Even as the impact of the pandemic on growth is subsiding, partly because of increases in vaccination rates, the economic scars left behind after two years of the pandemic are deep. Inflation and deficits in trade balances reflect supply bottlenecks, pent-up demand, and rising commodity prices in international markets. Support measures and reduced revenues have deteriorated fiscal balances. All these problems have become more pressing because of the immediate impact of the war in Ukraine, which has pushed up prices of oil and other commodities in international markets.

**Financial sectors in South Asia, already in relatively weakened positions before COVID-19, were effectively supported during the pandemic, but are facing renewed challenges.**

In 2019, non-performing loan (NPL) ratios for most countries in the region were higher than the average of emerging markets and developing economies. At the start of the COVID-19 pandemic, countries introduced lending support measures, including regulatory forbearance, which were extended during subsequent COVID waves. Loan restructuring with public guarantees alleviated banks' burden to cover potential loan losses and gave banks incentives to provide much-needed liquidity to firms. As a result of these support measures, reported NPL ratios declined during COVID and private sector credit growth was sustained, reaching even 30 and 20 percent growth in Nepal and Pakistan, respectively. However, such fast growth could lead to deterioration of bank asset quality if lender screening is not adequate and, as most moratorium programs have ended, a resurgence in defaults remains possible.

**Carefully designed monetary and fiscal policies are needed to weather the new external shocks on top of the legacies of the pandemic.**

There is limited scope for broad fiscal stimulus as fiscal space is limited and, equally important, the major shocks to South Asian economies have been negative supply shocks. As supply is curtailed, broad-based demand stimulus will merely lead to increased inflation. Consequently, it would be better to turn the focus to the quality of government spending. For example, targeted income support for vulnerable households that are struggling with higher food and energy costs is more efficient than price subsidies. There is scope for higher nominal interest rates set by central banks, as higher inflation has reduced real interest rates and financial conditions in international markets are tightening.

## **Chapter 2. Charting the course to a new normal**

**The forecast in this report for South Asia's GDP growth in calendar year 2022 is 6.6 percent, a full 1 percentage point lower than the World Bank forecast published in January of this year.** This downgrade is the net effect of the negative impact of the war in Ukraine and some positive surprises, especially the stronger than anticipated performance of the services sectors. Higher import prices will exert further pressure on the current account balances in the region in 2022. This report estimates that the war could reduce income growth in South Asia this year by 2.2 percentage points, 1.3 percentage point because of slower GDP growth and 0.9 percentage point because of terms-of-trade losses due mostly to higher fuel import prices. Most affected are likely Sri Lanka, which is already struggling to pay the import bills, and Maldives, whose oil imports as a percent of GDP are the largest of all South Asian economies and 20 percent of tourists in Maldives were coming from Russia and Ukraine. Energy subsidies as a percent of GDP are the highest in

Pakistan, which means that the price increase in international markets potentially poses a tough fiscal challenge. Higher food prices complicate humanitarian aid to Afghanistan. Bangladesh would be affected by a potential indirect effect of slowing import demand in Europe.

**In several countries uncertainty has steeply risen and further increases in commodity prices, additional supply disruptions, and tighter financial conditions remain threats for the whole region.** The balance-of-payments crisis, leading to widespread shortages, makes any forecast for Sri Lanka highly uncertain. The halting of data collection in Afghanistan precludes the possibility of a forecast. Three risk simulations for the region are presented in this report: (i) a 24 percent further increase in oil prices in 2022-2024; (ii) additional supply disruptions in global value chains because of lockdowns in Chinese cities or shortages of essential metals like palladium; and (iii) more aggressive than anticipated tightening of monetary policy in advanced economies (AEs). The higher oil price would have more permanent effects, reducing GDP growth by 1.2 percent from baseline. Supply chains would have a large impact in 2022 of 1.5 percent but would be short-lived. The simulation exercise also shows that it would be preferable if strong monetary tightening could be avoided in response to AEs sudden tightening to prevent negative impacts on the health of the financial sectors and the competitiveness of firms in international markets. Even if inflation is slightly higher than baseline, this is preferable assuming inflation expectations are well-anchored.

**High and volatile oil prices have exposed South Asia's vulnerabilities and have underscored the need to become less dependent on fossil-fuel imports.** The dependence on fossil fuels causes, apart from economic problems, also environmental damages, which in turn have a negative impact on the economy. Air pollution is one of the key negative side-effects of the burning of fossil fuels in South Asia. And the burning of fossil fuels obviously also contributes to climate change. The report analyzes the impact of a greening of the tax system, which internalizes the negative externalities in energy prices, and provides an illustrative example of the impact of phasing in a carbon tax. The main objective is to trigger an energy transition towards cleaner and more renewable forms of energy. Such greening of taxation can provide much needed fiscal space in South Asia. This is particularly important given the region's high informality that constraints revenue mobilization from standard tax instruments. The additional fiscal space will still require careful balancing of spending tradeoffs, but opportunities are abundant. The additional revenues can be used for further development of social safety nets, for infrastructure needed to support future growth, and for measures that help adapt to climate change.

## Chapter 3. Reshaping social norms about gender: A new way forward

**South Asia lags other regions, apart from Middle East and North Africa, in gender outcomes and in attitudes towards gender equality.** Female labor force participation in many countries of the region is among the lowest in the world, and other related forms of gender inequality (freedom of movement, social interactions, asset ownership, and parents' offspring preference) compare unfavorably to other countries at the same level of development. At the same time, South Asian gender attitudes tend to be more conservative than those in other regions and have become more so over time. Judging by responses to questions on gender attitudes from the World Values Survey, the share of individuals with traditional views in most countries has declined over the past few decades and is now under 50 percent. In the South Asian countries surveyed, however, most individuals still hold these traditional views and these majorities have increased. Women and the more educated tend to hold more progressive views than men and the less educated, respectively.

**Social norms are even more traditional than people's individual attitudes.** Social norms reflect individuals' expectations of what they think their reference group believes is acceptable or appropriate. New data used for this report measures for the first time both norms and attitudes. It finds that South Asian social expectations of gender roles tend to be more conservative than individuals' personal beliefs. Women expect their neighbors to be considerably more conservative than men do.

**Social norms and personal beliefs are important determinants of gender outcomes, such as female labor force participation, even after controlling for the level of economic development.** There is a significant, negative correlation between the level of conservative gender attitudes and women's labor force participation, likely reflecting bidirectional influences. Both social norms and personal beliefs are significantly related to cross-country differences in gender outcomes. Further, social norms are more important than personal beliefs in explaining differences in gender inequality that remain after the influence of economic development is accounted for.

**Traditional social norms about gender tend to persist, despite their negative impact on women's opportunities, the welfare of children, and overall economic growth.** Many norms are sustained despite their origins in long ago economic relationships and concerns that have become irrelevant with income growth and technological progress. The persistence of regressive gender norms may reflect their codification in law, pressures to conform, and the importance of family and communities in rural societies. Those practices include patrilocality (wives moving to husbands' families) and patrilineality (sons' rights to inherit). Regressive gender norms are also perpetuated because they support existing power relationships between men and women, such as control over assets and resources or decision-making

power within the household. Crises often result in changes in norms and can either exacerbate regressive norms or instill more progressive ones.

**Successful interventions need to tackle all barriers to women’s participation, including norms that are biased against women.** Investments in electrification and transportation can help overcome norms-related barriers to economic opportunities for women. Transfers, subsidies, and access to financial instruments can help families that wish to support their daughters. Legal changes have been successful in some instances in challenging norms. Amendments to the Hindu Succession Act, for example, granted daughters the same right as sons to ancestral property inheritance. But such interventions by themselves are not sufficient to achieve gender equality. Programs that focus on equipping women with skills, assets, and education to improve their ability to work can face difficulties if there are no alternatives to substitute for women’s household responsibilities (daycare, for example) or if men use violence to prevent a threat to their authority. Correcting misperceptions of societal attitudes, where individuals may believe that their reference group is more conservative than it is in reality, can increase the effectiveness of interventions. Influencing the beliefs of women’s families about the benefits of accessing opportunities, either through the provision of information or involving them with women in income-generating projects, can help overcome barriers.