INTERNATIONAL MONETARY FUND ASSESSMENT LETTER

1. The International Monetary Fund (IMF) restricts preparation of assessment letters to only when there has been a change in a country's circumstances, if the request for such is made within six months of an IMF board meeting on that country. A formal request for an IMF assessment letter was made by ADB on 22 May 2012. In response, the IMF replied that it would not be issuing a separate letter in this instance and referred ADB to their published staff report including a staff appraisal and press release associated with the recently approved Extended Credit Facility. The IMF held a Board meeting on Bangladesh in April 2012 to approve the $987 million Extended Credit Facility. Also in September 2012, the IMF team returned to Dhaka for the 2012 Article IV consultation and first review of the Extended Credit Facility arrangement.

INTERNATIONAL MONETARY FUND

BANGLADESH

REQUEST FOR A THREE-YEAR ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

March 28, 2012

KEY ISSUES

Background: Macroeconomic pressures have intensified since late 2010 due mainly to a negative terms-of-trade shock, rising oil imports, and accommodative policies. More recently, global headwinds and increasing oil prices have accentuated these pressures. As a result, the balance of payments went into a deficit in FY11 (July 2010–June 2011) and reserves declined significantly. The 2011 Article IV consultation staff report noted that without policy adjustments and additional external support, further anticipated reserve losses would heighten vulnerability to external shocks and increase risk of a payments crisis.

Program objectives: The government of the People's Republic of Bangladesh has requested a three-year Extended Credit Facility (ECF) arrangement with access of 120 percent of quota (SDR 639.96 million) in support of their reform program. It aims to restore macroeconomic stability, strengthen the external position, and engender higher, more inclusive growth—Bangladesh's key development objective. During the program period, the authorities are committed to taking actions to create more fiscal space, reinvigorate the financial sector, and catalyze additional resources to boost social- and development-related spending, tackle power shortages and the infrastructure deficit, and stimulate export-oriented investment and job growth.

Main components: Under the ECF-supported program, the main components are upfront macro-tightening measures buttressed by greater exchange and interest rate flexibility, sound debt management, and complementary reforms to tax policy and administration, public financial management, and the financial sector. Longer-term measures are also expected to focus on liberalizing the trade and investment regime.

Risks: A further rise in world oil prices could jeopardize the program's fiscal and reserve targets, necessitating additional policy adjustments and external support. Delays in legislative actions, weaknesses in implementation capacity, and opposition to a rationalization of energy subsidies without better-targeted support could undermine program objectives. These concerns will be addressed through extensive policy consultations and sizable technical assistance, as well as safety net reform.

Approved By
Masahiko Takeda and Thomas Dorsey

A staff team comprising Messrs. Cowen (head), Almekinders, and Toh and Ms. Kvintradze (Resident Representative) (all APD); Ms. Kaendera (FAD); and Mr. Leichter (SPR) visited Dhaka during November 30–December 13, 2011 and February 7–15, 2012. Mr. Maino (MCM) participated in the first mission. Mr. Eapen (OED) also joined the December discussions. Mses. Hussiada and Loucks (APD) assisted in the preparation of this report.

CONTENTS

PROGRAM MODALITIES

22. Program reviews. Semi-annual program reviews will be conducted (Table 7) based around quantitative targets and structural benchmarks. Test dates for the first and second program reviews will be end-June 2012 and end-December 2012, respectively.

23. Access and use. Under the current outlook and on the strength of envisaged reforms, the proposed access of SDR 639.96 million (120 percent of quota) has been determined by staff's assessment of the BOP financing need and guided by the norm of ECF arrangements for countries with outstanding concessional IMF credit of less than 100 percent of quota. Seven equal disbursements to BB are envisaged, beginning with program approval.

24. Gross external financing requirement. During the program period, the gross financing requirement is around US$19 billion, of which US$1 billion will be covered by the requested access to IMF resources and another US$0.6 billion from other exceptional financing (Table 8). Most of the rest of the external financing requirement will be met by multilateral and bilateral agencies (US$11.4 billion), led by the World Bank Group, AsDB, and Japan International Cooperation Agency, mainly as project-based lending; FDI (US$4.7 billion); and nonconcessional short-term oil credits (US$0.8 billion).

25. Capacity to repay. Bangladesh is expected to be able to meet its obligations to the IMF under the proposed ECF arrangement. With the proposed access, outstanding IMF resources would peak in Bangladesh's FY15 at SDR 670 million, equivalent to 1.7 percent of exports and remittances (Table 9). Debt service to the IMF (including previous obligations) would peak at SDR 131 million in FY13, equivalent to 0.4 percent of exports and remittances.

26. Poverty Reduction Strategy. Bangladesh's SFYP, entitled *Accelerating Growth and Reducing Poverty*, was released in July 2011. It provides a framework for implementing the government's poverty reduction strategy during FY11–15, as Bangladesh pushes to meet it Millennium Development Goals (Table 10). The government has also published its longer-term Outline Perspective Plan (2010–21), laying out its development vision, which will be implemented under the sixth and seventh five-year plans.

27. Technical assistance. Implementation of the ECF-supported program will be backstopped by considerable TA and capacity building from the IMF, World Bank Group, AsDB, and other DPs. Currently, the IMF envisages providing TA in a range of program-critical areas, notably follow-up tax reforms and VAT implementation; cash management, fiscal reporting, and subsidy reform; bank supervision and central bank accounting; and statistical methods. The World Bank Group is expected to continue focusing on revenue administration and tax reforms; PFM, SSN reforms, and vulnerability monitoring; central bank strengthening and financial sector reform; and statistical policy. The AsDB is also supporting revenue administration and involved in building a PPP operational framework and capital market development.

28. Statistical policy. The authorities are committed to strengthening macroeconomic statistics, in order to better inform policy decisions and monitor outcomes, guided by a national strategy for statistics under

preparation with World Bank support and a new Statistics Act expected to be approved in 2012 (MEFP, ¶30). While data are adequate for program monitoring purposes, work is under way to address deficiencies in national income accounts and the BOP in the context of ongoing IMF TA.

STAFF APPRAISAL

29. Bangladesh faces major challenges in restoring macroeconomic stability, strengthening its external position, and engendering higher, more inclusive growth. These efforts come at a time of increased global headwinds and firming oil prices, making all the more urgent the need for decisive policy adjustments and structural reforms. The government's near-term objectives focus on bringing down inflation, rebuilding a reserve buffer, and solidifying the foundation for sustained growth. To these ends, credible, well-coordinated actions are needed to build upon stabilization measures already in train. While policy buffers are limited, contingencies are in place to mitigate external risk factors, consistent with achieving program targets. Medium-term objectives center on creating more fiscal space and catalyzing additional resources to boost social and development spending and reduce the infrastructure deficit. They also aim at reinvigorating the financial sector and further liberalizing the trade and investment regime to stimulate business creation and job growth.

30. In support, the three-year ECF arrangement embodies a comprehensive set of policy adjustments and reforms aimed at meeting these challenges. Its core priorities in the first year focus on macro-tightening measures, supported by greater exchange and interest rate flexibility, sound debt management, and reforms in tax policy and administration, PFM, and the financial sector, and, over the medium term, improvements to the trade and investment climate. Upfront actions have been taken to begin addressing external, fiscal, and inflation pressures. Program conditionality is focused on macro-critical areas to better ensure lasting adjustment. In support, a number of critical TA and capacity building requirements have been identified, to be met by the IMF and other DPs.

31. A credible path of moderate fiscal consolidation is expected to anchor stability and generate resources to support growth. Further gains in tax revenue and curbs on subsidies will be necessary to create additional fiscal space for development spending, restrain domestic borrowing, and meet program fiscal targets. On tax reforms, the draft VAT law presents an opportunity to usher in a modern tax regime built around transparency and efficiency. Similar decisive steps will be needed on a direct tax law. All are expected to be supported by comprehensive administrative reforms.

32. Recent fuel and electricity price adjustments have helped mitigate fiscal pressures, but the current situation warrants sustained vigilance. In view of the rapid expansion in demand and sustained rise in costs, further price changes and subsidy reforms will be necessary to ensure fuel, electricity, and fertilizer subsidies do not undermine fiscal sustainability, heighten dependence on costly suppliers' credit, or exacerbate broader stability concerns. These efforts are also expected to free up resources