Bangladesh

The global recession’s late-unfolding effects will, this year, slightly slow growth, but it will likely improve next year as the worldwide recovery strengthens. Macroeconomic stability has been maintained, but liquidity pressures in banking have emerged and will need to be dealt with decisively. Power and natural gas shortages will have to be tackled through large and quick investments, and policy and institutional reforms accelerated, to raise medium-term growth. Therefore, greater implementation capacity is needed for government development projects and infrastructure investments under the new public–private partnership scheme.

Economic performance

This economy has performed better than many others in Asia due in part to its lack of integration with global financial markets as well as the nature of its garment and labor exports, which are targeted mainly at the low end of the market (a segment that was less affected during the early stages of the crisis).

Official sources estimate that GDP growth declined slightly to 5.9% in FY2009 (ended June 2009) from 6.2% in the previous year largely because of industry’s decelerating growth (Figure 3.15.1), as export production slowed during the global recession. Industry’s growth was also constrained by power and natural gas shortages and by a weakening in construction activity.

Agriculture performed well, aided by favorable weather and government support to farmers that improved their access to inputs and credit. Expansion in services decelerated as the slowdown in industry crimped trade and transport activity.

On the demand side, private consumption remained the major driver of growth (Figure 3.15.2), fueled by a healthy expansion in workers’ remittances from abroad. Total fixed investment, at 24.2% of GDP in FY2009, was unchanged as the marginal rise in private investment was offset by a decline in public investment due to continued sluggish implementation of the government’s annual development program (ADP). The contribution to growth of net exports of goods and services was negative.

Foreign direct investment (FDI) has stagnated at the meager level of less than $1 billion annually over the past 5 years. In an attempt to boost FDI into gas, the government invited bids for offshore gas exploration and awarded contracts for three offshore blocks. To attract potential investors into the power sector, it relaxed the cap on producers’ gas sales prices to bring them close to international levels.

Average inflation dropped to 6.7% in FY2009 from 9.9% the year before, with the fall in food prices steeper than that in nonfood prices. The steep decline in petroleum and food import prices and an uptick in domestic agricultural performance were the main factors contributing to easing price pressures. However, after falling to a 90-month low of 2.3%...
year on year in June 2009 (Figure 3.15.3), inflation accelerated to 9.0% in January 2010, with food and nonfood prices rising sharply. This upturn reflected the impact of unfavorable weather on domestic crop production and the strengthening of global prices of rice and other commodities.

Growth in broad money was strong throughout FY2009, advancing 19.4% year on year in June 2009, compared with the 17.5% program target of Bangladesh Bank, the central bank (Figure 3.15.4). This buoyancy largely reflected unexpected strength both in the banking system’s net foreign assets and in the balance-of-payments outturn. Expansion in private sector credit fell to 14.6% year on year in June 2009 (against a target of 18.5%), as slower domestic economic activity and business uncertainty curtailed demand.

Bangladesh Bank cut its policy rates (repo and reverse repo) by 25 basis points in March 2009 in an effort to bolster economic activity. Moreover, its operations in the foreign exchange market substantially raised commercial banks’ excess reserves and lending capacity. Reflecting these factors, the average interbank call money rate dropped sharply to 1.8% in June 2009, from 8.3% in March 2009. However, commercial banks’ weighted average lending rate declined only marginally to 11.9% in June 2009 and credit flows did not strengthen perceptibly. In October, the central bank cut the two policy rates by 400 basis points in an effort to encourage banks to reduce lending rates and to stimulate credit demand. After that move, credit to the private sector climbed strongly.

The taka–dollar exchange rate remained stable at about Tk69/$1 in FY2009, as Bangladesh Bank intervened heavily in the interbank market, purchasing $1.5 billion during the year (up from only $0.2 billion in FY2008) to prevent that rate from appreciating. However, the real effective exchange rate appreciated by 7.2% over the year due to higher domestic inflation than in its major trading partners, implying erosion in export competitiveness.

Revenue collection rose slightly to 11.2% of GDP in FY2009, but fell well short of the FY2009 budget target, mainly because of the slower growth in imports. Total spending at 15.3% of GDP was also lower than target. Lower international prices of food, fuel, and fertilizer contained current spending on subsidies, and the ADP was also substantially underspent due to continuing human resources constraints in key line agencies. The overall budget deficit was therefore only 4.1% of GDP, well below the target of 5.0%.

Export growth decelerated to 10.1% in FY2009 from 17.4% in FY2008, with essentially stagnant year-on-year export gains after the September 2008 global financial meltdown (Figure 3.15.5). Readymade garments posted a still-healthy growth of 15.4%, which helped raise their share in total exports to 79.3% from 75.8% the previous year, as other products’ exports declined by 5.7% on weak demand and lower prices.

Contracting in the second half from year-earlier levels, imports plummeted to only 4.2% growth in FY2009 from 25.6% (Figure 3.15.6). A good domestic crop and a combination of falling global commodity prices and weaker imports of capital machinery and raw materials were the major factors.

The improved trade deficit, together with 22.4% growth in workers’ remittances, lifted the current account surplus to $2.5 billion (2.8% of...
GDP) from $702 million (0.9% of GDP) in FY2008 (Figure 3.15.7). A small deficit in the capital and financial account resulted in a surplus of $2.1 billion in the overall balance of payments in FY2009, dwarfing the prior-year’s $331 million surplus. Foreign exchange reserves rose to $7.5 billion (3.8 months of imports) at end-June 2009, and surged to $10.6 billion at end-February 2010, nearly twice the level of a year earlier, and equivalent to over 5 months of imports (Figure 3.15.8).

Economic prospects

Economic forecasts for FY2010 and FY2011 assume continued prudence in macroeconomic management and steady progress in governance reforms. Commissioning of new power generation capacity should moderately reduce supply shortages.

GDP growth in FY2010 is forecast at 5.5%, somewhat lower than in FY2009 due in part to the lagged effects of depressed external demand on Bangladesh’s mainly low-end garment exports. In FY2011, growth is expected to rise to 6.3%, underpinned by the global recovery and strengthened business confidence and investment.

Despite continued policy support, agricultural growth is seen moderating in FY2010 to a still-high 4.1% from 4.6%, as the aus (summer) crop has been affected by drought and the aman (monsoon) crop by inadequate rainfall. The high base of the previous year and less remunerative farmgate prices are also factors. Sector growth is projected to nudge up to 4.3% in FY2011 on an expected return to normal weather.

Industrial growth is seen decelerating to 5.6%, reflecting subdued domestic and external demand in the first half of FY2010. Several indicators suggest that industry will remain sluggish throughout the year. Export performance was dismal in the first half, declining by 6.2% (Figure 3.15.9), with most items (including garments) contracting due to weak retail sales in industrial countries. In addition, domestic investor sentiment has not fully revived following the initial uncertainty over the extent and depth of the impact of the global recession on Bangladesh. Moreover, decelerating remittance growth will limit growth in consumer demand. Still, industrial performance is expected to strengthen in the second half of FY2010 as exports return to a positive growth path on recovering global momentum.

In FY2011, industry is likely to grow more robustly at 7.5% with further recovery in global demand and improved domestic business confidence that will raise construction activity and investment. Other domestic factors, such as financial support to small and medium-sized enterprises spearheaded by the central bank, should also help boost industrial output.

Services growth in FY2010 is forecast to slow to 5.9% from 6.3%, reflecting weaker performance in agriculture and industry. Trade and transport activity are especially affected. Growth is projected to rebound to 6.8% in FY2011.

With the rise in year-on-year inflation, the 12-month average has also picked up. In FY2010, average inflation is forecast to climb to 7.5% and then to 7.8% the following year. The excess liquidity in banks and international commodity price pressures are expected to stoke inflation.
The Monetary Policy Statement announced in January 2010 continues the accommodative stance. The statement seeks to maintain supportive monetary conditions to help exports recover and investment pick up. It also anticipates that the boost to production from improved credit availability and the November 2009 cut in fertilizer prices will help contain FY2010 inflation. The year-on-year growth in broad money (20.7%) in December 2009 was higher than the central bank’s annual program target of 15.5%, while growth in private sector credit at 19.2% was also above its program target of 16.7%.

Remittances reached a peak of $1.1 billion in November 2009, before falling to $8.44 billion in February 2010. Remittance growth dropped to 19.2% in the first 8 months of FY2010 from 27.0% in the year-earlier period. Job placements abroad also tumbled (42.2%) in this period (Figure 3.15.10) and many workers came home. Reflecting a decelerating rise in the number of new migrants and an increasing number of returnees, remittance growth is expected to slow further, to 16.5% in FY2010 and to 12.5% in FY2011.

Based on orders received, exports are set to perform better in the second half but, because they declined in the first half, full-year FY2010 growth is projected at only 5.0%. The first-half decline also suggests a more pronounced impact of the global recession in FY2010 than a year earlier. The government announced a Tk10 billion ($145 million) package in November 2009 to boost exports’ performance. With continued global recovery, growth is projected to rise to 11.0% in FY2011.

Imports declined sharply by 5.7% in the first half of FY2010 but are likely to pick up in the second half, with overall growth rising to 4.0% in FY2010 and to 14.0% in FY2011, as international fuel and nonfuel commodity prices recover and domestic demand for imported raw materials and capital machinery grows.

The surplus in the current account is expected to decline to 1.8% of GDP in FY2010 as export and remittance growth slow, although import growth will also decelerate. The surplus will slide further to 0.5% of GDP in FY2011 (Figure 3.15.11), as the trade deficit widens due to a recovery in import growth and a further slowing in remittance growth.

In June 2009, the government set an expansionary fiscal stance in the FY2010 budget. It included sizable spending on a new public–private partnership (PPP) scheme, a much larger ADP, an expanded social safety net program, and a special stimulus package (Box 3.15.1). Although ADP utilization of 35% in the first 7 months of the fiscal year is an improvement over past years, based on its current pace, the ADP allocation is unlikely to be fully spent. The allocation for PPPs is also likely to remain largely unused, as the preparatory work for launching the scheme is taking longer than foreseen. Thus, the FY2010 budget deficit is expected to be contained within the projected level of 5.1% of GDP (Figure 3.15.12).

The government has not raised the administered prices of domestic fuels since it lowered prices of diesel and kerosene (together, close to 75% of domestic consumption) in January 2009, despite subsequent increases in international oil prices. The Bangladesh Petroleum Corporation (BPC) is suffering losses from selling these products at below cost. It is making some profit on gasoline (petrol), which accounts for about 15% of consumption; the price was reduced in December 2008. Effective 1 March
2010, the Bangladesh Power Development Board (BPDB) increased tariffs by 6%–7%. Without domestic price increases, BPC is likely to incur a sizable deficit. The FY2010 budget earmarked $370 million for subsidies to BPC and to BPDB to cover their likely losses.

Several downside risks could undermine projections. These include a weaker than expected global economic recovery, failure of planned measures to address growing power and gas shortages, business confidence weakened by a lack of progress in economic and governance reforms, and an unexpected surge in commodity prices or in bank credit pushing inflation much higher. The threat of natural disasters always looms.

Development challenges

Infrastructure investment needs to be boosted for faster economic growth and poverty reduction. Underinvestment over the years has resulted in acute deficiencies, especially in power and gas, ports, and roads, which are restricting business opportunities and access to public services. Consequently, the government has to substantially raise project implementation capacity in public sector agencies, lift ADP utilization, and carry out PPPs in infrastructure. To launch the PPP scheme, the legal framework for setting the responsibilities of stakeholders, for cost-recovery provisions, and for compensation and redress mechanisms needs to be put in place quickly.

A combination of cheap labor and a supportive policy environment helped Bangladesh emerge as a major exporter of garments over the past two decades. However, overwhelming dependence on one industry has made the country’s export earnings acutely vulnerable to a global slowdown. Recent experience underscores the urgency of diversifying into other promising industries such as ceramics, pharmaceuticals, food processing, leather products, and spare parts for machinery and shipbuilding. An important requirement for such an export transformation is the necessary utility services such as power, gas, and water. Streamlining the export duty drawback system and improving customs and bonded warehouse facilities are also required.

Population pressure is a related concern. It is straining ecosystem services, such as safe water supply and habitat as well as other natural resources, and pressuring the government in terms of providing infrastructure, utilities, and other services. Although Bangladesh has made progress over the past two decades in nearly halving the total fertility rate to slightly above the population replacement rate, further progress is needed—by raising investment in family planning and reproductive health—to push the fertility rate to below the replacement rate. Job opportunities will also need to be created for the large number of youths entering the job market each year.

Climate-induced disasters are endemic in Bangladesh, ruining the lives and livelihoods of millions of people, damaging infrastructure, and harming the physical environment. Climate change multiplies these inherent risks, undermining development prospects and eroding the gains in poverty reduction. Major efforts need to be mounted for mobilizing funds for adaptation measures, putting in place the right policy frameworks, and building institutional capacity.