

BANGLADESH

During fiscal year 2001, Bangladesh posted figures for robust economic growth and low inflation, due mainly to a bumper harvest and a revival of growth in the industry sector. However, a deteriorating external environment and mounting fiscal imbalances could undermine economic growth over the short to medium term.

Economic Indicator (percent)	1998	1999	2000	2001		2002	
				Current	ADO 2001	Current	ADO 2001
GDP growth	5.2	4.9	5.9	6.0	5.7	5.5	6.0
Inflation rate	7.0	8.9	3.5	1.5	3.0	3.0	5.0
Current account/GDP	-1.1	-1.4	-1.0	-2.0	-1.5	-2.5	-1.8

Economic Assessment. The GDP growth rate in 2001 is now estimated at about 6.0 percent compared with a forecast growth rate of 5.7 percent made at the time of ADO 2001. Another bumper crop and a rebound of the industry sector contributed to this strong growth performance.

Foodgrain production in 2001 topped 26.8 million tons, representing growth of 7.6 percent over the preceding year. Favorable weather, expanded cultivation of high-yielding varieties, and improved availability of inputs at reasonable prices were all factors in another record harvest. However, despite the agriculture sector's large production increases, year-on-year growth was modest due to a high base for comparison, following record harvests in both 1999 and 2000.

Despite sporadic political unrest and mounting infrastructure constraints in the country, industry sector growth is estimated at 8.7 percent in 2001, compared with 6.2 percent in 2000. Higher growth was due mainly to a surge in output of export-oriented industries, namely garments, processed foods, and chemicals. Small-scale industries also registered an upturn in output. However, the traditional jute industry stagnated and construction growth slowed. Growth in the services sector was sustained by notable improvements in catering, telecommunications, and finance.

In 2001, investment activity increased moderately to 23.6 percent of GDP from 23.0 percent in the preceding year. Despite an increase in domestic savings, gross national savings declined to 21.6 percent of GDP in 2001 due to a decline in remittances from overseas workers. The country is yet to establish a well-functioning finance sector to mobilize domestic savings effectively.

The Government's revenue collection improved to 9.4 percent of GDP during 2001, compared with 8.5 percent in 2000. Despite this improvement, the revenue/GDP ratio continues to be one of the lowest among developing

2001 refers to fiscal year 2000/01, ending 30 June.

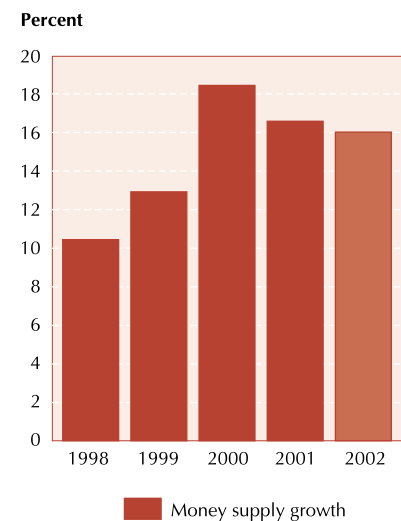
countries. An increase in imports, the introduction of a compulsory pre-shipment inspection scheme, and strengthened tax administration contributed to increased revenue collection. However, the budget deficit remained high at 6 percent of GDP on account of a sharp surge in expenditures. The fiscal deficit would have been substantially higher if quasi-fiscal activities, such as deficits among SOEs outside the annual development program, had been taken into account. A trend toward increased reliance on domestic borrowing, which amounted to some 3.5 percent of GDP in 2001, to finance the budget deficit remains a cause for concern because this is costlier than foreign financing. As a result of increased domestic borrowing, the Government's interest payment liabilities are rising. The ratio of interest payments on domestic debt to revenues rose from an already high 12.0 percent in the original 2001 budget to 13.6 percent in the revised 2001 budget estimates.

Although monetary policy remained expansionary to accommodate fiscal spending over the full year 2001, money supply growth slowed to 16.6 percent in June 2001 from 19.3 percent in December 2000. The main factor was the decline in net foreign assets in the banking system. The growth of credit to the private sector edged up from 13.7 percent to 16.9 percent, due to the revival of the industry sector.

The inflation rate fell further in 2001, to 1.5 percent from 3.5 percent in the preceding year, mainly because of successive record crop harvests and resulting deflation of foodgrain prices. It appears that any inflationary impact that the growth in money supply may have had was outweighed by the decline in food prices.

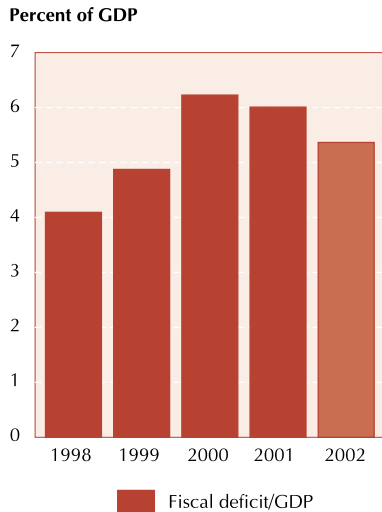
After two years of sluggish growth, exports grew by 12.4 percent year on year in 2001. Their base, however, remained narrow and undiversified, with ready-made garments and knitwear accounting for 75 percent of the total. While the overall annual growth rate of exports in 2001 was impressive, exports fell substantially during the latter half of the year from a 25 percent year-on-year growth rate in the first half. The major reason for the deceleration was the slowdown in the US economy and continued sluggish growth in Japan and the EU. Other important factors were continuing political disruptions and strikes, and infrastructure bottlenecks at the ports and in the supply of electricity. Imports picked up notably, due particularly to higher imported volumes of capital goods, and oil and oil products. The current account balance weakened in 2001 due to a deteriorating trade balance, a drop in overseas worker remittances, and higher payments for supplier credit. Foreign exchange reserves declined from \$1.6 billion, or 2.3 months of imports, at the end of 2000 to \$1.3 billion, or 1.6 months of imports, at the end of 2001. To address declining remittances, decelerating export growth, and falling foreign exchange reserves, the Government devalued the taka by 5.5 percent on 25 May 2001. The devaluation restored the real effective exchange rate to its early 1997 level; it also narrowed the gap between the official and informal-market exchange rates.

Monetary policy remained expansionary



Sources: Bangladesh Bank, staff estimates

Fiscal management is still a key challenge for the Government



Sources: Bangladesh Bureau of Statistics, staff estimates

Economic Management Issues. Fiscal management remains a key challenge for the Government in the near and medium term. Although the 2002 budget projects that the revenue/GDP ratio will increase by 0.4 percentage points and that the expenditure/GDP ratio will decline by 0.3 percentage points, it lacks, however, any substantive new measures to strengthen tax administration or to expand tax coverage. On the other hand, projected expenditures seem to be on the low side. The continued reliance on high-cost domestic borrowing is detrimental to domestic investment and could impair macroeconomic stability. To manage its fiscal deficit, the Government needs to exercise the utmost restraint in public spending, take measures to cut SOE losses, and strengthen tax administration.

Against a background of a further decline in foreign exchange reserves to \$1.25 billion, or less than 1.5 months of imports, at the end of August 2001, the Government has taken various steps to increase foreign exchange inflows including increasing punitive measures against illegal foreign exchange transactions; introducing incentives to encourage overseas workers to send their remittances through official channels; closer monitoring of imports to discourage the practice of overinvoicing; and encouraging repatriation of export earnings. To increase reserves in the future, the Government also needs to undertake urgent measures to improve the use of concessional funding, manage the exchange rate more flexibly, and initiate measures to diversify exports. This last measure would also require progress both in implementing reforms in the finance sector and in addressing mounting infrastructure constraints.

Forecast. For 2002, GDP growth is projected to decline to 5.5 percent due to more subdued export growth and investment stemming from the sharper than expected global slowdown and the loss of confidence and uncertainty generated by the recent terror attacks. Recent events are also likely to adversely affect remittances from migrant workers in the Middle East and the US. As a result of slower export growth and reduced remittances, the current account deficit is expected to widen. Higher public expenditures and the lagged effect of monetary expansion are likely to generate stronger inflationary pressures in 2002.