Executive Summary

At just under 6 percent, South Asia is expected to grow faster than any other emerging market and developing economy (EMDE) region in 2024–25. However, for all countries, this will represent a slowdown from pre-pandemic averages. Several potential adverse events could derail this outlook, including risks related to fragile fiscal positions. Government debt in South Asia averaged 86 percent of GDP in 2022, above that of any other EMDE region. In some countries, outright defaults have short-circuited growth while, in others, increasing domestic borrowing by governments has driven up interest rates and diverted credit away from the private sector. Elections could add to spending pressures. An urgent policy priority for the region is, therefore, to manage and reduce fiscal risks. Over the longer term, the policy priority is to accelerate growth and job creation in a sustainable manner. The energy transition, away from fossil fuels toward sustainable sources of energy, presents an opportunity for the region to lift productivity, cut pollution, reduce its reliance on fuel imports, and create jobs. South Asia uses twice as much energy to produce each unit of output as the global average and the region lags in the adoption of advanced energy-efficient technologies. Even fiscally constrained governments can take action to support the energy transition with market-based regulations, information campaigns, broader access to finance, and reliable public power grids. With about 9 percent of the region’s workers employed in pollution-intensive activities, and these workers less educated and more often informally employed than the average worker, the energy transition will create challenging labor market shifts. This calls for measures to boost job creation and facilitate worker mobility, geographically and across sectors.

Chapter 1. Regional outlook: Solid progress, but a long way to go. At just under 6 percent, output growth in South Asia is expected to remain stronger than in other regions in 2023–25, even with weak growth in the countries recovering from recent balance-of-payments crises. Foreign exchange and financial markets in these countries have stabilized, in part owing to the introduction of IMF-supported policy programs. But the financial systems of many countries in the region remain vulnerable and fiscal positions remain fragile. In some cases, restrictions on imports and foreign exchange transactions have yet to be fully unwound. The outlook is subject to downside risks from weak financial systems and fiscal positions. Growth prospects would also worsen in the event of a further economic slowdown in China or climate change-related natural disasters. In the short term, policy priorities include preserving financial stability and improving fiscal sustainability. In the longer term, it is important to boost private investment growth, make economies more open to trade, and seize the opportunities offered by the global energy transition.

Box 1.1 Fiscal deteriorations around elections. Among EMDEs, primary fiscal deficits, primary government expenditures, and government wage bills have tended to rise significantly around election years. While primary spending increases have tended to be partially reversed in the following year, post-election reversals of primary deficit and government wage bill increases have been more variable and at best partial. The consequent ratcheting up of primary deficits around elections in EMDEs can erode fiscal sustainability over the longer term, while the expansion of government wage bills can result in spending rigidities. In South Asia, in particular, fiscal positions have tended to deteriorate around national elections, and, in some cases, there is also evidence of targeted fiscal actions around subnational elections. While this result is true on average for the region, some countries—notably India in its 2023 budget—have avoided the risk of election-induced current spending increases. This points to a way forward for fiscally constrained governments in South Asia.

Spotlight. An ounce of prevention, a pound of cure: Averting and dealing with debt default. South Asia has the highest average government debt-to-GDP ratio among EMDE regions, at 86 percent in 2022, and four of the region’s countries are rated in or near sovereign debt
distress. The risk of sovereign defaults in the region is heightened not only by high levels of government debt but also by the increases in global interest rates over the past two years: the vast majority of past defaults occurred around the end of U.S. monetary policy tightening cycles and in countries with above-median government debt-to-GDP ratios. Past experience also shows that more than one-third of defaults failed to lower government debt or borrowing costs in a lasting manner. Defaults that succeeded in lowering debt or borrowing cost were accompanied more frequently than others by above-median debt restructurings, growth accelerations, and fiscal consolidations. South Asia’s above-average economic growth mitigates some of the default risks. Some South Asian countries have reduced their default risk by predominantly borrowing from domestic creditors. However, this strategy comes at a price: high domestic shares of government debt have been associated with higher borrowing costs and lower bank credit to the private sector. With the external environment likely to remain challenging over the next several years, it is all the more important to adopt policies to accelerate sustainable growth and shore up fiscal positions.

Chapter 2. Recruiting firms for the energy transition. As the world presses ahead with the energy transition, new energy-saving technologies offer South Asian countries an opportunity to modernize their economies. Currently, the energy intensity of South Asian economies is almost twice the global average—despite a decline over the past two decades that was almost entirely driven by firm-level, within-sector cuts in energy intensity. While the region’s firms have been early adopters of basic energy-saving technologies, they have lagged in the adoption of more advanced technologies, with smaller firms lagging particularly far behind. Policies that have been effective at encouraging technology adoption among firms include market-based regulation, dissemination of accurate information on energy savings, and financial support.

Chapter 3. Stranded jobs? The energy transition in South Asia’s labor markets. The transition away from fossil fuels in South Asia will have significant labor market impacts, which could leave many workers stranded in lower-wage jobs in declining industries. In all South Asian countries except India, pollution-intensive jobs outnumber green jobs and account for 6–11 percent of all jobs; only in India do green jobs outnumber—and then only slightly—pollution-intensive jobs, which account for 9 percent of all jobs. Pollution-intensive jobs are concentrated among lower-skilled and informal workers, whereas green jobs tend to be held by higher-skilled, better-paid, and formal-sector workers. Experience from past major economic transformations, especially in resource sectors, suggests that the transition away from fossil fuels will have large effects on the structure of employment and earnings, with lasting losses for some workers, and will cause significant internal worker migration. A wide range of policies will be needed to facilitate the necessary adjustment in labor markets while protecting vulnerable workers. These include: the provision of better access to high-quality education and training, finance, and markets; measures to facilitate labor mobility; and strengthening social safety nets.