Recent developments: Economic activity in South Asia began to revive in 2014 as India, the largest economy in the region, emerged from two years of modest growth. Regional growth is estimated to have accelerated to 5.5 percent in 2014, from 4.9 percent in 2013. In India, a slow economic recovery is underway, helped by a sharp slide in inflation to multi-year lows and improving export momentum in line with rising demand from the US, a major trading partner. With the reform agenda building momentum and current account vulnerabilities considerably diminished compared to 2013, currency and equity markets came under some pressure but were less affected than other emerging market peers during an episode of global financial volatility in December 2014. The improvement follows a sharp slowdown in the previous two years during which high inflation and a perception of policy paralysis had depressed domestic investment, while growing macroeconomic imbalances increased vulnerability to volatility in global financial markets. Improved political stability also supported activity elsewhere in the region, except Afghanistan where a difficult political transition following elections during 2014 has weighed on activity and crucial fiscal revenues, and Pakistan, where a spike in unrest in the second half of 2014, took a toll on confidence and activity.

Inflation has moderated sharply in the region, while a recovery in exports, declining oil import bills and strong remittance inflows are helping to narrow current account deficits. Capital inflows rose across the board in 2014. Several countries successfully tapped international bond markets, including Pakistan and Sri Lanka. The resilience of capital flows and asset markets has partly reflected improved (India) or healthy (Bangladesh) current account balances, robust growth prospects (India, Bangladesh), and ample global liquidity as a result of accommodative monetary policies in the Euro Area and Japan. Fiscal deficits remain large in the region and government debt ratios are high in some countries (Bhutan, India, and Pakistan), constraining policy space. Stagnant or declining shares of manufacturing in GDP in India and Pakistan are symptomatic of substantial supply-side bottlenecks, onerous regulations, underinvestment in human capital, large infrastructure deficits, and lagging reforms.

Outlook: Supported by a recovery in domestic demand, especially investment, regional growth is expected to steadily accelerate toward 6.8 percent by 2017. Contingent on strong and sustained progress on reforms, rising investment should help boost growth to 6.4 percent in 2015 and 7 percent by 2016. However, any slackening in the reform momentum could result in a more modest or slower pace of recovery. In Pakistan the economy should begin to recover as political tensions subside. However the pace of this recovery should remain slow on account of persistent energy shortages and a troubled security situation.

Soft oil prices will raise real incomes, support consumption and help ease current account pressures across a region of energy importers. Meanwhile, the region's smallest economies will be lifted by strengthening growth in India, which provides official financing flows to Afghanistan, Bhutan, and Maldives, remittances to Bangladesh and Nepal, and tourism to Maldives and Nepal. In Bangladesh, growth will likely be supported by continued remittances from GCC countries—a major destination for South Asian migrants—and recovery in private consumption demand if political stability is sustained. In Sri Lanka, with elections due in early 2015, growth in the near term will be buoyed by higher investment and government spending, while continued strong remittance inflows should support private demand.

Risks: Risks are mainly domestic in nature, predominantly of a political nature, and are roughly balanced. Downside risks include political tensions and slowing reform momentum that fails to address banking sector weakness, energy bottlenecks, and weak business environments. Improved growth prospects for South Asia are predicated on the implementation of structural reforms to ease supply side constraints, which are substantial, and to put government finances on a sustainable footing. Disappointments could weaken confidence, depress investment, trigger a reappraisal of growth prospects and reversal of investor sentiment, and, in Pakistan, derail financing under the IMF-supported program.

Among external risks, slower growth in the Euro Area, an important trading partner for South Asia, would affect the region's exports. India's openness to global financial markets leaves it exposed to sustained increases in financial market volatility, which could be triggered by a reappraisal of growth prospects or by geopolitical risks. However, risks on this front have receded considerably with the narrowing of India's current account balances since 2013.

On the positive side, regional growth might surprise on the upside if global energy prices continue to decline further than projected. This would raise real household incomes and encourage consumption spending, and ease fiscal and current account pressures. Finally, there remains the potential for stronger than expected growth in the United States, where the recovery is looking increasingly healthy, and from the Euro Area if recently announced monetary measures successfully support growth.

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South Asia forecast summary

(annual percent change unless indicated otherwise)

					Est.	Forecast		
	00-10[a]	2011	2012	2013	2014	2015	2016	2017
GDP at market prices (2010 US$)								
Calendar Year Basis[b]								
Afghanistan	12.8	6.1	14.4	3.7	1.5	4.0	5.0	5.1
Bangladesh	6.2	6.5	6.3	6.0	6.1	6.4	6.8	7.0
Bhutan	8.7	7.9	5.1	2.0	5.5	7.9	8.4	8.6
India[c]	7.3	7.9	4.9	4.7	5.5	6.2	6.8	7.0
Maldives[d]	7.0	6.5	1.3	4.7	5.0	5.3	4.3	4.3
Nepal	3.9	4.1	4.3	4.6	5.2	4.8	4.6	4.5
Pakistan[c]	4.2	3.1	4.0	4.9	5.0	4.7	4.9	4.9
Sri Lanka	5.2	8.2	6.3	7.3	7.8	7.5	6.8	6.5
Fiscal Year Basis[b]								
Bangladesh	6.1	6.5	6.5	6.0	6.1	6.2	6.5	7.0
India[c]	7.5	6.6	4.7	5.0	5.6	6.4	7.0	7.0
Nepal	3.9	3.4	4.9	3.8	5.5	5.0	4.7	4.5
Pakistan[c]	4.2	2.7	3.5	4.4	5.4	4.6	4.8	4.9

Source: World Bank.

World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.

a. Growth rates over intervals are compound average

b. Please see regional annex for details on fiscal year reporting.

c. Historical data is market price basis and forecasts are factor cost basis.

d. Real GDP growth at basic prices (i.e excluding taxes and including subsidies) in percent.