

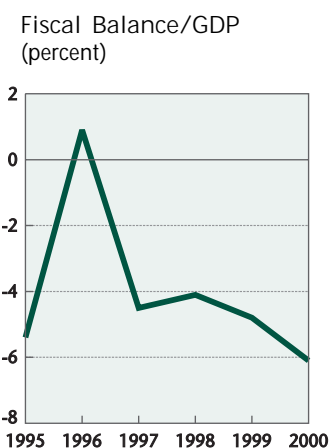
BANGLADESH

The economy has recovered from the devastating floods of 1999. However, unless the recent loosening of fiscal and monetary policies is corrected, macroeconomic stability and economic growth are likely to be affected in the short to medium term.

Economic Indicator (percent)	1997	1998	1999	2000	2001
GDP growth	5.4	5.2	4.9	5.5	5.7
Inflation rate	2.6	7.0	9.0	3.8	7.0
Current account/GDP	-2.2	-1.1	-1.4	-1.1	-1.2

Economic Assessment. The GDP growth rate in 2000 is estimated at 5.5 percent, higher than the flood-affected rate of 4.9 percent achieved in 1999. As in the past few years, overall performance in 2000 was driven by the agriculture sector, which expanded by an estimated 6.4 percent, considerably faster than the 4.8 percent of 1999. Foodgrain production in 2000 was its highest ever at 24.3 million metric tons, representing an 11.5 percent increase over the 21.8 million metric tons of 1999. This surge in crop production is attributed to favorable weather conditions, timely supply of agricultural inputs such as fertilizer, diesel, and seeds at stable prices, and few pest and disease attacks. The industry sector recovered slightly to record a 5.6 percent gain in 2000, up from 4.9 percent growth in 1999. However, this was markedly lower than the pre-flood growth trend of about 8 percent a year. The service sector maintained a growth rate of just over 5.0 percent. Investment (22.4 percent of GDP) and national savings (21.3 percent of GDP) are estimated to be only marginally higher in 2000 than in 1999.

The fiscal deficit was sharply higher at 6.1 percent of GDP compared with the target deficit of 4.4 percent of GDP in the original 2000 budget. If contingent liabilities arising from losses incurred by state-owned enterprises are taken into account, the fiscal position would be even weaker. A significant shortfall in revenue, and an overrun in current and development spending, contributed to a surge in the budget deficit. This higher than targeted budget deficit was funded by domestic bank borrowing amounting to 1.6 percent of GDP. The 2001 budget continues this recent trend of unsustainable fiscal deficits. It projects a fiscal deficit equivalent to 6.1 percent of GDP, to be financed by domestic borrowing of 3.6 percent of GDP, including bank borrowing of 1.3 percent of GDP. Weaker revenue collection and an overrun in expenditures are likely in the run-up to the elections to be held by October 2001, which may jeopardize price stability and strain the balance of payments. Resorting to substantial domestic borrowing may impose a heavy debt-repayment burden in future budgets as well.



2000 refers to fiscal year 1999/2000, ending 30 June.

The rapid rise in bank borrowing resulted in an acceleration of the money supply (19.2 percent annual growth in March 2000), and a simultaneous crowding-out of private sector access to credit (10 percent annual growth in the same month compared with 14.2 percent annual growth in March 1999). The inflationary impact of the expansionary fiscal and monetary policies has not yet, however, been felt because of improved agriculture sector performance and excess capacities in the economy. Inflation was only 3.8 percent in 2000 due mainly to depressed food prices resulting from successive bumper crops.

The export growth rate declined to 2.7 percent in 1999, due mainly to floods. In 2000 exports recovered, rising by 8.3 percent. The bulk of this export improvement came from garments and knitwear, together accounting for 76 percent of total exports, while earnings from traditional items such as jute and tea declined. Provisional data put import growth in 2000 at 6.8 percent, slightly higher than in 1999, mainly due to the surge in imports of nonfood items, particularly oil products. With a strong expansion of workers' remittances (14 percent), amounting to \$1.95 billion in 2000, the current account deficit was contained at 1.1 percent of GDP. Foreign exchange reserves remained at a critical level of \$1.6 billion, or only 2.2 months of import cover. The stock market, depressed in recent years, showed some improvement after several incentives were announced in the 2001 budget to develop the capital market.

Structural Issues. The greatest challenge facing Bangladesh in the short to medium term is the emerging weakness of macroeconomic management. The sharp surge in government borrowing from the banking system and expansionary public expenditure policy point to an alarming loosening of fiscal policy. The resulting need for monetary accommodation has exerted strain on macroeconomic stability. If this loosening is not reversed, macroeconomic stability and economic growth will be seriously affected. The revenue mobilization effort needs to be strengthened and steps should be taken to modernize the tax administration system. In addition, the Government should adjust the administered prices of public utilities and prioritize expenditures, pruning those which are unproductive. It also needs to address the mounting banking sector problems of a large debt overhang—over 40.0 percent of loans are nonperforming. The Government's overarching goal is poverty reduction, and this can only be successfully pursued in an environment of macroeconomic stability. The gas and fuel oil price adjustments made in August 2000, along with a devaluation of the taka, are steps in the right direction. Along with prudent macroeconomic management, a comprehensive reform program is needed for the financial sector, public sector administration, and private sector development, to accelerate the pace of economic growth.

Forecast. GDP growth for 2001 is projected at 5.7 percent. The agriculture sector is expected to maintain its average growth rate of recent years, provided that weather conditions remain favorable. The recovery in the manufacturing sector, including export industries, is crucial for maintaining balance-of-payments stability.

