**Box 1**

**THE RISE TO PROMINENCE OF INDIA’S ECONOMY**

India has gradually gained in global economic prominence over the past decade. In purchasing power parity (PPP) terms, in 2014 India was already the third-largest country in the world after China and the United States. With growth expected by many observers to remain strong in the future, India’s contribution to global growth, and thus its relevance for the euro area outlook, may increase further. This box attempts to put India’s recent policy developments into perspective and to assess the economic prospects and challenges for the country.

India already plays an important role in the global economy. In 2014 it accounted for 6.8% of world GDP on a PPP basis (see Chart A) and provided the largest contribution to global growth after China (see Chart B). In contrast, in global trade and financial markets, India has played a relatively smaller role thus far. It accounted for less than 2% of euro area exports and just 2.5% of world imports in 2013, which is more in line with India’s share of world GDP based on market exchange rates. At the end of 2013, India was the recipient of less than 1% of the global stock of foreign direct investment (FDI); in terms of outward FDI, the country’s share of the global FDI stock was even smaller (see Chart C). India’s impact on commodity markets on the demand side has also been comparatively small, considering its large population. For example, its share of world energy consumption was less than 5% until recently – much smaller than China’s share (more than 20%).

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**Chart A Shares of world GDP**

(Percentages of world GDP)

- United States
- euro area
- India
- Japan

Sources: IMF World Economic Outlook, April 2015, and ECB calculations.
Notes: GDP shares are based on the purchasing power parity valuation of each country’s GDP. Figures for 2014 are marked on the chart; data for ensuing years refer to IMF projections.

**Chart B Contributions to global growth**

(Percentage changes; percentage point contributions)

- China
- other AEs
- G7
- other EMEs
- India
- global growth

Sources: IMF World Economic Outlook, April 2015, and ECB calculations.
Notes: “Other AEs” refers to all advanced economies outside the G7. “Other EMEs” refers to all emerging market economies besides India and China. Data for 2015 and ensuing years refer to IMF projections.
India is widely expected to outpace China to become the world’s fastest growing large economy this year. India’s near-term outlook has improved, benefiting in particular from recent policy reforms and the lower oil prices, which have helped the country to address some long-standing macroeconomic vulnerabilities, including high inflation and large current account and fiscal deficits. Consumer price inflation has fallen significantly in recent quarters and is expected to remain below 6% until the end of the current fiscal year (April 2015 to March 2016). In an environment of easing inflation, the Reserve Bank of India lowered its policy rate twice earlier this year, reducing it to 7.5%, and is expected to maintain an accommodative stance to support growth. In the future, the newly adopted inflation targeting regime could help to enhance the credibility of India’s monetary policy. Fiscal deficits have declined over the past several years, with the central government’s fiscal deficit falling to 4.1% of GDP in the last fiscal year, as the government took the opportunity of the lower global oil prices to remove some fuel subsidies. India’s current account deficit has also declined, falling from 4.8% of GDP in 2012 to about 1.4% in the last fiscal year. Recent policy reforms, including plans for accelerated public infrastructure investment, appear to have buoyed business and consumer confidence about the economic outlook. Against this backdrop, with recent data suggesting a faster underlying pace of growth,1 most forecasters expect India’s growth to accelerate over the next few years to around 8%, outpacing that of China (see Chart D).

Looking further ahead, India’s growth potential remains high as the country will continue to enjoy a large demographic dividend. Demographic trends suggest that by 2030 India will overtake

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1 The revised GDP series released by India’s Central Statistical Office on 30 January and 9 February this year shows a significantly stronger pace of growth in recent years. Having sharply moderated from 11% in 2010 to 5.3% in 2012, India’s economic activity is estimated to have rebounded by 6.4% in 2013 and 7.2% in 2014 – upward revisions of 1.7 percentage points and 1.1 percentage points respectively.
China as the world’s most populous country with the largest labour force. By that time, with more than one billion people of working age, India’s working age population would be larger than those of the United States and Indonesia combined (the economies with the third, fourth and fifth-largest populations respectively). In addition, in contrast to China, India’s working age population (as a share of total population) is expected to keep rising (see Chart E). As a consequence, the labour contribution to India’s potential growth would be expected to gradually increase over the next decade. For example, the IMF and Consensus Economics project India’s GDP growth to average 7.6% between 2015 and 2020.

The outlook for India, however, depends on the country’s ability to address a number of major challenges. Recent policy initiatives by the government appear to have boosted market confidence, and they provide a stronger basis for stable macroeconomic management, including sound fiscal policies and a focus on price stability for the central bank. The Indian government has also taken a number of steps to improve the business climate. Additional structural reforms to address the legacy impediments to growth, including measures to reduce bureaucracy and speed up infrastructure investment, could help to sustain the strong pace of growth in the coming years.

Assuming India fulfils its potential, its standing in the global economy is likely to increase. Given India’s rapid growth and rising share of world GDP, its contribution to global growth is likely to increase. According to the latest IMF projections, India’s contribution to global growth is expected to be even larger than the combined contribution of the G7 by 2018, albeit remaining second to China’s contribution (see Chart B).