

Bangladesh

Growth in gross domestic product (GDP), inflation, and the current account surplus for FY2007 (ended 30 June 2007) came in close to the projections made in March this year, in *Asian Development Outlook 2007 (ADO 2007)*. For FY2008, this *Update* slightly revises down the earlier projection of GDP growth, but foresees higher inflation and a slightly wider current account surplus. The growth and external outlooks remain positive, though curbing inflation remains a challenge. Economic prospects will also depend on the caretaker Government's success in maintaining political stability and broad public support.

Updated assessment

GDP growth remained robust at an estimated 6.5% in FY2007, propelled by rising domestic and external demand. A strong expansion in industry (9.5%) and continued buoyancy in services (6.7%) largely offset agriculture's moderation following its postflood bounceback of the preceding year (Figure 3.1.1). Industry was sustained by strength in manufacturing (up 11.2%), in turn driven by continued growth in external demand for garments. The manufacturing and trade performance sustained steady expansion in services.

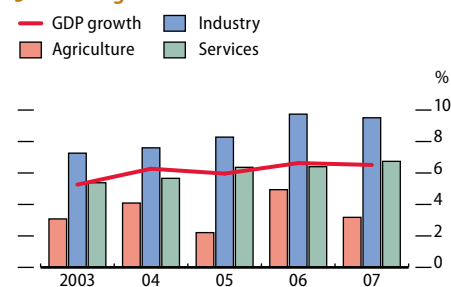
On the expenditure side, growth was underpinned by private consumption. Private investment, aided by growth in bank credit and workers' remittances, also contributed to sustaining economic expansion. But total investment, at 24.3% of GDP in FY2007, declined by 0.4 percentage points compared with the preceding year, on moderation in public investment following downsizing of the annual development program. Net exports of goods and services were a slightly negative factor that subtracted from growth, though by less than in the previous year.

Inflation continued to creep up, to 9.2% in June 2007 on a year-on-year basis, with increases in both food and nonfood prices (Figure 3.1.2). Rising domestic demand pressures, stemming from a steady expansion of income, a large increase in workers' remittances from abroad, and high monetary growth heightened inflationary pressures, as did a further rise in international food and commodity prices. Imported fuel has only a limited impact given its small weight (4%) in the index and low energy intensity of production.

The Government's recent administrative measures to counter inflation, such as investigations of certain businesses suspected of hoarding supplies; measures to regulate stock levels and prices; as well as its encouragement to new importers to enter the market and so induce greater competition, appear to have had no discernible impact on inflation. They have, rather, created uncertainty in the business environment, contributing to price pressures.

Bangladesh Bank gave tightening guidance for monetary policy in FY2007, without adjusting policy rates, reserve requirements, or liquidity ratios, instead relying on open-market operations. Treasury bill yields and

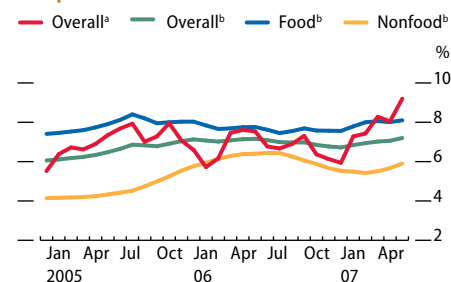
3.1.1 GDP growth



Source: Bangladesh Bureau of Statistics, *National Accounts Statistics*, June 2007.

[Click here for figure data](#)

3.1.2 Change in consumer price index and components



^a Year on year. ^b 12-month moving average.

Source: Bangladesh Bank, *Economic Trends*, July 2007, available: <http://www.bangladesh-bank.org>, downloaded 14 August 2007.

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bank lending and deposit rates increased only marginally during the year. Broad money (M2) growth reached a record high of 22% in December 2006 (Figure 3.1.3), slowed in subsequent months to 17% in June, but still substantially exceeded the central bank's program target of 14.7%.

Growth in net foreign assets held by Bangladesh Bank increased substantially, by 52.0% over the year to June 2007 and accounted for about one third of the increase in M2. Growth in credit to the private sector at 15.1% for the year (18.3% in FY2006) was contained partly by erosion in business confidence following the caretaker Government's anticorruption measures. Growth in credit to government expanded rapidly to peak at 35.9% in December 2006 but fell to 13.9% by June 2007, in large part reflecting disbursement of budgetary support from the World Bank.

At 10.6% of GDP, revenue collection in FY2007 was lower by 0.1 percentage point of GDP than the previous year (Figure 3.1.4). Despite a rise in current expenditures, overall spending was held down by reduced development outlays. The fiscal deficit came in on target at 3.7% of GDP: 2.1% financed domestically and 1.6% abroad. Although Bangladesh has high nominal rates for corporate income tax and value-added tax (VAT), it has much lower revenue productivity than most other Asian countries. To achieve the required revenue buoyancy and thereby enhance the tax ratio, it is essential to reform the tax laws and streamline tax administration.

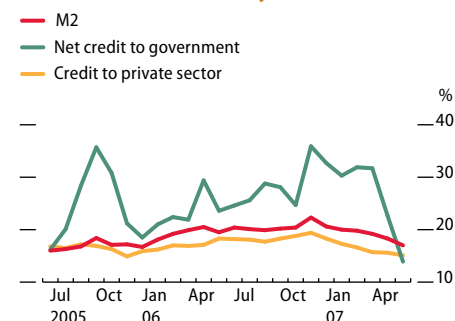
The losses of state-owned enterprises (SOEs) and associated quasi-fiscal obligations pose a significant fiscal risk in the period ahead. In FY2007, the combined net loss of the 44 nonfinancial SOEs was estimated at \$613 million, or about 1% of GDP, widening from a \$425 million loss in the previous year. Administrative prices of fuel, electricity, and fertilizer, and operations of the government-owned airline caused most of the losses in this area.

A 16–21% upward adjustment in fuel prices in April 2007 helped limit losses at Bangladesh Petroleum Corporation (BPC) to an estimated \$460 million (0.7% of GDP) in FY2007. Following the adjustment, domestic prices of the two major products, diesel and kerosene, amounted to 79% of breakeven costs (calculated using July 2007 international product prices). Without any further changes in domestic and international prices, BPC's losses are forecast at \$364 million, or 0.5% of GDP, in FY2008.

To facilitate the Corporation's operations, the Government is assuming its overdue bank loans (contracted largely to cover past losses). These will be financed through a \$1.1 billion bond to be issued in FY2008, which would provide the banks with an earning asset. However, to avoid re-accumulation of losses at BPC and of nonperforming loans (NPLs) at the four nationalized commercial banks (NCBs), the Government needs to quickly introduce an automatic price adjustment mechanism and improve the Corporation's operating efficiency.

The losses of the Bangladesh Power Development Board should also fall, because the electricity tariff to the distribution companies was raised by 10% in March 2007. However, these companies may pass on only a 5% increase to urban consumers. But switching over to a cost-reflective tariff structure for generation would be more desirable as the annual loss of the Board, even at new tariffs, is estimated at \$200 million in FY2007.

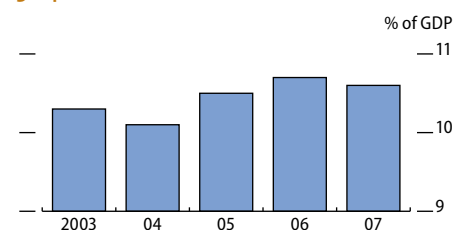
3.1.3 Growth of monetary indicators



Source: Bangladesh Bank, *Economic Trends*, July 2007, available: <http://www.bangladesh-bank.org>, downloaded 14 August 2007.

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3.1.4 Government revenues



Source: Asian Development Outlook database.

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No substantial changes have been made to reduce fertilizer losses. Finally, Biman Bangladesh Airlines, the loss-making state-owned carrier, is to be made a public limited company as a first step in fostering commercial operations, leading to eventual partial privatization.

Exports grew by 15.8% in FY2007, essentially reflecting robust performance in the garments industry (Figure 3.1.5). Concurrently, imports rose by 16.6%. The rise in the trade deficit was more than offset by a 25% surge in officially recorded overseas workers' remittances, owing to an increased number of workers abroad, as well as efforts to bring in remittances through official channels. The current account surplus rose to an estimated \$952 million, or 1.4% of GDP, for the year. The capital account, including a large errors and omissions item, shifted to a \$541 million surplus from a \$486 million deficit a year earlier, mainly reflecting a swing in the short-term borrowing item from large net repayments to large borrowing. International reserves amounted to \$5.1 billion in June 2007, a rise of \$1.6 billion during the fiscal year (Figure 3.1.6).

The performance of the banking sector improved with liberalization, entry of new private sector banks, and strengthened regulation and supervision. But the financial intermediation cost is still high, with a large volume of NPLs.

The Dhaka Stock Exchange general index surged by 60.5% in FY2007, buoyed by strong domestic institutional buying (Figure 3.1.7). The upward trend in prices was interrupted in early August 2007 as global financial turbulence buffeted many stock markets. However, the index fully recovered and went to new highs by end-August. Market capitalization had already exceeded \$7.0 billion by end-June 2007, pushing it to 11% of GDP from a meager 6% a year previously. But the market remains small compared with those of its regional peers, and more company listings are needed for further development.

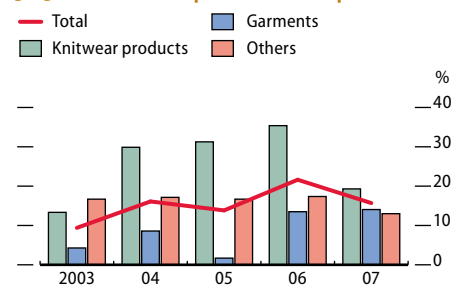
Prospects

Key baseline assumptions for the FY2008 forecast are similar to *ADO 2007*'s: the authorities will continue measures to promote macroeconomic stability with a focus on curbing inflation, raising revenues, and pursuing a more flexible approach to exchange rate management. The spotlight of structural measures will stay on revamping SOEs and fostering financial sector reforms.

The caretaker Government appointed in January 2007 (by the president who postponed Parliamentary elections and stepped down as the head of the caretaker Government) has enjoyed widespread public support for its anticorruption campaign as well as efforts to strengthen the electoral process and advance previously stalled economic reforms. This Government has indicated its commitment to completing electoral reforms by end-2008. Nevertheless, political uncertainty will prevail until new elections are held, slated before end-2008.

GDP growth is forecast at 6.5% in FY2008, lowered slightly from the *ADO 2007* projection because of recent floods, which have fortunately been less severe than those in recent years. Despite the floods, agriculture is expected to show growth of 2.8%, slightly less than last year. Rising

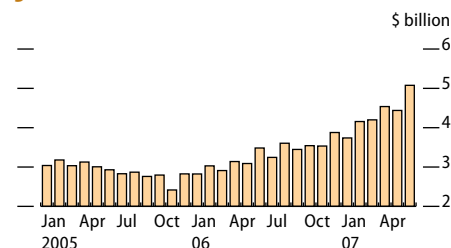
3.1.5 Growth in exports and components



Source: CEIC Data Company Ltd., downloaded 31 August 2007.

[Click here for figure data](#)

3.1.6 Gross international reserves



Source: Bangladesh Bank, *Economic Trends*, July 2007, available: <http://www.bangladesh-bank.org>, downloaded 14 August 2007.

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3.1.7 Dhaka Stock Exchange general index



Source: CEIC Data Company Ltd., downloaded 31 August 2007.

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official development assistance and larger private flows are expected to raise investment, including in power generation. The conditions for the expansion of industry remain favorable because of a likely continued uptrend in export-oriented manufacturing and new capacity in textiles, garments, light engineering, and power. Services seem set to climb in line with the steady expansion in industry.

This *Update* raises the inflation projection for FY2008 to 7.0% from the 6.0% in *ADO 2007* because of heightened pressures in the second half of FY2007. Bangladesh Bank's monetary policy statement, announced in mid-July 2007, set an objective of limiting inflation to a range of 6.5–7.0% in FY2008. The statement noted that the central bank would review the need for adjusting its policy instruments. Maintaining a cautious monetary policy stance will be a challenge since the recent flooding has occurred at a time of high monetary expansion and rising inflation. Nevertheless, achieving the upper end of the range appears feasible, though it would represent a marginal improvement over FY2007.

The strength of the external sector in FY2008 is likely to be sustained, with strong growth in overseas workers' remittances offsetting the rising trade deficit. Although the ending of the quota arrangements in garments and textiles has so far had a positive impact on Bangladesh, the country still runs the risk of facing tough competition in its two largest markets—the European Union and the United States (US)—as the “safeguard quota” provisions on the People's Republic of China expire at end-2008. To retain competitiveness, Bangladesh needs to cut lead-times for delivering garments, upgrade labor skills, and improve its infrastructure.

The thrust of the FY2008 budget is to create a stable environment for accelerated economic growth. In FY2008, although revenue is projected to rise to 10.8% of GDP, higher expenditure, caused by a rise in development spending, is forecast to widen the fiscal deficit to 4.2% of GDP. Strong efforts to meet the revenue target will be needed because any greater bank borrowing to finance planned expenditure would push reliance on banking system finance to a level that would undermine monetary control and accelerate inflation.

Between the introduction of a flexible exchange rate regime at end-May 2003 and end-June 2006, the taka depreciated: by 17% against the US dollar and by 11.5% in terms of the real effective exchange rate (Figure 3.1.8). This has supported growth in exports and remittances. But in FY2007, because of higher foreign exchange inflows from a notable improvement in the current and capital accounts, the taka appreciated slightly against the dollar and by 2.5% in real effective terms. Given comfortable reserves, the central bank is in a position to allow some greater flexibility in the exchange rate in line with market trends, intervening only to correct disorderly movements.

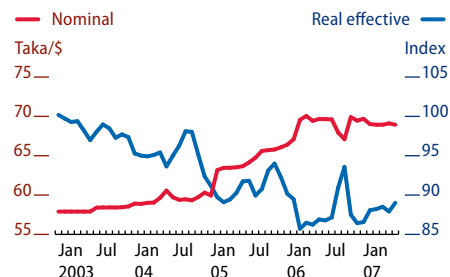
Bangladesh faces various risks that could derail these projections. Political uncertainty, however, is the key one. The outlook will depend crucially on the caretaker Government's success in maintaining political stability with broad public support until the elections are held. Any material setback on the political front would undermine business confidence and negatively affect investment and growth.

3.1.1 Selected economic indicators (%)

	2007		2008	
	ADO 2007	Update	ADO 2007	Update
GDP growth	6.5	6.5	7.0	6.5
Inflation	7.0	7.2	6.0	7.0
Current acct. bal. (share of GDP)	1.0	1.4	0.2	1.0

Sources: Bangladesh Bureau of Statistics; staff estimates.

3.1.8 Exchange rates



Source: Bangladesh Bank, *Economic Trends*, July 2007, available at: <http://www.bangladesh-bank.org>, downloaded 14 August 2007.

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