Bangladesh

Growth in FY2010 was better than expected in April 2010, as a pickup in domestic demand neutralized the impact of weak expansion in exports. Inflation came in below the April projection, and the current account surplus was higher. For FY2011, this *Update* retains the outlook of a moderate uptick in growth, but with a slightly lower forecast for inflation and a larger fall in the current account surplus. To raise growth prospects, power and gas shortages need to be eliminated and reforms accelerated. More fundamentally, political stability will be critical to boosting growth.

Updated assessment

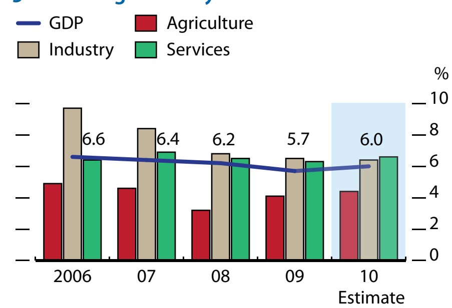
Ministry of Finance sources estimate GDP growth for FY2010 (ended June 2010) at 6.0% on a preliminary basis. This is higher than the projection of 5.5% in the *Asian Development Outlook 2010* (*ADO 2010*) released in April as well as the previous year's 5.7% (Figure 3.2.1). Given the sharp decline in the growth of exports and remittances—the economy's two traditional drivers—the better than expected performance stemmed from a boost in domestic consumption, which was underpinned by a strong expansion in credit to the private sector and a rise in public sector wages. Investment was reported to be unchanged at 24.4% of GDP.

Growth in agriculture is estimated at 4.4% (4.1% projected in *ADO 2010*) as major crops performed better than forecast. The higher production was aided by continued government support (including subsidies on input prices), higher procurement prices, expanded credit, and better delivery of extension services. The services sector grew by 6.6% (as against 5.9% projected in *ADO 2010*), reflecting stronger than expected performances of wholesale and retail trade, and transport services.

Industrial growth of 6.4% came in slightly lower than a year earlier as power shortages continued. Still, it was higher than the *ADO 2010* projection of 5.6%, with domestically oriented manufacturing more than offsetting the effects of slower production for export. Robust growth of mining and quarrying and continued expansion of construction and the housing sector, especially in the second half of the fiscal year, also bolstered the sector's performance.

After decelerating in the previous year, inflation rose in FY2010, reaching a 9.1% year-on-year high in February 2010 from 2.3% in June 2009, then moderating through the end of the fiscal year (Figure 3.2.2). Annual average inflation edged up to 7.3% (marginally lower than the 7.5% projected in *ADO 2010*) from 6.7% in FY2009. With relatively benign global commodity prices, inflation pressures intensified, primarily because of demand pressures from the rapid private credit growth and a boost in public sector wages.

3.2.1 GDP growth by sector



Source: Ministry of Finance. *Bangladesh Economic Review 2010*.

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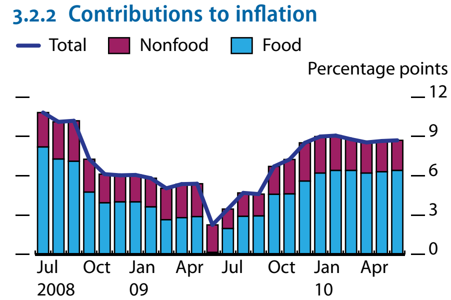
3.2.2 Contributions to inflation



Source: Bangladesh Bank. 2010. *Monthly Economic Trends*. July. http://www.bangladesh-bank.org

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This chapter was written by Mohammad Zahid Hossain, Shamsur Rahman, and Md. Golam Mortaza of the Bangladesh Resident Mission, ADB, Dhaka.

Money supply (M2) and private credit grew strongly year on year during FY2010 (Figure 3.2.3), exceeding their respective annual targets set in the monetary policy of Bangladesh Bank (the central bank). Net credit to the government, however, declined in this period, as strong revenue growth reduced the need for borrowing. Facing mounting inflation pressures, Bangladesh Bank raised commercial banks' cash-reserve requirement by 50 basis points to 5.5% in May 2010. In August 2010, the bank also raised the repo and reverse repo rates by 100 basis points.

The bank's Monetary Policy Statement (MPS), issued in July 2010, indicated that there may have been some diversion of private credit into consumer spending and into speculative investments in the stock market and real estate.

The lending rate declined slightly to 11.2% in June 2010 from the year-earlier level. But the contemporaneous decline in the deposit rate was greater, falling to 6.0%, and to a negative 1.3% in real terms.

To bolster growth, the government adopted an expansionary fiscal stance for FY2010. Expenditure expanded by 25.5% (raising its share in GDP to 16.0% from 14.3% in FY2009). Revenue collection during the year was buoyant: at an estimated 11.5% of GDP, it was up by 1.1 percentage points from FY2009 (Figure 3.2.4). The pickup in domestic economic activity, together with improvements in tax administration, contributed to the strong tax receipts.

Another year of underspending in the annual development program (4.1% of GDP, in place of the 4.4% originally planned) and the good revenue outturn contained the fiscal deficit to 4.5% of GDP (lower than the 5.0% budget target).

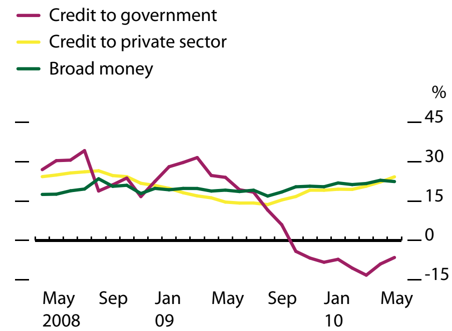
In FY2010, net losses of the 44 nonfinancial state-owned enterprises were estimated at $18.7 million, a marked switch from the net profit of $477.2 million in the previous year. A move back into loss of the Bangladesh Petroleum Corporation (BPC) (because no adjustment in the domestic administrative prices of petroleum products were made following the steep rise in global oil prices over the fiscal year), a much worse loss of the Bangladesh Power Development Board (BPDB), and weaker net income of the Bangladesh Telecommunication Regulatory Commission largely accounted for the sharp deterioration (Figure 3.2.5).

The government released $303.5 million (out of the $370 million earmarked in the FY2010 budget) to enable BPC and BPDB to settle part of their past liabilities to banks and other creditors. The 6%–7% rise in the power tariff, effective March 2010, aimed to reduce BPDB losses, though expected new generation (from rental diesel units under construction) will raise costs.

Export growth slowed to 4.2% from 10.1% in FY2009 (Figure 3.2.6) as readymade garment exports (knitwear and woven cloth products) grew by only 1.2%, dropping their share in total exports ($16.2 billion) from 79.3% in FY2009 to 77.1% in FY2010. Continued weak retail sales and low prices in the United States (US) and the European Union (EU), combined with domestic power outages and limited supplies of natural gas used in processing, contributed to the disappointing export performance.

In addition, frequent labor unrest for higher pay and better working conditions affected production. A new minimum wage of Tk3,000 a month (about $43) was set in June, a raise from Tk1,662 a month

3.2.3 Growth of monetary indicators



Source: Bangladesh Bank. 2010. *Monthly Economic Trends*. June. http://www.bangladesh-bank.org

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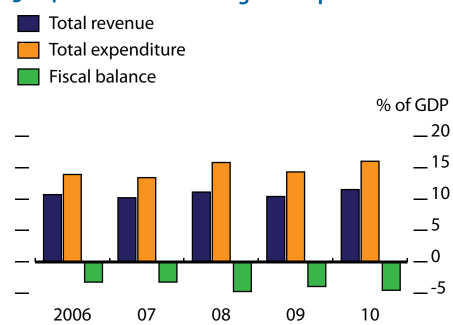
3.2.4 Government budget components



Source: Asian Development Outlook database.

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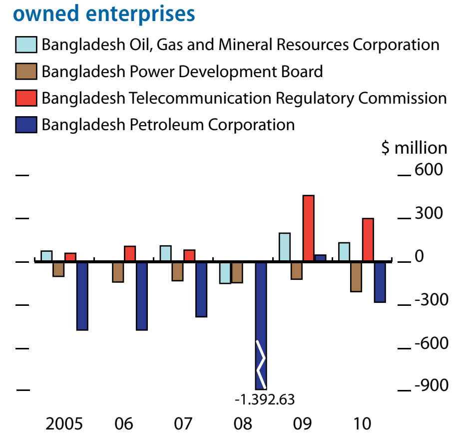
3.2.5 Profit and loss at selected state-owned enterprises



Source: Ministry of Finance. *Bangladesh Economic Review 2010*.

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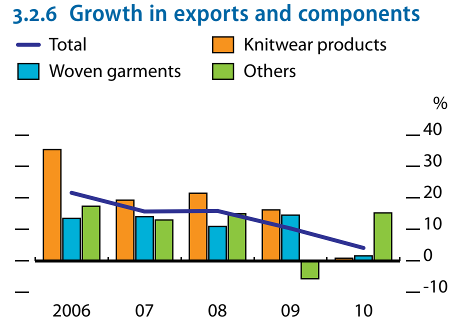
3.2.6 Growth in exports and components



Sources: Bangladesh Bank. *Annual Report 2008–2009*; 2010. *Major Economic Indicators: Monthly Update*. June. http://www.bangladesh-bank.org

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prevailing since 2006, however the new wage was less than the Tk5,000 a month that garment workers asked for.

Earnings from other products increased sharply by 15.2% but still accounted for less than one quarter of exports. Takings from jute and jute goods rose sharply, responding to the rising demand for these environment-friendly products. However, revenue from frozen foods, tea, and chemicals declined because of weak demand.

Imports rose by only 5.4% in FY2010 (Figure 3.2.7). Rice imports fell, following the good domestic production. The import of consumer and intermediate goods declined, and that of capital goods decelerated.

Remittance growth fell by nearly half to 13.4% from the 22.4% in the previous year, mainly because of the continued decline in the numbers of workers leaving for jobs abroad (Figure 3.2.8). Nevertheless, with a limited expansion in the trade deficit, increased workers' remittances boosted the current account surplus to $3.7 billion from $2.4 billion in FY2009 (at 3.7% of GDP, the surplus was well above the *ADO 2010* projection of 1.8%).

The deficit in the combined capital and financial account narrowed to $313 million in FY2010 from $374 million a year earlier, despite a marked decline in net foreign direct investment, reflecting larger capital transfers and lower net outflows of portfolio and other investment. Gross foreign exchange reserves of the central bank reached $10.7 billion at end-June 2010, up by about $3.3 billion from the previous year (Figure 3.2.9).

The exchange rate against the US dollar remained essentially stable at about Tk69/$1 in FY2010, as the central bank made large foreign exchange purchases in the interbank market to prevent nominal appreciation. Still, due to higher relative domestic inflation, the real effective exchange rate appreciated by about 5% during the fiscal year.

The Dhaka Stock Exchange general index rose steeply (Figure 3.2.10), as significant new involvement of institutional participants and retail investors helped the index to gain 105.8% in the year to end-June 2010. Low returns on bank deposits and ready availability of credit appeared to play a major role. Market capitalization also doubled during the year, reaching $38.6 billion (about 38.7% of GDP), primarily reflecting the stock price rise, though there were new listings.

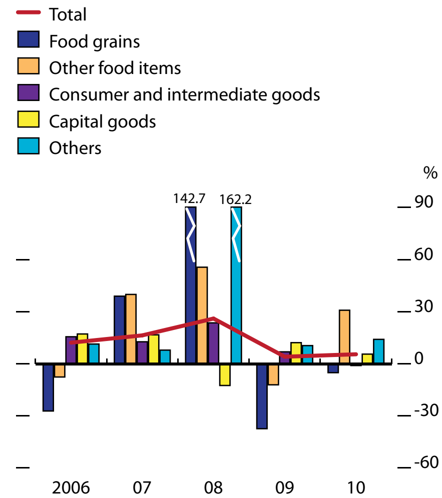
To limit exposure of banks and financial institutions to the stock market, the central bank restricted banks' exposure to no more than 10% of their liabilities. It allowed financial institutions to invest up to 25% of their paid-up capital and reserves.

Prospects

The forecast for FY2011 assumes that government policy will balance growth with containing inflation; that political stability will prevail; that progress is made on structural reforms; that planned additional rental power generation will reduce shortfalls; and that normal weather conditions will prevail.

GDP growth in FY2011 is forecast at 6.3% (Figure 3.2.11), unchanged from *ADO 2010*. The slow global recovery will prevent export and remittance growth from returning to their respective precrisis levels. Stronger domestic demand, supported by the ready availability of credit

3.2.7 Growth in imports and components



Sources: Bangladesh Bank. *Annual Report 2008–2009*; 2010. *Major Economic Indicators: Monthly Update*. June. http://www.bangladesh-bank.org

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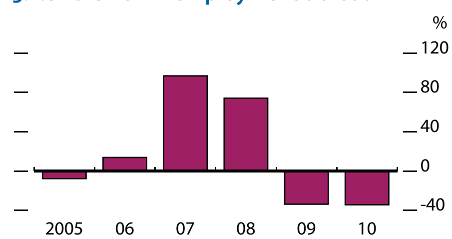
3.2.8 Growth in employment abroad



Source: Bangladesh Bank. 2010. *Monthly Economic Trends*. July. http://www.bangladesh-bank.org

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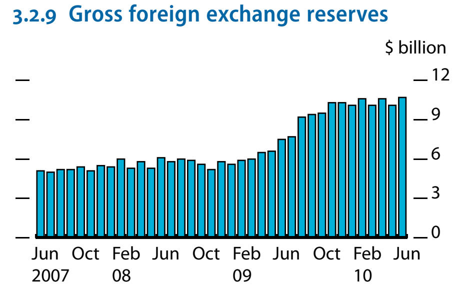
3.2.9 Gross foreign exchange reserves



Source: Bangladesh Bank. 2010. *Monthly Economic Trends*. June. http://www.bangladesh-bank.org

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for productive purposes and continued fiscal stimulus, will buttress the modest expansion.

As posited in *ADO 2010*, more robust industry performance of 7.5% growth is the main factor seen supporting overall GDP growth in FY2011. Some pickup in production for export, on the back of strong domestic demand and higher production by small and medium-sized enterprises and by agro-based industries, underlie the projection. The government's purchase of rental power and better demand management is expected to alleviate power shortages that have been a major constraint on industrial production.

Agriculture growth is expected to be 4.1%, slightly slower than in FY2010 but close to its historical average. Higher industry growth, alongside some revival of trade, is expected to push up expansion in services slightly to 6.7%.

The FY2011 budget continues an expansionary stance: public expenditure is projected to rise by 19.6% from the previous year. The budget included a $288 million–equivalent stimulus package for exporters to help them cope with the continued impact of weak global demand. Budget policy seeks to support a higher medium-term growth trajectory by boosting spending on infrastructure, especially additional energy sources. It also takes aim at social equity by strengthening safety net programs and making higher investment in health and education.

The budget deficit is projected to widen to 5.0% of GDP in FY2011, from 4.5%. Three-fifths of the deficit will be financed by domestic borrowing (a higher share than in FY2010) and two-fifths by external sources (Figure 3.2.12). Given the government's estimate of available nonbank financing sources, the bulk of the domestic financing increase will need to come from the banking system, potentially limiting private sector access to credit.

The FY2011 budget targets a 16.8% increase in revenue (about a 0.5% increase in the tax-to-GDP ratio), aided by widening the tax base, simplifying tax payment, and strengthening tax enforcement. About half a million new income tax payers are expected to be added to tax rolls during the year.

The budget provided several tax incentives for stimulating economic activity. It lowered duties on equipment for power and energy, industrial machinery, and selected industrial raw materials; cut domestic taxes applicable for small and medium-sized businesses and agro-based industries; and eliminated value-added tax on local production for selected items while keeping it unchanged on identical imported goods.

The government is giving priority to eliminating the growing power shortages through heavy investment in the sector. For the short term, it is putting in place a program of small (100 megawatt) rental generation units. Since over four-fifths of current power generation is gas fired, it seems open to addressing gas shortages by inviting international bidding for gas exploration. It is also seeking ways to diversify fuel sources through importing liquefied natural gas and coal for power generation.

Separately, a landmark agreement that was signed with India in August provides for a power transmission line to be built between the two countries. Power imports from India should be available by end-2012.

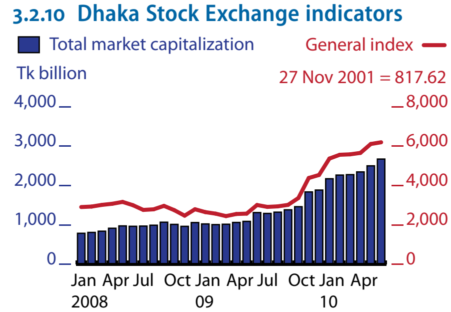
To boost infrastructure investment, the government issued new

3.2.1 Selected economic indicators (%)

	2010		2011	
	ADO 2010	*Update*	*ADO 2010*	*Update*
GDP growth	5.5	6.0	6.3	6.3
Inflation	7.5	7.3	7.8	7.5
Current acct. bal. (share of GDP)	1.8	3.7	0.5	0.2

Source: ADB estimates.

3.2.10 Dhaka Stock Exchange indicators



Source: Bangladesh Bank. 2010. *Major Economic Indicators: Monthly Update*. June. http://www.bangladesh-bank.org
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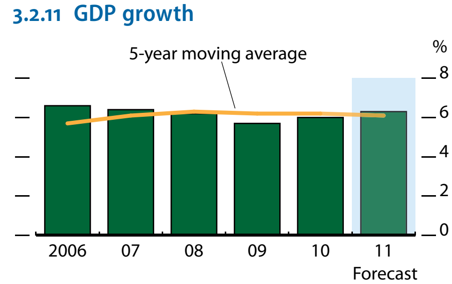
3.2.11 GDP growth



Sources: Bangladesh Bureau of Statistics. 2009. *National Accounts Statistics*. May; Ministry of Finance. *Bangladesh Economic Review 2010*.
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public–private partnership (PPP) guidelines and took steps to set up a Bangladesh Infrastructure Finance Fund to facilitate PPP in infrastructure. The government earmarked $430 million in the FY2011 budget to fund the new entity, adding to a reallocation of $230 million of unused resources for PPP projects included in the FY2010 budget. Bond issues are another likely source of funding.

This *Update* shaves the average inflation projection for FY2011 to 7.5% from the 7.8% in *ADO 2010* (Figure 3.2.13), in view of the likely moderation in global oil and other commodity prices. Still, expected adjustments in domestic power and gas tariffs, demand-side pressures from higher public expenditure, and the lagged effects of strong money-supply growth will sustain inflation at close to the FY2010 rate.

Compared with projections in this *Update*, the MPS aims at higher growth (6.7%) and lower inflation (6.5%) for FY2011. However, with the central bank alert to unproductive and speculative use of credit, the MPS projects that the year-on-year growth in money supply will slow from 18.8% in FY2010 to 15.2% in FY2011, while private credit growth will decline from 21.1% to 16.0% over the same period.

Imports are forecast to grow by 11.0% in FY2011, reflecting a rise in domestic demand for imported raw materials and capital equipment. Exports—continuing the rising trend seen in the fourth quarter of FY2010—are expected to grow by 8.0%, largely in response to the moderate expansion in global demand (and reflecting the previous year's low base).

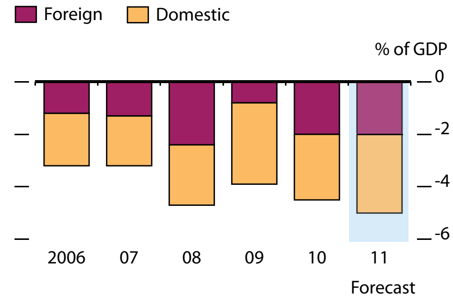
The country's market share for readymade garments in the US rose marginally to 4.3% in FY2010, although it declined slightly in the EU to 8.5% in the third quarter of FY2010.

Bangladesh stands to gain if the People's Republic of China sheds some part of the readymade garment market because of its rising labor costs. In addition, if the government's plans for improving power and gas supply and transportation facilities come to fruition—and so take off some of the costs that the industry currently has to shoulder—the competitive edge of Bangladesh vis-à-vis other developing-country producers in this market segment will be honed.

Slower growth of 8.0% in workers' remittances is foreseen because of the continued decline in the outflow of migrant workers. Nevertheless, remittance receipts will offset the modestly larger trade deficit. The current account surplus is estimated to fall sharply to 0.2% of GDP (Figure 3.2.14).

Several downside risks could prevent these projections from being realized. A waning recovery in the US and EU would likely result in weaker retail sales and lower demand for Bangladesh's exports. Inability to reduce power and gas supply shortages as planned would constrain growth. Finally, political instability or natural disasters would also undermine the forecast expansion.

3.2.12 Deficit financing



Source: Asian Development Outlook database.
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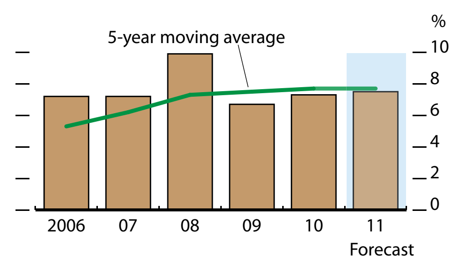
3.2.13 Inflation



Source: Bangladesh Bank. 2010. *Monthly Economic Trends*. June. http://www.bangladesh-bank.org
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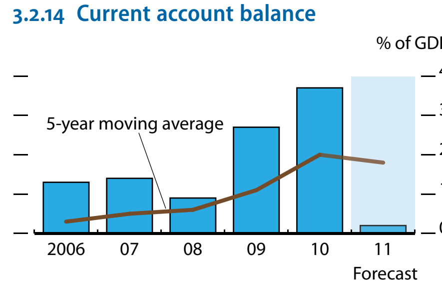
3.2.14 Current account balance



Source: Bangladesh Bank. *Annual Report 2008–2009*. http://www.bangladesh-bank.org
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