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BANGLADESH

Quarterly Economic Update

June 2013

Asian Development Bank

Bangladesh Resident Mission
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NOTES

(i) The fiscal year (FY) of the government ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2012 ends on 30 June 2012.

(ii) In this report, "$" refers to US dollars, and "Tk" refers to Bangladesh taka.

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MACROECONOMIC DEVELOPMENTS

Highlights

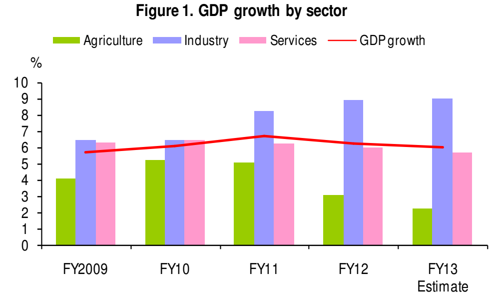
- Gross domestic product growth slowed to 6.0% in FY2013
- Agriculture growth dropped to 2.2% due to slower crop and horticulture growth
- Industry grew strongly led by healthy manufacturing growth
- Services growth decreased slightly due to lower agriculture growth and slower private credit and import growth
- Inflation fell to 7.7% in FY2013 with lower food and nonfood prices
- The FY2013 fiscal deficit remained within budget
- The FY2014 budget proposes a moderately expansionary fiscal policy stance
- Slowing growth in private credit undermines the central bank's accommodative policy stance
- Higher remittance and export growth and a decline in imports raised the current account surplus
- Bangladesh needs to improve the business climate to stimulate domestic and foreign investment

Sector Performance and Economic Growth

GDP growth moderates to 6.0% in FY2013 because of decreased private investment and weaker consumption

1. Gross domestic product (GDP) growth for FY2013 is officially estimated at 6.0% (Figure 1). Although lower than the FY2012 growth of 6.2%, this respectable growth was achieved in a challenging global and domestic economic environment. Weaker aggregate demand resulting from decreased private investment and subdued consumption reflected by slower growth in private sector credit caused the moderation in GDP growth. Increased political unrest, including frequent *hartals* (general shutdowns), and the uncertainty in the lead up to the national elections expected by January 2014 affected private investment and consumption. Nonetheless, strong remittance

Figure 1. GDP growth by sector



inflows, increased exports to advanced economies and newly discovered markets, and higher public investment partly offset the slide in aggregate demand.

2. Agriculture growth declined because of slower growth in crops and horticulture. Industry grew strongly, due to continued robust manufacturing growth and higher growth for construction, and mining and quarrying subsectors. Services growth moderated slightly because of lower agriculture growth and slower trade activities, particularly related to imports.

Major macroeconomic indicators remain broadly on track

3. Major macroeconomic indicators remained broadly on track. Inflation eased with food and nonfood prices falling—lower global food and commodity prices and slower credit growth and taka appreciation contributed. Lower imports and healthy remittance inflows resulted in a current account surplus in the first 10 months of FY2013 compared with the deficit in the year earlier period. The fiscal deficit is contained within the budget target as annual development program (ADP) implementation remained below target, current spending was held in check because of periodic adjustments in administered power and fuel prices, and the steady rise in revenue collection. Foreign reserves rose.

Continued macroeconomic stability and expansion in fiscal space is essential

4. The government needs to unleash the economy's growth potential by investing more in physical and social infrastructure, implementing institutional and structural reforms, improving governance quality, and maintaining a supportive macroeconomic environment. Controlling inflation is a priority, and will require greater coordination of macroeconomic policies. Rationalizing subsidies, containing recurrent spending and boosting revenues are essential to expand the fiscal space to invest more in priority sectors. The government needs to reform tax policies and tax administration, improve budget implementation capacity, and pursue a sound debt policy.

Business climate needs to be significantly improved

5. To support dynamic private-sector-led development focusing on enhanced private and foreign direct investment (FDI), Bangladesh's business climate needs to be significantly improved by reducing the cost of doing business, liberalizing the trade regime and facilitating trade, improving the business regulatory environment, ensuring contract enforcement, and improving the dispute settlement mechanism. Constraints in factor markets also need to be addressed. Finance sector reform is vital for increasing financial depth, inclusion, access, and efficiency.

Concerted efforts are needed to enhance social inclusiveness and greater equity in the provision of public goods

6. Concerted efforts are needed to enhance social inclusiveness and increase equity in access to public resources, human development, and other public goods. Existing disparities across genders in access to basic needs and legal rights need to be eliminated. Massive investment is necessary to foster skills-based education. Increasing quality and access to health services

is important for human development. Social safety net programs need to be made more effective through better targeting, coordination, monitoring, and implementation including by introducing direct cash transfer mechanisms. Implementation and enforcement of the core conventions and labor rights of the International Labour Organization (ILO) are vital for creating a decent employment environment. A strategic policy framework is needed to increase social security for the ageing population. Over the medium term, a comprehensive pension system for the elderly will be necessary to better maintain social harmony.

7. The government needs to implement fundamental reforms for core institutions, improve public administration capacity, and implement a strong anticorruption strategy. Good institutions, rule of law, accountable and effective public service agencies, and sound government agencies dealing with finance, taxation, planning, public administration, and monetary policies are essential to ensure sustained high economic growth and social development.

Reforms of core institutions, improved public administration capacity, and a strong anticorruption strategy are needed

8. The FY2014 budget (paras. 76–94) supports the government's commitment to advance reforms. Implementation of the Value Added Tax and Supplementary Duties Act, passed in November 2012, is beginning. The new law will modernize the tax system and generate substantial domestic revenue to support higher development spending. The authorities have committed to adjust fuel and electricity prices, conduct efficiency audits of fuel and electricity utilities to bring subsidy-related costs fully on-budget, capitalize all earlier subsidy-related loan losses (equivalent to 0.5% of GDP) of state-owned commercial banks (SCBs), and phase out external borrowing by Bangladesh Petroleum Corporation (BPC) through oil-related supplier credits. In March 2013, the government issued guidelines on budget monitoring and reporting under the Public Money and Budget Management Act to strengthen public financial management.

FY2014 budget reiterates the government's commitment to advance reforms

9. Reforms are in progress to strengthen monetary discipline and the financial system. Amendments to the Bank Companies Act were sent to Parliament in March 2013. To strengthen the securities market, Parliament passed the Demutualization Act in April 2013. The central bank undertook reforms to develop the foreign exchange market. It is also preparing a strategy paper to review the Foreign Exchange Regulation Act to develop a road map to liberalize exchange control and thus facilitate FDI and foreign portfolio investment.

Reforms are in progress to strengthen monetary discipline and the financial system

Agriculture

10. Agriculture growth decelerated to 2.2% in FY2013 from 3.1% in the year before, caused by the decline in crop and horticulture growth from 2.0% in FY2012 to 0.2% in FY2013.

Agriculture growth fell to 2.2% in FY2013, caused by a decline in crops and horticulture growth to 0.2%

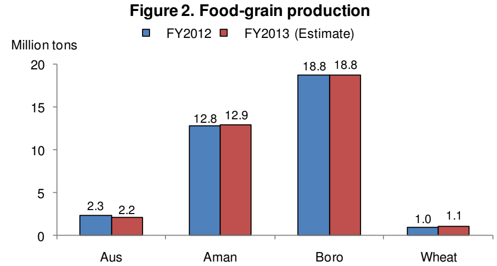
Lower output prices and higher input costs affected farmers' profits from rice production. Depressed agriculture performance during 2 successive years suggests that slower productivity growth might be contributing to lower growth in crop output. Within agriculture, animal farming increased slightly to 3.5% in FY2013, from 3.4% in the previous year. Forest and related services grew by 4.5%, slightly higher than 4.4% in FY2012. Fisheries continued healthy growth at 5.5%, responding to increased income and population growth.

11. Government policy continued to provide support for agriculture. The government distributed 14.4 million input assistance cards to farmers and reduced non-urea-fertilizer prices by about 70%–79% in three phases. In 35 districts, the government arranged to supply tractors, power tillers, harvesters, and other agricultural equipment—subsidizing the costs by 25%. It increased the agriculture subsidy from Tk95 billion in the original FY2013 budget to Tk120 billion in the revised budget. Bangladesh Agriculture Development Corporation distributed nearly 60% of *boro* seeds, irrigation facilities were extended to about 0.11 million hectares, 11,550 hectares were recovered from water logging, and public food storage capacity was enhanced to about 2.0 million tons. Under the agriculture rehabilitation program, the government supplied free seeds and fertilizer to farmers. As part of this program, the government distributed free seeds and fertilizer to 332,500 farmers to produce *Ufshi Aus* and *Bona Aus* (Nerica). To encourage the use of organic fertilizer, the government fixed an annual target of setting up 0.18 million compost piles in farmer homesteads.

Agriculture was aided by a variety of government policy support

12. According to provisional estimates from the Bangladesh Bureau of Statistics, growth in food-grain production sharply slowed in FY2013. Total food-grain production (rice and wheat) is provisionally estimated at 34.9 million tons in FY2013, only 0.02% higher from actual production in FY2012 (Figure 2). *Aus* (summer crop) production equaled 2.2 million tons cultivated from 1.1 million hectares, 7.5% lower than 2.3 million tons in FY2012, due to a decline in cultivation area. Although less than optimal monsoon rainfalls and flash floods caused some losses, *aman* (monsoon crop) production was 12.9 million tons from 5.6 million hectares, 0.8% higher than 12.8 million tons in FY2012, due to a marginal increase in cultivation area. The cultivation area for both broadcast and local transplant *aman* declined, while the cultivation area for high-yielding-variety *aman* rose sharply compared with the previous year. At 18.8 million tons (provisional

Figure 2. Food-grain production



Food-grain production in FY2013 is estimated at 34.9 million tons, almost unchanged from the previous year

estimate), *boro* (winter crop) production remained almost unchanged from the previous year. Wheat production was provisionally estimated at 1.1 million tons, 8.0% higher than actual production the previous year. Wheat production has been increasing, as per capita wheat consumption particularly among the urban population whose diet is progressively diversified, has been rising.

13. The government procured 1.13 million tons of food grains (1.01 million tons of rice and 0.12 million tons of wheat) from domestic sources as of 30 May 2013, against the target of 1.16 million tons in FY2013. *Aman* procurement equaled 0.27 million tons at Tk26/kilogram (kg) for parboiled rice and Tk25/kg for white rice; *boro* procurement for the current season equaled 38,150 tons at Tk29/kg, and wheat 0.12 million tons at Tk25/kg. In addition, the government procured 0.70 million tons of rice from the previous *boro* season.

The government procured 1.13 million tons of food grains from domestic sources as of 30 May 2013

14. As of May 2013, total food-grain import in FY2013 stood at 1.86 million tons (28,470 tons of rice and 1.83 million tons of wheat) against the target of 2.24 million tons. Of the total, public import totaled 0.46 million tons and private import 1.40 million tons. With the satisfactory public stock of rice, the major part of the public import was for wheat (helping to stabilize flour prices); the government distributed flour through its open market sales program.

Total food-grain import was 1.9 million tons in the first 11 months of FY2013

15. The government continued its efforts to increase food security to minimize hardship of vulnerable groups. This included the distribution of more food grains through nonmonetized channels. By 30 May 2013, the government had distributed 1.87 million tons of food grains (1.31 million tons of rice and 0.56 million tons of wheat) under the public food distribution system, against the target of 2.48 million tons in FY2013. The government distributed 0.61 million tons of food grains through monetized channels and 1.26 million tons through nonmonetized channels.

The government distributed more food grains to ease the hardship of vulnerable groups

16. At the end of May 2013, after distributing food grains through the monetized and nonmonetized channels, the public food-grain stock was 0.87 million tons (0.62 million tons of rice and 0.25 million tons of wheat), lower than 1.19 million tons at the end of May 2012.

Government stock of food grains was 0.9 million tons at 31 May 2013 compared with 1.2 million tons at 31 May 2012

Industry

17. The uptick in industry sector performance since FY2011 was maintained in FY2013, with growth of 9.0% compared with 8.9% in FY2012. Manufacturing growth was strong although down slightly to 9.3% in FY2013 from 9.4% the previous year. Large- and medium-scale manufacturing growth moderated to 10.3%

Strong industry sector growth continues

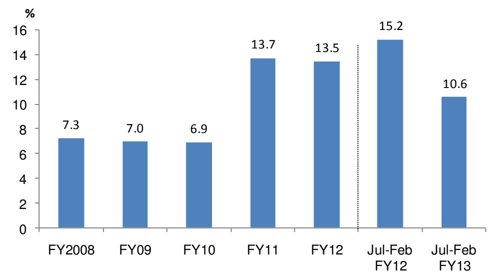
from 10.5%, while small-scale manufacturing growth rose to 6.8% from 6.5%.

18. The nonmanufacturing subsectors demonstrated mixed performance. In FY2013, construction increased by 8.1% up from 7.6% in FY2012. Mining and quarrying activities grew strongly by 11.1% compared with 7.8%. Growth in the gas subsector rose to 9.2% from 4.3%. Growth in electricity fell to 8.6% from 13.2% and that in water supply fell sharply to 6.6% from 11.5% in FY2012.

Nonmanufacturing subsectors demonstrate mixed performance

19. The general index for large- and medium-scale manufacturing rose by 10.6% during July–February FY2013 (Figure 3). The major industrial category—jute, cotton, wearing apparel, and leather—rose by 9.4%; chemicals, petroleum, and rubber by 8.5%; food, beverages, and tobacco products by 18.8%; fabricated metal products by 16.4%; nonmetallic products by 4.3%; basic metal products by 25.0%; and paper and paper products by 3.2%. The index for wood products, including furniture, declined by 5.2%.

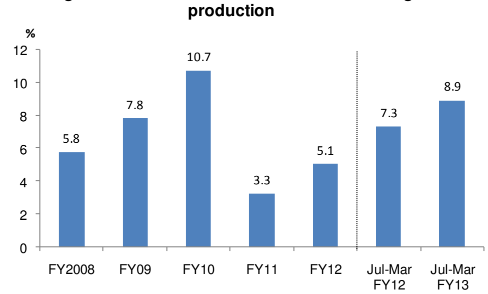
Figure 3. Growth of medium- and large-scale manufacturing production



The general index for large- and medium-scale manufacturing rose by 10.6% during July–February FY2013

20. The general index for small- scale manufacturing grew by 8.9% during July–March FY2013 (Figure 4). Food, beverages, and tobacco production rose by 19.4%; wood and wood products by 5.5%; textiles, leather, and apparel production by 3.4%; metal products and machinery by 0.9%; nonmetallic mineral products by 2.9%; and paper, printing, and publishing by 3.3%. Indices for chemicals, rubber, and plastic declined by 2.2%; basic metal industries by 4.0%; and other manufacturing by 2.8%.

Figure 4. Growth of small-scale manufacturing production



The general index for small-scale manufacturing grew by 8.9% during July–March FY2013

Services

21. Services sector growth in FY2013 is estimated at 5.7%, down from 6.0% in FY2012 because of lower agriculture growth and slowdown in private credit and imports. Wholesale and retail trade, the major services subsector, grew by 4.7% compared with 5.6% in FY2012, a decline reflecting weaker domestic demand.

Services sector growth fell to 5.7%

Hotel and restaurant services growth remained unchanged at 7.6%.

22. Transport, communication, and storage services rose slightly to 6.7% from 6.6% in FY2012. Within the transport sector, land transport services growth fell from 5.5% to 4.8%, and support transport services and storage subsector growth from 10.7% to 8.4%. Water transport edged up slightly from 1.2% to 1.5%, air transport from 13.2% to 14.8%, and post and telecommunications growth rose from 9.2% to 10.7%.

Transport services growth rose slightly

23. Financial intermediation services growth declined to 9.0% from 11.0% in FY2012 due to a fall in private investment, slowdown in private credit and imports, and the effects of political unrest. Monetary intermediation services growth fell to 9.3% from 11.3%, insurance declined to 8.2% from 10.3%, and other financial intermediation growth fell to 8.4% from 10.0%.

Lower financial services growth was caused by a slowdown in private credit and imports, and political unrest

24. During FY2013, real estate, renting, and business activity growth remained unchanged at 4.1%, the growth recorded in the previous year. Public administration and defense services growth declined to 5.1% from 5.8%. Education services grew strongly by 9.7% from 7.2%. Health and social services growth edged down to 7.5% from 7.9%; and community, social, and personal services growth edged up slightly to 4.9% from 4.8%.

Education services continue to grow, while heath services growth declined

Economic Growth

25. To accelerate poverty reduction and create jobs for the large and growing labor force, Bangladesh needs to raise economic growth, e.g., by about 8.0% annually over the medium term. It attained average growth of just over 6.0% in the past decade, with some contribution from capital accumulation, modest rise in labor productivity, and total factor productivity. While total factor productivity growth requires a longer time span to materialize, Bangladesh's short- and medium-term growth prospects mainly hinge on accelerating capital deepening, supported by higher private and public investment and FDI. Increased private investment is required to expand the capacity of existing firms, diversify the economy, and unleash new growth drivers. At the same time, large investment in power, energy, transport, and skills development is needed for crowding in private investment and FDI. In addition, good governance and political stability are also essential for enhancing Bangladesh's growth prospects.

Higher private investment is vital for increasing GDP growth and creating jobs

26. In spite of the high priority attached in the Sixth Five-Year Plan (6th FYP) (FY2011–FY2015), boosting private investment has become a major challenge. The private investment–GDP ratio fell by 1 percentage point to 19.0% in FY2013 from the revised estimate of 20.0% in the previous year. Private investment

Private investment fell in FY2013

stagnated at 19.0%–20.0% of GDP during FY2007–FY2013. Both short- and medium-term factors contributed to the low private investment performance. While the short-term constraints are often policy induced, the medium-term constraints are linked to the economy's structural and institutional bottlenecks.

27. Weaker private investment demand is reflected in slower private credit growth, which decelerated to 12.7% in April 2013 from 18.2% in April 2012. Despite the cut in policy rates by the central bank to soften monetary tightening in the second half of FY2013, private investment did not pick up. National savings at 29.5% of GDP in FY2013 were also lower, from 30.0% in FY2010, with a consequent impact on investment. Lower investment demand is also indicated by the 3.4% decline in capital goods imports during July–April of FY2013, down from 11.8% growth in the corresponding period of the previous year.

Medium-term constraints to private investment are linked to infrastructure and institutional bottlenecks

28. The medium-term constraints to private investment are linked to the inefficient financial system and undeveloped capital market, infrastructure bottlenecks, and poor investment climate. Unplanned urbanization and the inefficient land market accentuate land scarcity. Despite the increase in electricity generation capacity, supply remains unreliable and costly, and lags the rising demand. New investment projects are postponed due to lack of gas and electricity supply. Transport connectivity remains fragile because of inadequate investment and poor operation and maintenance services. Likewise, skill shortages constrain private investment growth. Compared with other countries in the region, Bangladesh lacks resources within the budget to finance infrastructure investments. Subsidies, leakages, and capacity constraints worsen this situation. Apart from infrastructure shortages, growing weaknesses in the financial market, reflected by balance sheet problems of the SCBs, constrain healthy private investment.

FDI inflow is a potential growth driver

29. While the Bangladesh economy needs to identify new growth drivers, the importance of FDI as a potential driver for propelling the economy to a higher growth trajectory cannot be overemphasized. The country needs larger FDI inflows to increase private investment in infrastructure, create jobs, and raise total factor productivity growth—the long-run growth driver. FDI unleashes many positive externalities including increased skills and managerial efficiency, provision of a better work culture, and transfer of knowledge and international best practices. It also crowds in modern services. FDI has been playing an important catalytic role in fostering the rapid growth experienced by many developing countries, including Cambodia, the People's Republic of China (PRC), India, Indonesia, Lao People's Democratic Republic, Malaysia, Philippines, Sri Lanka, Thailand, and Viet Nam. Although, global FDI inflows declined by 18.0% in 2012, developing countries absorbed $680 billion of FDI, the second

highest amount ever recorded, and $130 billion more than FDI inflows to developed countries.[1] FDI inflows to South Asia rose by 23.0% to $39 billion in 2011 (2.6% of global FDI inflows) after a slide in 2009–2010 caused by the financial crisis in the advanced economies.

30. Net FDI inflows to Bangladesh have been increasing modestly, e.g., from $748 million in FY2008 to $995 million in FY2012, and $1.1 billion during July–April of FY2013, a rise of 7.2% over the year earlier period. Average annual FDI inflows to Bangladesh stood at $818 million during 2005–2011 compared with $75 billion to the PRC, $18 billion to India, $4.2 billion to Viet Nam, and $2.5 billion to Pakistan. Bangladesh's FDI share of GDP is also low by cross-country comparison; it decreased from 1.3% in FY2008 to 0.8% in FY2013. The FDI share of GDP in 2012 for other developing countries was 7% in Cambodia, 3% in the PRC, 1.7% in India, 2.1% in Indonesia, 3.4% in the Lao People's Democratic Republic, 13.7% in Maldives, 1.6% in Sri Lanka, and 6% in Viet Nam.[2]

FDI inflows to Bangladesh remain low compared with other developing countries

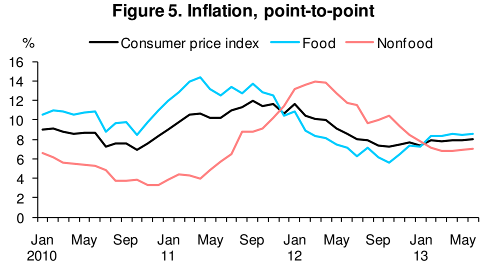
31. While the 6th FYP envisaged attracting FDI inflows to boost public–private partnerships (PPPs), it aimed at increasing the share of PPP financing in total investment from 0.5% of GDP in FY2010 to 2.5% by FY2015. Notwithstanding the increase in budgetary allocations, major progress has not been accomplished. A number of implementation issues are challenging PPP operationalization along with the poor investment climate, land scarcity, and shortage of infrastructure. To operationalize PPP as envisioned by the 6th FYP, the authorities need to design appropriate pricing mechanisms, financing modalities, regulatory and legal frameworks, a competitive and transparent bidding process, assessments of risks and returns, and an arbitration and litigation mechanism. They also need to develop stewardship and engage competent staff. The private sector needs to develop capacity for building productive partnerships.

Implementation challenges constrain PPP dynamism

Inflation

32. Year-on-year inflation, measured by the consumer price index using FY1996 as the base year, decelerated from 11.6% in January 2012 to 7.2% in October 2012, because of lower nonfood and food prices. Inflation started

Figure 5. Inflation, point-to-point



Inflation began to rise slowly from November 2012 due to supply disruptions and the rise in power and fuel prices

[1] United Nations Conference on Trade and Development. 2013. *Global Investment Trade Monitor.* 11 (23 January).

[2] World Bank. http://data.worldbank.org

rising slowly from November 2012, reaching 8.0% in June 2013 (Figure 5) following the rise in food prices due to frequent supply disruptions because of political unrest, and upward adjustments in government-administered domestic power and fuel prices.

Food inflation is showing a rising trend, but nonfood inflation is moderating

33. Food inflation rose to 8.5% in June 2013 from 7.1% in June 2012. Nonfood inflation moderated steadily, decelerating to 7.0% in June 2013 from 11.7% in June 2012 reflecting weaker domestic consumption and investment demand.

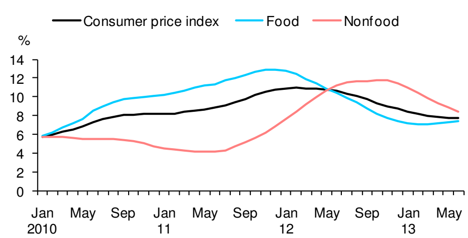
Urban inflation is higher than rural inflation

34. Urban inflation remained higher than rural inflation, although both declined over the past year. Rural inflation fell from 7.9% year-on-year in June 2012 to 7.7% in June 2013, while urban inflation slowed from 10.3% in June 2012 to 8.7% in June 2013.

Average inflation moderates to 7.7% in FY2013 from 10.6% in FY2012

35. Average annual inflation moderated from 10.6% in FY2012 to 7.7% in FY2013 (Figure 6). Although the upward power tariff adjustment in September 2012 and the January 2013 increase in various fuel prices by 5.3%–11.5% put some pressure on prices, inflation moderated in FY2013 because of lower international food and commodity prices, slower private credit growth and strong supervision by the central bank to discourage unproductive use of credit, and the priority attached by the government to building higher food-grain stocks. Appreciation of taka also contributed.

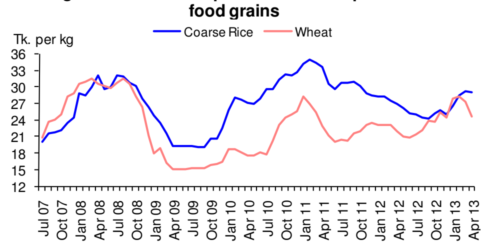
Figure 6. Inflation, 12-month moving average



Prices of rice and wheat rose

36. Rice prices were lower and quite stable for most of 2012. Although average retail prices of coarse rice declined in the first quarter of FY2013, they started rising from the second quarter following the increase in wholesale prices. The average retail price of rice (coarse) rose to Tk29/kg in April 2013, 7.5% higher than Tk27/kg in April 2012. The current rising trend is unlikely to reverse before the next *boro* crop harvest. The retail price of wheat rose to Tk24.6/kg in April 2013, up 12.1% from Tk21.9/kg in April 2012 (Figure 7).

Figure 7. Domestic open market retail prices of food grains



Fiscal Management

37. Fiscal discipline was maintained in FY2013, with a steady growth in revenue. Although collection was below target, both recurrent and development spending remained within target, although development spending rose quite strongly. Fiscal deficit was contained within budget. Reforms encompassing tax policy and tax administration are under way. Progress is also being made in streamlining public financial management; rationalizing energy and fertilizer subsidies; increasing efficiency and transparency of key social safety net programs; and strengthening capacity for debt management, contingent liabilities, and related fiscal risks.

Fiscal discipline was maintained

38. Total revenue rose to 13.5% of GDP in FY2013 from 12.5% in FY2012. The tax–GDP ratio increased to 11.3% from 10.4%, although remaining well below the regional average. Collection from income and profit taxes grew strongly by 25.4%. Collection from value-added tax (VAT), the main tax instrument, rose by 19.3%. Tax receipts from import duties increased by 21.2%. Collection from supplementary duties grew by 22.2%. Overall growth in indirect taxes was higher at 21.6%.

Revenue–GDP ratio increased

39. The National Board of Revenue (NBR) stepped up measures to improve tax collection to raise the tax–GDP ratio to 12.5% by FY2016. Parliament approved a landmark VAT law in 2012. NBR is preparing a VAT implementation plan and timetable, and is undergoing organizational restructuring. NBR is also working on reforming the income tax code, rationalizing rates, and exemptions and thresholds leading to the adoption of a new direct tax code. Despite a delayed start, NBR expects to complete the automation of issuance of taxpayer identification numbers linked to national identification and business identification numbers soon. An alternative dispute resolution program was rolled out in July 2012.

NBR making progress with tax policy and tax administration reforms

40. Public spending was on track, despite the inclusion in recurrent spending of interest payments on earlier domestic borrowing. Total spending in FY2013 rose to 18.2% of GDP from 16.6% in FY2012. Recurrent spending increased from 9.7% of GDP in FY2012 to 9.9% in FY2013. Interest payments (22.7%) had the highest share. At the end of April 2013, the banks had excess liquidity of Tk695.0 billion, providing no evidence of crowding out of private investment.

Public spending on track

41. Development spending rose from 4.4% of GDP in FY2012 to 5.6% in FY2013. ADP spending (90.7% of development spending) increased from 4.1% of GDP to 5.0%, although falling short of the budget target (5.3% of GDP) due to continued capacity deficits in line ministries. To enhance efficiency in public spending, the government fixed quarterly limits on the issuance of

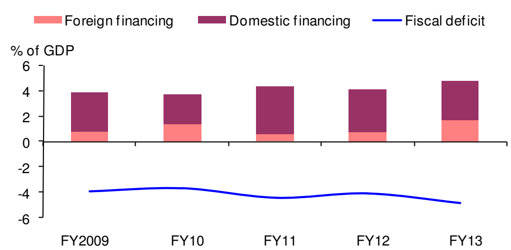
Development spending increased by more than 1 percentage point of GDP

new payment orders by line ministries with a view to improving cash management and expenditure controls. In addition, all line ministries have been brought within the integrated budgeting and accounting framework. The government also strengthened monitoring of ADP implementation by the top 10 ministries. It is preparing a formal project formulation and appraisal technical manual.

Fiscal deficit was within the budget target

42. The fiscal deficit was 4.8% of GDP in FY2013, within the budget target (5% of GDP) (Figure 8). Financing from domestic sources constituted 65.4% of the deficit and net foreign financing 34.6%. Despite the increase in foreign financing to 1.7% of GDP in FY2013 from 0.8% in FY2012, domestic borrowing was still high at 3.1%. Government borrowing from the banking system stood at 2.7% of GDP, while nonbank borrowing was lower at 0.4%. Compared with FY2012, domestic borrowing was lower because of higher foreign financing and better control of subsidy spending.

Figure 8: Fiscal deficit and financing



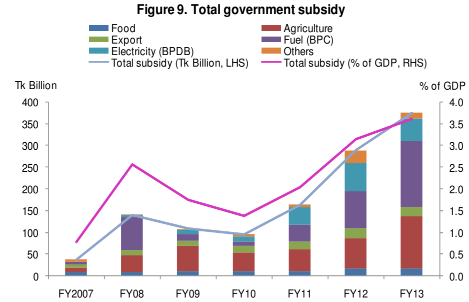
Primary deficit increased

43. The primary deficit rose from 1.9% of GDP in FY2012 to 2.6% in FY2013. The government has not yet put in place an automatic fuel price adjustment mechanism, as agreed with the International Monetary Fund (IMF) under the extended credit facility, but indicates that it would continue to adjust prices to limit the gap with international prices and stay within budgeted limits on fuel subsidies.

Subsidy spending rose to 3.6% of GDP in FY2013 from 3.1% in FY2012

44. Containing increasing subsidies has been a major challenge for the government since FY2008. In FY2013 subsidy-related spending reached $4.6 billion (3.6% of GDP) from $3.6 billion (3.1%) in FY2012 (Figure 9). Agriculture subsidies (fertilizer, diesel, and power support to farmers) rose to $1.5 billion (1.2% of GDP), up from $885.0 million (0.8%) in FY2012. Fuel subsidy was the major component of subsidy-related spending mainly because of using oil instead of natural gas, which is in short supply, as the primary fuel in power generation. The fuel subsidy in FY2013 rose to $1.9 billion (1.5% of GDP) from $1.1 billion (0.9% of GDP) in the previous year. The power subsidy declined to $641.4 million

Figure 9. Total government subsidy



(0.5% of GDP) from $803.5 million (0.7% of GDP) due to adjustments in the power tariff.

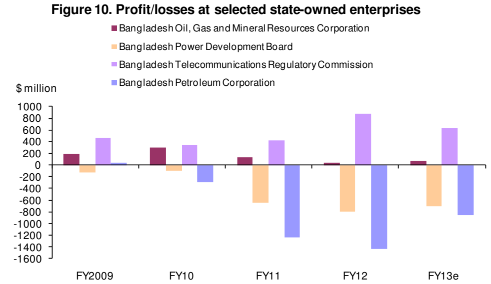
Further adjustments in power tariffs and fuel prices expected in FY2014

45. Total subsidies in FY2014 are projected to decline to $4.1 billion (2.7% of GDP) because of expected upward adjustments in fuel and power prices. The planned special audit of of state-owned enterprises (SOEs) dealing with fuel, power, and fertilizer is expected to contribute to cutting costs by identifying any misuse of resources and increasing operating efficiency.

Net losses of nonfinancial SOEs declined to $910.8 million from $1.2 billion in FY2012

46. Of the 48 nonfinancial SOEs, 29 earned profits of $869.8 million, the remaining 19 incurred losses of $1.8 billion. Net losses of these SOEs in FY2013 (up to 22 April 2013) are estimated at $910.8 million, a decline from $1.2 billion in FY2012. BPC with a loss of $861.1 million and Bangladesh Power Development Board (BPDB) with a loss of $713.3 million accounted for 88.4% of the losses, together equivalent to 1.2% of GDP (Figure 10). The government released $2.5 billion (compared with the $2.4 billion allocated in the FY2013 budget) to enable BPC and BPDB to settle part of their past liabilities to banks and other creditors.

Figure 10. Profit/losses at selected state-owned enterprises



Government takes measures to lower contingent liabilities

47. As a medium-term strategy, the government will encourage base power plants for power generation instead of rental power plants. It will stabilize fertilizer subsidies through better targeting, stricter monitoring, and price adjustments. An interagency committee, formed in October 2012, is tasked with monitoring fertilizer subsidy-related commitments and payments with a subsidy cost capped at Tk60 billion in FY2013. With a view to containing fiscal risks associated with contingent liabilities, the government retained limits on new nonconcessional external debt maturing in more than 1 year.

Monetary and Financial Developments

The central bank adopts a more accommodative monetary policy

48. In early 2013, the central bank eased its monetary policy stance given the downward trend of inflation and the need to stimulate investment and growth. In implementing monetary policy, the central bank relied mostly on open market operations through regular auctions of treasury bills with required adjustments in their yields, and on repo and reverse repo operations. No changes in policy rates have been made though since the repo and reverse repo rates were cut in February 2013. The weighted average yield on 91-day treasury bills was 8.3% in May 2013, down from 11.3% in May 2012. Similarly, the yields on

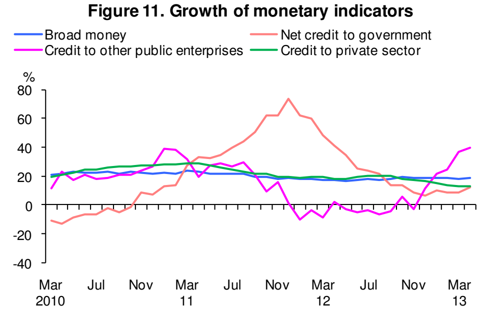
182-day bills declined to 10.2% from 11.4%, and that on 364-day bills declined to 10.3% from 11.4% in the same period. The rate on 30-day Bangladesh Bank bills also declined to 7.1% in May 2013 from 9.4% in November 2012, when its auction was resumed after nearly 2 years. As part of the overall reform in government debt markets, the government introduced a 2-year treasury bond in April 2013 to better match investor demand, and removed the 1-year holding period for nonresident holdings of treasury securities.

49. The overall easing in monetary policy is also reflected in the interbank market. The interbank call money rate has remained stable since the beginning of FY2013 because of the central bank's close monitoring of the day-to-day liquidity position in the money market and lower liquidity demand. On a weighted average basis, the interbank call money rate was 7.2% in May 2013, down from 15.0% in June 2012. Excess liquidity in the banking system has been rising due to the continued high lending rates of commercial banks and sluggish business environment, which reduced demand for credit. The tighter monetary policy followed earlier by the central bank had little impact on the liquidity position as excess liquidity in the banking system remained high at Tk695.0 billion at the end of April 2013, up from Tk456.8billion at the end of June 2012.

Interbank call money rate remained stable

50. Although broad money (M2) growth was high, private credit growth did not respond equally to the monetary easing. On a year-on-year basis, M2 growth rose to 18.5% in April 2013 (Figure 11), up from 17.2% in April 2012, and higher than the annual monetary program growth target of 17.7%. The higher than targeted M2 growth is driven by the high growth in net foreign assets (44.8%, compared with the 8.7% growth in April 2012) because of the decline in import payments and higher remittance inflows. Because of lower credit demand from the government and the private sector, domestic credit growth moderated to 13.6% from 21.0% during the same period, and remained lower than the FY2013 target of 18.9%. Growth in net credit to the government declined sharply to 12.2% in April 2013, compared with 41.1% in April 2012. The growth in private credit slowed to 12.7% in April 2013, and remained lower than the annual target of 18.5% and actual growth of 18.2%, a year earlier.

Figure 11. Growth of monetary indicators



Money supply growth remained higher than the annual target

51. Reserve money growth accelerated, reaching 18.8% year-on-year in April 2013 (above the annual target of 16.1%) up from

Reserve money growth accelerated

10.2% in April 2012, because of the sharp rise in the central bank's net foreign asset growth (53.1%, compared with 6.2% in April 2012) supported by the strong remittance growth and lower import payments. Net domestic assets of the central bank fell sharply by 65.8% in April 2013 compared with the high growth of 21.3% in April 2012, due to lower credit demand from the government and banks. While the net claims on the government declined by 11.3% in April 2013, from the high growth of 41.4% in April 2012, the claims on banks declined by 61.0% from the high growth of 29.1% during the same period. At the end of April 2013, the reserve money multiplier of 5.4 remained unchanged from the end of April 2012.

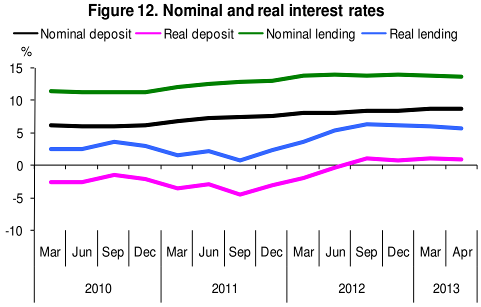
Government borrowing through savings certificates increased

52. The government's outstanding borrowing through sales of national savings certificates rose slightly to Tk644.2 billion at the end of April 2013, from Tk638.2 billion a year earlier, partly offsetting the decline in net credit growth to the government from the banking system. To finance the FY2014 budget, the government is expecting to borrow more through the savings instruments by offering higher interest rates. At the same time, the government decision to withdraw advance income tax deductions on savings instruments may encourage savers to buy more savings instruments.

Interest rate spread narrowed slightly

53. The weighted average lending rate declined slightly to 13.6% at the end of April 2013, from 13.7% at the end of April 2012 (Figure 12). The deposit rate rose to 8.7%, from 8.2%, becoming positive in real terms because of lower inflation. The interest rate spread of the banking system narrowed only slightly to 4.9% in April 2013 from 5.0% in April 2012, indicating continuing inefficiencies and market segmentation in the banking system.

Figure 12. Nominal and real interest rates



Disbursements of industrial term loans rose

54. Disbursement of industrial term lending stood at Tk320.2 billion during July–March of FY2013, 27.8% higher than the year earlier period. Disbursement to large-scale industries (64.6% of total industrial term lending) rose by 28.9%, medium-sized industries (29.9% of total funds) by 26.2%, and small and cottage industries by 19.5%.

Loans for agriculture and SMEs rose

55. Loans to agriculture and small and medium-sized enterprises (SMEs) are being prioritized, in line with the central bank's policy directives. Of the Tk141.3 billion targeted for credit disbursement to agriculture and nonfarm rural activity, Tk117.4 billion (83.1% of total target) was disbursed during the

first 10 months of FY2013, up 15.1% over the corresponding period of FY2012. Similarly, outstanding loans to SMEs reached Tk955.2 billion in March 2013, representing 7.7% growth over March 2012. The ratio of SME loans to total loans in the banking system declined to 21.0% in March 2013, from 21.8% in March 2012. The central bank set a Tk741.9 billion SME loan disbursement target (22.4% higher than for 2012) for 2013 for local and foreign banks and nonbanking financial institutions.

56. Financial soundness indicators show weakened performance for the banking system, especially of the SCBs. The ratio of gross nonperforming loans (NPLs) to total loans in the banking system rose to 11.9% at the end of March 2013, from 6.6% at the end of March 2012. While the gross NPL ratio for SCBs rose further to 27.1% at the end of March 2013 from 12.1% at the end of March 2012, the gross NPL ratio for private commercial banks rose from 3.4% to 6.2%, and for specialized banks from 24.1% to 27.2%. The gross NPL ratio for foreign banks rose to 4.6% from 3.2% during the same period. The net NPL ratios for all banks rose from 1.1% at the end of March 2012 to 5.8% at the end of March 2013.

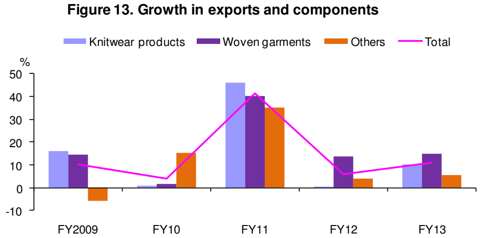
Financial soundness indicators weakened

57. Although the finance sector has shown strong resilence to external shocks like the global economic and financial crisis, the excessive exposure of financial institutions to capital markets and deteriorating financial conditions in banks created a challenging situation. The risk-weighted capital asset ratio of all banks decreased to 10.5% in December 2012 from 11.4% in December 2011. Although private commercial banks made considerable progress in complying with Basel II requirements, the financial position of SCBs and specialized banks deteriorated, reflecting a worsening in asset quality and the application of tighter loan classification and provisioning standards. The quality of risk management and supervision remains weak. Inadequate profits and transferred provisions for write-offs led to major banks faliing to maintain the required provisions against their NPLs. To reverse the deterioration in banks' financial conditions, improved risk management and control of bank operations, clearer and expanded supervisory powers for the central bank, and stronger risk-based supervision are required.

Balance of Payments

58. Exports grew by 11.2% in FY2013, compared with 6.0% in the previous year (Figure 13). Export growth picked up steadily as the year progressed with

Figure 13. Growth in exports and components



Exports grew by 11.2% in FY2013

demand rising for the low-end of the market garment from Bangladesh. After growing slowly year-on-year by 2.1% in the first quarter, exports rose by 7.0% in the first 6 months of FY2013 and 10.2% in the first 9 months.

Garment exports rose by 12.7%

59. Readymade garment exports—accounting for about 79.6% of total export earnings—grew by 12.7% in FY2013, up from 6.6% in FY2012. While exports of woven garments rose by 15.0%, export earnings from knitwear grew by 10.4%. Garment exports to the European Union grew by 11.8% and to the United States (US) by 10.3%. While woven exports to the European Union rose by 15.4%, knitwear exports rose slowly by 9.4%. On the other hand, woven exports to the US grew by 10.0% and knitwear exports by 11.5%.

60. Among the other major export items, earnings from agricultural products (33.0%), footwear (25.0%), leather (21.1%), jute goods (14.2%), and petroleum products (14.0%) maintained notable growth, although export earnings from most other items declined: frozen food by 9.1%, home textiles by 12.6%, chemical products by 9.7%, and raw jute by 13.7%.

Export earnings from newly discovered markets grew rapidly

61. Export earnings from the newly discovered markets grew rapidly. In FY2013, export earnings from 13 countries[3] rose by 21.1% to $5.4 billion, which was 19.8% of total export earnings. In comparison, export earnings from the European Union—the main source of export earnings—grew by 11.5% to $13.7 billion (50.8% of total export earnings) and from the US by 6.2% to $5.4 billion (20.1% of total) during the same period. Garment export earnings from the 13 countries rose by 24.0% to $3.2 billion (15.0% of total garment export earnings).

Export earnings fell short of the annual target

62. Export earnings fell short of the annual target of $28.0 billion by 3.5%. Several factors may have been responsible for this below-target performance: (i) the reduction of profit margins due to lower per unit garment prices and higher production costs caused by high interest rates and power tariffs placed garment exporters at a disadvantage; (ii) demand from the European Union and the US is still not growing significantly; (iii) with the real appreciation of the taka, Bangladesh's export competitiveness weakened; and (iv) continued political and labor unrest disrupted production and distribution chains, especially of export-oriented industries.

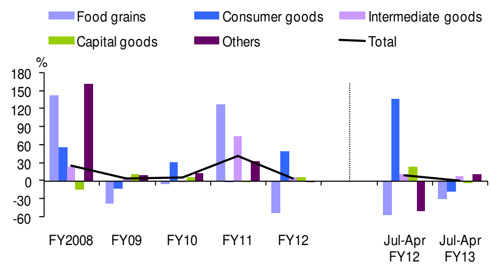
Imports declined by 0.9% during July–April of FY2013

63. Import payments (recorded by customs) declined by 0.9% during July–April of FY2013 over the corresponding period of FY2012 (Figure 14). Large declines in imports of food grains,

[3] Australia; Brazil; Canada; the People's Republic of China; Hong Kong, China; India; Japan; Republic of Korea; Russian Federation; South Africa; Thailand; Turkey; United Arab Emirates.

consumer goods (e.g., sugar, spices, and edible oil), and fertilizer contributed. The decline in commodity prices in the world market and the central bank's monetary tightening measures in the first half of the year contributed to slower growth in import payments. The 0.2% decline in capital machinery imports reflects the weak investment environment. Food-grain imports fell by 30.4% because of the larger domestic food stock. Imports of consumer goods also fell by 16.3%, reflecting subdued consumer demand. Among consumer goods, imports of sugar fell by 46.6%, spices by 17.4% and edible oil by 11.8%. Among intermediate goods, high or moderate growth was maintained for imports of raw cotton (24.7%); textile and articles thereof (14.1%); yarn (12.3%) and iron, steel, and other base metals (9.5%). The import of fertilizer declined by 17.9%, while petroleum imports fell by 5.0%.

Figure 14. Growth in imports and components



Import letters of credit declined

64. The total value of import letters of credit opened declined by 1.7% during the first 10 months of FY2013 because of the slower growth in letters of credit for industrial raw materials (1.8%), and decline for petroleum products (14.8%) and other consumer products (20.7%). Letters of credit rose for the import of capital machinery (by 29.3%), food grains (by 16.3%), and intermediate goods (by 0.5%).

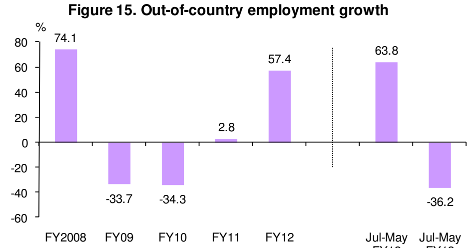
Remittance inflows grew by 12.6% in FY2013

65. Earnings from remittance inflows have grown briskly since the beginning of FY2013. In FY2013, out-of-country workers remitted $14.5 billion, 12.6% higher than a year earlier. Remittance inflows from all major sources gained momentum. During July–April of FY2013, remittance inflows from Oman grew by 61.3%, the US by 24.4%, United Arab Emirates by 21.6%, Malaysia by 18.2%, and Saudi Arabia by 10.8%. Remittance growth from Kuwait (0.2%) and the United Kingdom (1.2%) was negligible.

Growth of out-of-country jobs for Bangladeshi workers fell sharply

66. The number of out-of-country jobs for Bangladeshi workers declined sharply by 36.2% in the first 11 months of FY2013, indicating a likely slowdown in remittance inflows in the coming months (Figure 15). A total of 407,238 Bangladeshis found jobs abroad during that period, compared with 638,292 in the

Figure 15. Out-of-country employment growth



corresponding period of FY2012 because of a sharp decline in recruitment in the United Arab Emirates (83.0%) and Oman (19.5%). However, the number of jobs for Bangladeshi workers rose in Saudi Arabia by 8.8% and in Singapore by 10.6%.

FDI and foreign aid into Bangladesh increased in FY2013

67. Net FDI inflows into Bangladesh and net foreign assistance increased in the first 10 months of FY2013. Net FDI rose slightly to $1.1 billion in the first 10 months of FY2013, up from $1.0 billion during the same period of FY2012. Net foreign assistance increased to $1.2 billion, up from $960.4 million. As FDI into Bangladesh remains low, an improved business climate and greater private participation in infrastructure development, including through PPP, are needed to attract higher FDI.

Current account moved to a surplus because of higher growth in remittances and lower trade deficit

68. The trade deficit narrowed to $5.9 billion in July–April of FY2013, from $7.5 billion in July–April of FY2012 because of the decline in imports. Despite higher services and primary income deficit compared with the same period a year earlier, the higher growth in workers' remittances and lower trade deficit raised the current account to a surplus of $2.2 billion, up from a deficit of $181.0 million in the corresponding period of FY2012.

Overall balance shows a significant surplus

69. The combined capital and financial accounts recorded a surplus of $2.8 billion during July–April of FY2013, up from the surplus of $1.5 billion in July–April of FY2012 because of higher medium- and short-term loans. As a result, the overall balance showed a surplus of $4.4 billion in July–April of FY2013, a significant rise from the deficit of $106.0 million in the corresponding period of FY2012.

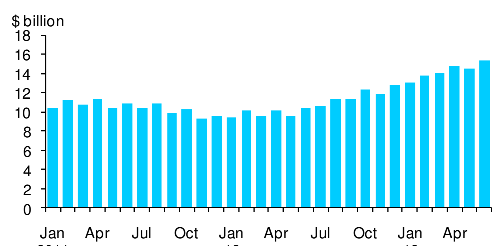
Cabinet approved the TICFA between Bangladesh and the US

70. The cabinet approved the draft Trade and Investment Cooperation Forum Agreement (TICFA) between Bangladesh and the US. While the agreement, once signed, is expected to institutionalize trade and investment cooperation in the areas of service sector and intellectual property rights, the agreement will also cover issues such as governance, promotion of fundamental labor rights, and protection of the environment. In another development, the US recently suspended the Generalized System of Preferences (GSP) for Bangladesh citing issues relating to workers' safety and labor standards. GSP covers less than 1.0% of Bangladesh's about $5.0 billion worth of annual exports to the US, but does not include garment, the country's main export item.

Gross foreign exchange reserves rose

71. Gross foreign exchange reserves of the central bank rose to $15.3 billion (nearly 5 months imports) at the end of June 2013, up from $10.4 billion a year earlier (Figure 16). The

Figure 16. Gross foreign exchange reserves

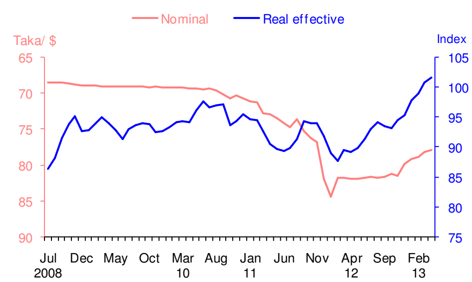


decline in import payments together with growth in export receipts, larger growth in remittances, increase in oil import-related credit, and strong aid disbursements helped the central bank accumulate strong foreign reserves. To prevent the taka from appreciating and eroding Bangladesh's export competitiveness, the central bank purchased foreign exchange from the commercial banks. With lower demand for import payments, banks had to sell foreign exchange to the central bank to stay within the relatively tight net open position limits, set at 15.0% of risk-weighted capital. To foster foreign exchange market development, the central bank revised the net open position limits in April 2013 by about 40.0% by updating the bank's risk-weighted capital bases.

Exchange Rate

72. The weighted average nominal (taka–dollar) exchange rate appreciated from Tk81.93 = $1.00 at the end of May 2012 to Tk77.76 = $1.00 at the end of May 2013 (an appreciation of about 5.4%) because of the better balance of payments conditions (Figure 17). In May 2013, the nominal effective exchange rate appreciated by 7.3% year-on-year as imports fell but exports and remittances grew quite strongly. Because of the higher nominal appreciation and higher domestic inflation relative to that of the trading partners, Bangladesh's real effective exchange rate appreciated by 12.3% year-on-year as of May 2013. Although the strengthened real exchange rate mirrors a more favorable current account, it is also indicative of some loss in export competitiveness.

Figure 17. Exchange rates

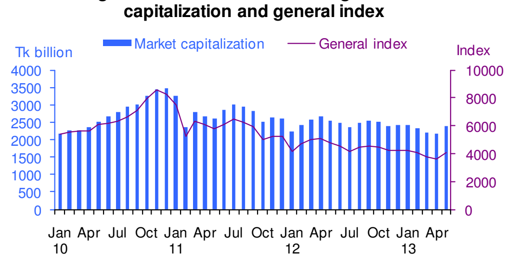


Both nominal and real effective exchange rates appreciated

Capital Market

73. Rapid price corrections have taken place since the beginning of FY2013 with significant volatility in major stock market indicators. The Dhaka Stock Exchange (DSE) general index fell by 13.4% from 31 May 2012 to 31 May 2013, reaching 4,100.5 points (Figure 18). The market price–earnings ratio declined from 12.6 in May 2012 to 12.1 in May 2013, reflecting continuous price corrections in the market. Despite the listing of 11 new companies in FY2013, DSE market

Figure 18. Dhaka Stock Exchange: Market capitalization and general index



Major stock market indicators remained subdued

capitalization declined by 5.8% by 31 May 2013, from 31 May 2012. Net foreign portfolio investment during July–April of FY2013 was $192.0 million, down from $222.0 million in the same period of the preceding year.

74. The Chittagong Stock Exchange (CSE) selective categories index largely followed trends of the DSE index. The CSE index fell by 8.6% by 31 May 2013 from 31 May 2012, and CSE market capitalization declined by 6.8%.

Parliament passed the Demutualization Act

75. Parliament passed the Demutualization Act in April 2013. Based on the act, the Securities and Exchange Commission is working to approve the demutualization models for CSE and DSE. The government is planning to consider tax exemption once the proposed demutualization of the stock exchanges is in place. Effective functioning of demutualized stock exchanges is needed to ensure stability in market operations. In the FY2014 budget, the government announced its intentions to establish a separate clearing and settlement company for settling transactions in the stock exchanges. The government has amended the Securities and Exchange Commission Act 1990 and Securities and Exchange Ordinance 1969. The Securities and Exchange Commission (Private Placement of Debt Securities) Rules 2012 have been formulated along with amendments for the Securities and Exchange Commission (Mutual Fund) Rules 2001. From 28 February 2013 onward, all omnibus accounts are to be converted into separate beneficiary owner accounts. The government is expected to constitute a special tribunal to dispose of capital-market-related cases.

SPECIAL TOPIC: FY2014 BUDGET

76. The minister of finance presented the FY2014 budget proposals to Parliament on 6 June 2013. Budget preparation, with the national elections expected by January 2014, was a major challenge in the backdrop of stagnant private investment and lower than expected revenue performance. Attaining the announced high-growth target of 7.2% and maintaining macroeconomic balance, including keeping inflation in check, were key. Other issues included striking an appropriate balance between sector priorities and advancement of reforms, and mobilizing financing to close the fiscal deficit. Continuing weakness in world demand and low worldwide business confidence, compounded by the aftermath of the Savar tragedy, created a challenging external environment.

Macroeconomic Framework

77. The FY2014 budget set a high GDP growth target of 7.2%, up from 6.0% in FY2013. The growth drivers envisaged in the budget include increases in (i) investment from 26.8% of GDP to 27.6%, (ii) export growth from 11.2% in FY2013 to 15%, (iii) revenue as a percent of GDP from 13.5% to 14.1%, and (iv) remittances from $14.5 billion to $17 billion.

78. Attaining the growth target will be a challenge. Given the current lull in private investment activity, investment is unlikely to rise as expected. Supply-side constraints including (i) infrastructure shortages, especially related to electricity, energy, and transport; (ii) skills shortages; and (iii) weak public sector project implementation capacity will constrain growth. Budget implementation will also be challenging, with the expected change of government midway through budget implementation.

79. The FY2014 budget envisages lower inflation of 7.0%, down from 7.7% in FY2013. The authorities are seeking to attain the inflation target through monetary and fiscal consolidation (from the demand side) and increased agriculture production and strengthened food security (from the supply side). While monetary growth targets appear consistent with lower inflation, the final outcome will depend on how the planned fiscal expansion plays out. The higher domestic bank borrowing, if the high revenue target is not attained, and likely shortfall in mobilizing foreign financing and nonbank borrowing, may create inflationary pressures. Further adjustments of the administered energy prices, as mandated under the IMF extended credit facility, could result in cost–push inflation.

Revenue Measures

80. The revenue target aims at a 19.9% increase in revenue earning over FY2013. Tax revenue is projected to grow by 20.9% and nontax revenue by 14.9%. Tax revenue from taxes administered by NBR, accounting for more than 96.0% of the tax revenue and over 80.0% of total revenue, is projected to rise by 21.2%, compared with growth of 15.1% in FY2013 (up to May). VAT is expected to generate 36.7% of NBR taxes, 35.5% will come from income and profit taxes, 15.3% from supplementary duties, and 10.7% from import duties.

81. **Institutional reforms.** While the mandatory pre-shipment-inspection (PSI) system for customs management is set to be terminated, an optional PSI system is proposed to ensure (i) smooth customs valuation and assessment functions, and (ii) the continued support of PSI companies in developing a valuation database. Installation of the Automated System for Customs Data (ASYCUDA) World software technology is in progress. An NBR audit cell was established and an online taxpayer identification number (TIN) registration process is expected

to soon be operating, using information on national identity cards available from the Election Commission. This will enable taxpayers to get TIN registration and TIN certificates without visiting any tax office. A simplified two-page tax return for salaried taxpayers was introduced.

82. **Major direct tax measures.** The threshold for tax-free income for individual taxpayers was raised from Tk200,000 to Tk220,000, while keeping tax slabs unchanged. The threshold for women taxpayers and senior citizens (65+) was raised from Tk225,000 to Tk250,000, and for physically challenged taxpayers from Tk275,000 to Tk300,000. The minimum tax payable by an individual taxpayer remains unchanged at Tk3,000, except for taxpayers in district towns (Tk2,000) and villages (Tk1,000). The corporate tax rates for cigarette manufacturing companies were enhanced, based on public health and environmental considerations. The tax rate for publicly traded mobile phone companies was also raised.

83. To stimulate investment and economic growth, the investment ceiling for individuals was raised from Tk10 million to Tk15 million. Investment of undisclosed income in productive sectors and apartments has been allowed on payment of tax, although the economic justification of the measure remains unclear. The total income ceiling eligible for tax rebate was raised from 20% to 30%, and the rate of tax rebate from 10% to 15%. The existing tax-holiday facilities have been extended to June 2015, with a view to providing incentives to new industries and creating jobs. Tax exemption for gains from share transactions by individual taxpayers will continue. The existing provision of charging a 3.0% tax on the premium over the face value of shares of a company has been withdrawn; this is expected to motivate new companies to enlist in the capital market. The provision of charging 0.05% tax at source on the total income from bond sales was repealed and investors in private sector open-end mutual funds allowed the same tax advantage (15.0% tax rebate) as public mutual funds. The threshold of tax-exempted income from dividends was raised from Tk5,000 to Tk10,000.

84. **Major import stage tax measures**. To encourage investment, the present 3.0% customs duty on capital machinery will be reduced to 2.0%, and the 12.0% on intermediate raw material imports to 10.0%. More attention is being given to promote the interests of domestic agriculture, the food industry, and other industries, through measures aimed at enhancing their effective protection either by raising duties on final products or lowering duties on raw materials or through a combination of both measures. To protect the interests of domestic pulp-producing industries, duties on bamboo, the main raw material for pulp, was withdrawn. For the textile sector, customs duty on artificial filament tow, a raw material for acrylic yarn, used for making sweaters was withdrawn. To encourage the domestic float-glass industry, supplementary duties on imported float glass were raised and customs duties on cobalt oxide, a raw material for the glass industry, were reduced. Customs duties for iron, steel, and engineering were rationalized. To protect the growing domestic billet-producing industry, the specific duty on imported billets was enhanced; and to encourage the domestic mold and die-making industry, the customs duty on alloy steel, a raw material for these industries, was withdrawn. To protect domestic production of gas cylinders, the customs duty on imported gas cylinders was increased and the VAT exemption facility for local manufacturing of gas cylinders was extended to 30 June 2017.

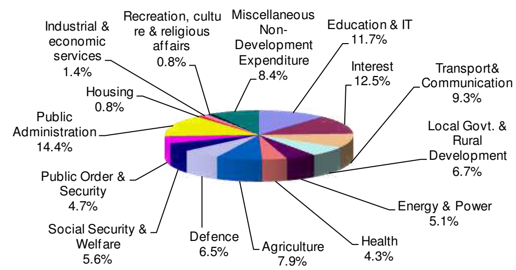
85. To promote the domestic computer and tourism industry, customs duties on digital and web cameras and server racks were reduced from 25% to 10%. Customs duties were also reduced on (i) optical fibers and their raw materials, (ii) FEP/Teflon to promote the domestic medical equipment industry, (iii) solar lanterns to help expand their use by low-income groups, and (iv) minibus chassis and windshields. To protect the domestic shipbuilding industry, the duty and VAT exemption on ships was made applicable on imported ships of capacity above 5,000 deadweight tons.

86. **Major VAT measures.** To boost SMEs, which are making major contributions to job creation and economic growth, the annual turnover threshold for application of VAT was raised to Tk80 million. The capital investment limit was raised to Tk4.0 million and turnover limits for cottage industries availing of tax exemption facilities, to Tk6.0 million. To discourage tobacco consumption and raise revenue, the value ranges of cigarettes were enhanced.

Public Spending

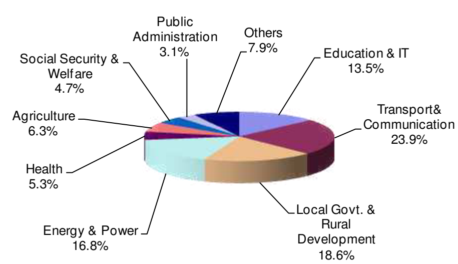
87. Aggregate spending will rise from 18.2% of GDP in FY2013 to 18.7% in FY2014, growing by 17.5% in nominal terms. Recurrent spending will increase by 21.5% (compared with 14.7% in FY2013), and development spending by 25.1%. Of the total budget allocation (development and recurrent), education and technology will receive 11.7%, transport and communications 9.3%, agriculture 7.9%, local government and rural development 6.7%, social security and welfare 5.6%, energy and power 5.1%, and health 4.3%. The highest allocation (14.4%) is for public administration, followed by interest payments (12.5%) (Figure 19). Within the development budget, 23.9% of the allocations will go to transport and communications, 18.6% to local government and rural development, 16.8% to energy and power, 13.5% to education and technology, 6.3% to agriculture, 5.3% to health, and the remaining 15.6% to other sectors (Figure 20).

Figure 19. Sector shares in overall public spending in FY2014



88. Greater caution would need to be exercised in utilizing the large block allocation of Tk118.0 billion (7.0% of total revenue) set aside in the budget so that the money is not spent on low-priority projects and activities. Downsizing subsidy allocations is appropriate, although the total amount remains high (2.7% of GDP). More resources (9.8% higher than in FY2013) are allocated to social safety net programs and the list of recipients streamlined by reducing overlaps, resulting in fewer recipients than before. The increase in interest payment (16.6% of revenue, and about half of the financing for the fiscal deficit) is reducing the fiscal space. The government set aside Tk153.4 billion (9.2% of revenue), a significant portion of which is to meet the capital shortfall of the weakly performing SCBs faced with deteriorating financial conditions, as required under the IMF extended credit facility. The authorities need to take steps to strengthen operational independence of these banks and minimize their scope for lending on noneconomic considerations to prevent capital shortfalls from reemerging in the future. Implementing an ADP (more than 90% of the development budget) of a much larger size (25.8%) than that of FY2013 will be a challenge. Despite a few measures proposed for improving ADP implementation, capacity constraint may affect implementation. Processing of PPP projects has not made much progress in terms of finalizing transactions since the new PPP scheme was announced in the FY2010 budget. Slow progress in implementing PPP projects has held back overall investment in infrastructure.

Figure 20. Sector shares in development spending in FY2014



Priority Development Sectors

89. **Energy.** As power supply and primary energy shortages are major constraints to achieving sustained high growth, creating jobs, and reducing poverty, the government attached high priority and a larger budgetary allocation to the energy sector. Power generation has increased significantly since 2009, although costly oil-fired rental power plants, due to be phased out by 2015, accounted for about half of the new generation. While the government aims to substantially boost power generation over the next 3-4 years, a major challenge will be to ensure the necessary primary energy supply. Much less progress has been made in the gas subsector.[4] To augment the supply of primary energy, a large investment is needed in oil and gas exploration, and priority needs to be attached to finalizing the coal policy. Attention needs to be given to enhancing regional cooperation in power, attracting private investment in power and gas, and improving the capacity and governance of the power and energy systems.

90. **Transport and communications.** To improve transport and communication services, the government has prioritized several road, railway, and waterway projects. It has allocated sizable resources to the construction of the Padma Multipurpose Bridge. Given the already high road density in Bangladesh, the government in the 20-Year Road Master Plan, 2008–2028 emphasizes repair and maintenance of existing roads rather than construction of new roads, with a view to building a safe and reliable road communication system. To improve road subsector performance, implementation efficiency needs to be improved together with ensuring the timely availability of funds. To develop the railway system as a safe, reliable, economical, and environmental means of transporting passengers and cargo, investment needs to be increased and reforms accelerated.

91. **Education.** As a key driver of the country's economic development, human resource development is a central focus of the present government. The government is prioritizing the enhancement of overall quality and relevance of the education system, and boosting the skills profile of the labor force. It is working to eradicate illiteracy and formulated a policy on nonformal education. Initiatives have been stepped up to bring qualitative changes in education curricula and education management. The government is planning to bring more than 700,000 children to school under the Education for All program during 2013–2017.

92. **Agriculture.** To ensure sustained high growth in agriculture and thus enhance food security, investment for boosting agricultural productivity and higher allocations for farm research and development is necessary. Allocations for the agriculture subsidy in FY2014 decreased to Tk90.0 billion from Tk120.0 billion in FY2013. The budget attached importance to fisheries and livestock, which have major potential to create jobs and reduce poverty. Poultry farms will remain exempt from income tax, and the import of poultry and fish feed will be duty-free.

93. **Water resources.** The higher budgetary allocations to water resources aimed to utilize the sector's potential to contribute to higher economic growth and poverty reduction. To prevent river erosion, the government plans to construct another 1,200 km of embankments, repair and maintain more than 15,000 km of riverbanks, construct and repair over 4,000 flood control structures, and preserve and repair 1,500 km of riverbanks in the next 5 years starting in FY2014. A 15-year master plan was prepared to complete capital dredging of the main rivers. To mitigate the impacts of climate change, the government plans to construct cross dams and other infrastructure to reclaim land from the sea. Under the *Haor* Development Master Plan and

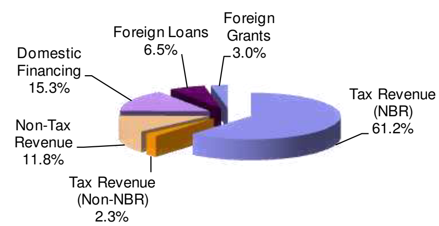
[4] Government of Bangladesh. 2013. *Roadmap on Power and Energy Sectors: Trend of Progress*. Dhaka.

Database, the government identified 17 special areas for development to be implemented over 20 years.

Fiscal Deficit and Financing

94. The fiscal deficit target is set at 4.6% of GDP. Of this, foreign assistance will finance 1.8% and domestic sources 2.8% (Figure 21). Of the domestic-financed portion, borrowing from the banking system will finance 2.2% of GDP and nonbank sources the remaining 0.6%. Attaining the deficit target may be a challenge and the higher revenue growth target could be difficult to reach unless major discretionary measures are adopted. Any shortfall in revenue collection will widen the deficit. The foreign borrowing target is also much larger than in the past, and the amount mobilized may fall well short of the target. On the other hand, a lower target has been set for borrowing from the banking system, while the targeted nonbank borrowing is nearly double that of the FY2013 amount. The amount mobilized from nonbank sources will likely also be lower. If the shortfall in revenue collection, foreign financing, and nonbank borrowing is significant, borrowing from the banking system will likely rise, reducing the flow of credit to the private sector and posing risks to macroeconomic stability, unless the spending program is appropriately downsized.

Figure 21. Sources of financing public spending in FY2014



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ADB's vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region's many successes, it remains home to two thrids of the world's poor. Around 903 million people in the region live on $1.25 or less a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

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