

BANGLADESH: POLITICAL AND ECONOMIC UPDATE

This note is an update of the political and economic situation in Bangladesh provided in the information paper (IN.302-08) of 2 October 2008.

A. Background

1. Following two years of emergency rule by an army-backed caretaker government, an elected government took office on 6 January 2009 after national elections on 29 December 2008 that were deemed “free, fair and credible” by international observers. The caretaker government was installed on 11 January 2007 and a state of emergency was declared following political deadlock and prolonged violence over electoral reforms. The caretaker government during its tenure launched a broad-based governance reform program, which included reconstitution of the Election, Anticorruption, and Public Service commissions; separation of the Judiciary from the Executive; and preparation of a credible voter list; among other reforms. Following a clear road map, the caretaker government lifted the state of emergency in mid-December 2008 and conducted a peaceful election with the participation of all political parties. About 87% of the more than 80 million registered voters participated in the election conducted using a new voter list with photographs.

B. Recent Political Developments

2. The Awami League (AL)-led grand alliance swept back to power after seven years following its landslide victory in the national elections on 29 December 2008. The grand alliance, including former President H.M. Ershad’s Jatiya Party and some leftist parties, clinched an overwhelming majority with 262 seats in the 300-member parliament. The Bangladesh Nationalist Party (BNP)-led four-party alliance that ruled the country from 2001-2006 gained only 33 seats, down from 217 in 2001. The Islamist party, Jamaat-e-Islami, the BNP’s key ally in its four-party alliance, secured only 2 seats, down from 17 in 2001.

3. A 32-member cabinet was sworn in on 6 January with AL chairperson Sheikh Hasina as Prime Minister (PM), while senior AL leader Zillur Rahman has been designated as the country’s next President. Mr. Abul Maal Abdul Muhith, a former Executive Director at ADB and Alternate Executive Director at the World Bank, is the Minister for Finance. The “planning” portfolio has been separated from Finance, with Mr. A.K. Khandaker, a planning minister in an earlier government, as Minister. The PM has retained the critical ministries of Power, Energy and Mineral Resources. Including the PM, the new Cabinet has the highest number (5) of women in the country’s history, with key portfolios, including Home and Foreign Affairs. The new PM has said her government’s first tasks would be to improve law and order, control prices of essentials, and reduce prices of agricultural inputs to bring them within farmers’ reach. She also cautioned that stern action would be taken against corruption and misuse of power, providing assurance that the reform process including the anti-graft drive initiated during the caretaker regime would continue.

4. The winning coalition has promised to make parliament effective and inclusive, though the country’s political history has been marked by confrontation and bitter rivalry. The opposition BNP now seems to have accepted the election results and stated that it would cooperate with the new government. Unlike previous elections, the law and order situation remained stable in the days following the polls, and the transition back to a democratically elected government was relatively peaceful. The newly elected grand alliance, which campaigned on a platform of cutting

food prices, controlling corruption and combating terrorism, faces the difficult challenge of resolving a serious energy crisis and power shortage, raising infrastructure investment, addressing the impacts of the global economic downturn, and raising living standards in a nation where more than 60 million people live on less than \$1 a day. An important test of the new government's commitment to reform and good governance will be whether it decides to ratify the 117 ordinances promulgated by the caretaker administration.

5. Meanwhile, the country is preparing for the first *upazila* (sub-district) elections in some 18 years on 22 January as part of its plan to strengthen local government administration. Over 7,200 candidates are contesting the elections in 481 upazilas across the country for the posts of chairman, and two vice-chairmen, one of which is reserved for women. The upazila councils are given a large number of functions and responsibilities relating to civic and community welfare, as well as local development.

C. Response of the International Community

6. International and local election observers unanimously termed the 29 December polls as free, fair and credible. Over 700 global monitors, including delegations from the Asian Network for Free Elections, European Union, International Republican Institute, National Democratic Institute, Commonwealth, Asia Pacific Democracy Partnership, Asia Foundation, and the diplomatic missions of numerous countries were unanimous that the election was of "international standard." The international community, including the United States, the United Kingdom, and the European Union, has also urged political parties to devise a new approach for an effective and inclusive parliamentary democracy and to carry on with the governance reform process initiated by the caretaker government to face the challenges ahead.

D. Recent Economic Developments and Outlook

7. Economic performance in the first half of FY2009¹ held up well with a pick up in domestic economic activity and robust growth in exports and remittances. Continued growth in readymade garment production, together with improvements in business confidence and recovery in housing and construction, stimulated industrial activity in the first quarter of FY2009. Falling prices of construction materials and a rise in demand for real estate because of the growth in bank credit and higher remittances helped to revive the construction subsector. Services, especially wholesale and retail trade and transport and telecommunications, also performed well in the first quarter of FY2009. Rapid growth in the mobile phone market and a growing number of healthcare service providers are contributing to robust service sector growth. The continued expansion in agriculture and industry is also likely to have a positive impact on services sector growth. Exports grew by 27% through November 2008 and remittances by 31% through December 2008, over the corresponding periods of the previous fiscal year.

8. Before the onset of the global financial crisis, a 6.5% growth target for FY2009 appeared attainable. With the financial crisis in the advanced economies unfolding and recession setting in, a growth rate of 5.8% seems more likely in FY2009. Industrial growth is expected to moderate to 6.7% from 6.9% in FY2008 as production for exports begins to slow in the second half of the fiscal year with cooling global demand. Deceleration in remittance growth will also dampen domestic demand. Services growth will slow to 6.2%, down from 6.7% in FY2008, due to lower activities in the export sector and declines in consumption spending induced by lower income and moderation in remittance growth. Agriculture is expected to perform well, aided by

¹ FY2009 covers the period from 1 July 2008 to 30 June 2009.

favorable weather conditions, expansion of cultivable land, and various government support programs. Overall, agriculture is expected to grow at 4.0%, up from 3.6% in FY2008.

9. Inflation moved steadily downward as the second quarter of FY2009 unfolded, sliding from 10.2% year-on-year in September to 7.3% in October and then further to 6.1% in November. The rapid decline in international commodity prices and improved domestic food supplies are the main factors pushing inflation lower. The decline in food inflation was steeper than that for nonfood inflation. The cut in the domestic administered price of oil in October and December 2008, after an increase in July, also helped to ease pressures. Oil prices are expected to be cut further in the second half of the fiscal year as international prices remain weak. Inflation is projected at about 7.5% for the year as a whole, down from 9.9% in FY2008.

10. Macroeconomic stability should be preserved despite slowing revenue collections, which decelerated to 15.3% growth during July-November of FY 2009 from 22.8% in the corresponding period of FY 2008. Weakening private sector activity, as the impacts of the global economic slowdown take hold, could slow revenue collections further. Import-based revenues will be affected by the cuts in customs duties in the FY2009 budget and the erosion in import values resulting from the declines in international commodity prices. However, lower spending for food, fertilizer and fuel subsidies compared with the budget targets will help to keep public spending in check in FY2009. The Public Resources and Budget Management Ordinance enacted in 2008, setting a cap on domestic borrowing by the Government, will also help to control public spending. The budget deficit is therefore expected to be within the budgeted level of 4.9% of GDP.

11. The external position should also remain stable with annual export growth projected to be 16.5% in FY2009, still higher than the 15.7% growth in FY2008. Further, the fall in international commodity prices is expected to contain growth in the import bill, which is projected to moderate to 18.0% in FY2009. Although growth in remittance inflows will also slow, the current account in FY2009 is expected to show a modest surplus of 0.8% of GDP. Foreign exchange reserves during the year are expected to remain at a relatively comfortable level equivalent to about 3 months of goods and services imports.

12. The key challenges for the new Government over the longer term will be to raise infrastructure investment and government revenue mobilization, accelerate Annual Development Program implementation, address deficiencies in institutional capacities in key line agencies, and create more jobs. Addressing power and gas shortages will be critical to encourage private investment to enhance longer-term growth prospects. Confrontational politics, if it reappears with the restoration of democracy, will also slow down economic activity.

E. Status of and Implications for ADB Operations in Bangladesh

13. With the caretaker government's strong support that translated into a greatly improved implementation environment, ADB's portfolio performance was very strong in 2008. Disbursements reached an all time high of \$615.64 million during the year, and there is now only one project at risk. The Bangladesh portfolio currently consists of a total 52 ongoing loans, with a net loan amount of \$3.58 billion. Cumulative uncontracted and undisbursed balances are at \$1.88 billion and \$2.14 billion, respectively.

14. As the political transition was relatively smooth and peaceful in comparison with the past, the project implementation environment was largely uninterrupted, maintaining the safety and effectiveness of ADB's operations. It is expected that the implementation environment will

further improve as the new political government settles in. In particular, it is hoped that the law and order situation will stabilize further and there will not be any significant political disruptions as the opposition BNP has accepted the poll results and offered to help the new government. The new PM's announcement of her government's commitment to improve law and order, continue reforms and improve governance, and the new leaders to be installed through elections to the local government bodies, are also expected to infuse dynamism in the administration, which may contribute to better project implementation. However, in the near term, the expected widespread transfer of government officials may temporarily affect the congenial atmosphere for implementation of development programs. The new government may also need some time to start making decisions on project implementation issues, resulting in delays in some cases. To address the situation, BRM remains vigilant in its assessment of the evolving situation and will proactively raise issues with senior officials to expedite the implementation process, including on key procurement actions and policy decisions.