



Executive Summary

In short order, a series of once-in-a-lifetime shocks has hit South Asia. The devastating floods in Pakistan, a full-blown economic crisis in Sri Lanka, and the ongoing war in Ukraine, which caused skyrocketing commodity prices, are happening when countries in South Asia are still trying to recover from COVID-19. As a result of these crises, many households face severe economic hardship. In Sri Lanka, people suffer from shortages of essential items; floods in Pakistan have wreaked havoc on millions of people that lost their homes; soaring food prices across the region have adverse impacts on households' ability to obtain sufficient food; people in Afghanistan suffer from double-digit declines in income and reduced access to core services; and the lives of migrant workers, upended during COVID lockdowns, face uncertainty and possible scarring effects from the pandemic.

The economic headwinds manifest themselves as problems in the balance of payments. Elevated global food and energy prices have increased import bills while a slowdown in the global economy has reduced momentum in the region's export growth. This happens when trade balances were already deteriorating because of a rise in domestic spending: government deficits were increasing because of relief efforts and private consumption rebounded after the lockdowns ended. Falling or stagnating remittance inflows through official channels have worsened the situation further for several countries. The resulting larger current-account deficits are becoming increasingly difficult to finance. Heightened uncertainty in the global markets, together with monetary tightening in advanced economies, have shifted investor sentiment and increased net capital outflows from the region in the first half of 2022. The balance-of-payments pressures have in turn resulted in dwindling foreign exchange reserves and led to requests by Sri Lanka, Pakistan, and Bangladesh to the IMF for support. Countries have also resorted to restrictive measures to curb imports, but with potentially detrimental effects on the economic recovery. Apart from the balance-of-payment problems, several serious domestic challenges also warrant attention, not least the supply bottlenecks and deteriorated asset quality in the financial sectors.

Despite the mounting challenges, there are also optimistic signs, as some sectors and some countries are recovering strongly. In India, services exports have recovered more strongly than in the rest of the world, and India's ample foreign reserve buffers have afforded resilience to the country's external sector. In most countries in the region, telecom and business services are also driving the recovery. The recovery of the tourism sector has remained robust in Maldives, while Bhutan recently fully re-opened its borders to tourists after prolonged lockdowns since 2020.

Against this backdrop, growth forecasts for South Asia have been downgraded. Growth in the region is expected to slow down to 5.8 percent in the calendar year 2022, 1 percentage point lower than forecasted in June, mainly because of a weakening of growth in the second half of 2022. The growth path diverges among South Asian countries: The more services-led economies (India, Nepal, and Maldives) are expected to maintain a reasonable recovery trend despite headwinds, while Afghanistan, Sri Lanka and Pakistan are in more precarious shapes and will see poverty increase in 2022 amid severe domestic crises. All countries in the region will see their resilience tested as global energy prices are expected to remain very high and global demand for goods will weaken. The countries responding to high import prices by setting price caps or quantity barriers—which distort price signals—will experience a negative impact on growth.

The growth forecast depends on the uncertain outlook for commodity prices, growth in high-income countries, and the amount of tightening in global financial markets. The report presents simulations to assess the impact of a changing international environment. The impact differs across countries, but the general conclusion is that changes in commodity prices have the largest impact. The impact of changes in import demand in the rest of the world and of capital-flow reversals is more muted as South Asia has not deeply penetrated export markets and several countries had limited access to private international finance.

Various structural changes are occurring in the background, which creates opportunities for the region's long-term resilience. A realization that the limited fiscal space is impacting debt sustainability has led many countries to undertake revenue measures such as increasing indirect taxes, broadening the tax base, and reducing fuel subsidies, which if fully implemented could improve long-term fiscal viability. Financial innovations and digital technologies that create more flexible employment opportunities could provide people with tools to withstand future shocks and increase the region's resilience. However, it is crucial that the opportunities translate into a more inclusive development path in which workers in the informal sector, and especially women have better access to markets and finance. On the downside, extreme weather events will become much more common with climate change, which calls for the urgent need to improve climate resilience through upgrading adaptation mechanisms and maintaining sufficient financial reserves.

Labor migration, both international and domestic, is a key part of life in South Asia. Just before the COVID-19 pandemic began, in 2019, 41.2 million people from South Asia were living outside their country of birth. In some South Asian countries such as Nepal and Sri Lanka, international diaspora numbers are close to 10 percent of the home country's population. In parts of Bangladesh, approximately one-third of households out-migrate temporarily during the pre-harvest lean season. The flow of migrants represents the interaction of two economic forces: reallocation of labor to places where it is more productive and adjustment to local economic shocks such as weather-related shocks; both are central to inclusive and resilient development.

Despite the importance of migration to individuals and the region, migrants in South Asia face considerable barriers to mobility. Mobility costs—pecuniary and non-pecuniary—and frictions in credit and labor markets have hindered these benefits of labor mobility from being fully tapped. For example, on average, Bangladeshi workers were spending the equivalent of more than US\$3,000 to move abroad before the COVID pandemic, a figure that represented about 2.5 years of the median household income. Seasonal migrants from rural India faced the equivalent of 80 percent of their daily earnings at the migration destination in daily migration costs, including non-pecuniary costs of harsh living conditions at the destination. Migration also exposes South Asians to risks because of the precarious labor market conditions that poor migrant workers face. For example, the legal (visa) status of emigrants to GCC countries, the most common international destination for South Asian emigrants, is contingent on their holding temporary jobs in low-skill sectors. Similarly, poor internal migrants in South Asia work largely in the informal sector, where they lack access to social protection.

The COVID crisis exposed this vulnerability on a large scale, as migrants returning home during COVID-related lockdowns face multiple hardships. New survey-based evidence confirms that the COVID shock substantially slowed down new migration flows and created an unprecedented wave of return migration. The surveys also reveal that return migrants, especially women, struggled to assimilate into the home labor markets, with high unemployment rates among the newly returned migrants. Due to the overall fall in outmigration, migrant-sending households experienced disproportionate declines in income, driven by a drop in remittances received. A troubling possibility is that the pandemic shock has had long-term scarring effects on the costs and frictions associated with migration.

To ensure that migration can continue to play a key role in development and as a coping mechanism in the face of shocks, two policies deserve priority. First, it is vital to address unnecessarily high costs and frictions in migration, particularly those that might have worsened during the COVID crisis. The second main policy priority for the region is to learn from the pandemic experience and incorporate measures to “de-risk” migration into migration-supporting policies and institutions. In particular, because many poor migrant workers are employed in informal jobs, reforms to extend social protection to the informal sector should be designed to include migrant workers without deterring mobility.