Bangladesh

Growth slowed, inflation quickened, and exports weakened, but the current account surplus nearly doubled on strong remittances. The authorities began implementing a program of macroeconomic and structural reforms to correct emerging imbalances and foster sustained, rapid growth. Weak external and domestic demand are projected to slow growth this year but leave the current account in surplus. Political instability in the run-up to elections is a risk. Improving the business climate and infrastructure, deepening the financial sector, and liberalizing trade are needed to boost investment and competitiveness.

Economic performance

GDP growth slowed to 6.3% in FY2012 (ended June 2012) from 6.7% in the previous year (Figure 3.15.1). Agricultural growth halved to 2.5% from 5.1% in FY2011, as crop growth dropped to 0.9% from 5.7%. Higher power, fuel, and fertilizer prices, and reduced area for the monsoon season (aman) rice crop, weakened performance. Industry growth was strong at 9.5%, up from 8.2% in FY2011, as manufacturing expanded by 9.8% and construction and power both turned in somewhat better performances. Domestic market-oriented small-scale manufacturing benefited from new tax incentives and greater access to financing. Services growth slowed slightly to 6.1%, mainly because of lower exports and imports.

On the demand side, private consumption benefited from a marked expansion in workers’ remittances and higher bank credit. Reflecting the global economic slowdown, growth in exports and imports alike decelerated sharply, with net exports subtracting from growth. At 25.4% of GDP, investment was slightly higher than the previous year’s 25.2%. Public investment improved to 6.3% of GDP from 5.6% in FY2011 but was mostly offset by the decline in private investment to 19.1% of GDP. Although new foreign direct investment (FDI) rose to $1.0 billion because of larger inflows into the banking, telecommunications, energy, and garment industries, FDI was still less than 1% of GDP and 5% of total investment.

Year-on-year inflation steadily worsened to 11.6% in January 2012 because food prices remained elevated while nonfood prices rose in response to rapid growth in credit, upward adjustments in government-administered fuel and power prices, and sharp taka depreciation. However, inflation declined from February, reaching 8.6% in June 2012, as food prices dropped with improving market supply following the harvest and as monetary policy tightened (Figure 3.15.2). Inflation averaged 10.6% in FY2012, up from 8.8% in FY2011.
Money supply and credit growth slowed as the year progressed (Figure 3.15.3) and the central bank’s midyear tightening of monetary policy took hold. By June 2012, year-on-year growth in broad money was brought down to 17.4% from 21.3% a year earlier. Private credit growth slowed to 19.7% from 25.8% in the same period of the previous year. Expansion in net credit to the government was slashed to 25.2% by June 2012, down from 73.5% in December 2011, as higher mandated prices for fuel and electricity reduced the need to finance subsidies.

The central bank tightened monetary policy in FY2012, lifting repo and reverse-repo policy rates by 100 basis points to 7.75% and 5.75%. Moreover, in January 2012, it withdrew the 13.0% interest rate cap on commercial bank lending rates and stepped up its monitoring of liquidity conditions in the interbank call money market to foster better transmission of its policies. Reflecting these steps, short-term rates adjusted rapidly, with the weighted average yield on 91-day Treasury bills climbing to 11.4% by June 2012 from 6.8% in June 2011. Higher rates on new bank lending were reflected in the system’s overall average lending and deposit rates, the former rising to 13.8% from 12.4% and the latter to 8.2% from 7.3%.

Budget revenues rose strongly to 12.5% of GDP from 11.7% in FY2011 as tax compliance improved (Figure 3.15.4). Income tax receipts rose by 22.8%, and indirect taxes grew by 22.9%. Current spending advanced slightly to 10.0% of GDP in FY2012 from 9.7% the previous year. Despite improved utilization of its allocation, annual development program spending still fell short of the budget allocation; this helped to limit the fiscal deficit to 5.1% of GDP, marginally above the budget target of 5.0%.

Export growth braked sharply to 6.2% in FY2012 from 39.2% in FY2011, as demand in the euro area and the US weakened for the mainly low-end garments on offer and per-unit prices fell. Exports of ready-made garments—accounting for nearly four-fifths of total earnings—grew by only 6.6%, down from 43.4% a year earlier. Exports of other products also slowed. Imports grew by only 5.4% in FY2012, markedly slowing from 41.8% in FY2011, which mainly reflected moderation in imported inputs for the garment industry, including capital equipment, and lower prices for cotton and other raw materials. Food grain imports declined because of higher stocks, though imports of consumer goods—about 10.0% of total imports, mainly sugar, edible oil, and milk—grew rapidly. Remittances strengthened by 10.2% in FY2012, up from 6.0% in the previous year, because of a larger number of Bangladeshi workers going abroad, taka depreciation since early 2011, and better banking services.

Despite the widened deficit in trade and services, larger workers’ remittances raised the FY2012 current account surplus to $1.6 billion, or 1.4% of GDP, from $885.0 million (0.8%) in FY2011 (Figure 3.15.5). The combined capital and financial accounts recorded a smaller deficit of $486.0 million in FY2012, a significant narrowing of the $1.3 billion deficit in FY2011 because of higher FDI and much smaller net repayments of trade credit. The overall balance of payments showed a surplus of $494.0 million in FY2012, a significant rise from the deficit of $656.0 million in the previous year.

Earlier pressure on the exchange rate abated in the second half of FY2012, as import demand slowed and remittances rose. In nominal
terms, the taka nonetheless depreciated by 9.4% against the US dollar in FY2012, reflecting developments in the first half (Figure 3.15.6). The real effective exchange rate rose by 2.2% year on year at the end of June 2012 because domestic inflation outpaced that of trading partners, indicating some erosion in export competitiveness. In the first 7 months of FY2013, the real effective rate rose further by 9.1%, as the nominal exchange rate remained broadly stable and an adverse inflation differential persisted.

### Economic prospects

Economic forecasts for FY2013 and FY2014 rest on four assumptions: First, the central bank’s slight easing in monetary policy announced in January 2013 will not stoke inflation, given the declining trend in international commodity prices and a favorable domestic crop outlook. Second, the government will contain subsidies by continuing to raise fuel and electricity prices and thus keep in check its need for bank borrowing. Third, though political activity is expected to be volatile, social stability will be maintained. And, finally, weather will be favorable.

GDP growth is projected to edge lower in FY2013 to 5.7% (Figure 3.15.7). Export demand, a major contributor to GDP growth, is expected to slacken slightly, reflecting the Asian Development Outlook baseline assumptions that the euro area economy stagnates and the US recovery remains frail. Despite higher remittances, growth in demand for private consumption is expected to weaken as households adopt a cautious approach to spending because of political uncertainties ahead of parliamentary elections expected by early 2014, depressing production in industries oriented to domestic markets. Lower rice prices will further dampen consumer demand through reduced agricultural income. Ongoing decline in imports of capital equipment and slow import growth for raw materials indicate lower utilization of existing production capacity and a lull in investment. A drop in import letters of credit opened for machinery and industrial raw materials signals weak economic activity in the coming months. With some strengthening of economic activity expected in the euro area and the US in 2014, GDP growth is projected to recover moderately to 6.0% in that year on the back of gradual rises in exports, consumer spending, and investment.

Industry growth is expected to slow to 6.5% in FY2013, reflecting slack demand externally and domestically. The Monetary Policy Statement released in January—which cut repo and reverse-repo rates by 50 basis points to 7.25% and 5.25%, effective 1 February 2013, and slightly raised the targets for private credit growth—signaled greater emphasis on sustaining growth while maintaining the 7.5% target for average inflation for the year. However, these measures are unlikely to spur much more private borrowing as long as prevailing consumer and investor sentiment remains subdued. Headwinds to growth include worsening power shortages as new supply lags growing demand, the inability of new industrial units to get natural gas connections because of supply limits, increased fuel and electricity prices along with wage pressures adding to production costs, and sluggish activity in the real estate market and construction. With expected improvements in external and domestic demand, industry growth is projected at 7.5% in FY2014.
Favorable rainfall during planting and expanded acreage sown to the winter rice crop should help agricultural output in FY2013 recover to 4.2% growth. Greater access to credit resulting from central bank initiatives is expected to bolster output from livestock, aquaculture, and non-cereal crops. In FY2014, agricultural growth is projected to ease to 4.0%, returning to trend following the previous year’s high base. Services growth in FY2013 is expected to slow to 6.0%, reflecting weaker economic activity, and then expand by at least 6.1% in FY2014 on moderate recovery in overall demand.

Average annual inflation is projected to slow to 7.8% in FY2013 (Figure 3.15.8). Inflation decelerated year on year from 11.6% in January 2012 to 7.9% in February 2013 because of easing nonfood prices in conjunction with broadly stable food inflation. Although the January 2013 increase in various fuel prices by 5.3%–11.5% will put pressure on prices, higher crop production and lower international food and commodity prices are expected to dampen inflation. The continuation of appropriate monetary policies is expected to ease inflation to 7.0% in FY2014.

Export growth is expected to slow slightly to 6.0% in FY2013, reflecting economic doldrums in the euro area and slow recovery in the US (Figure 3.15.9). Garment exports rose by 10.1% in the first 8 months of the fiscal year but are expected to slow again. Earnings from other exports have been mixed, showing little change. Export growth is expected to rise to 8.0% in FY2014 on slightly better demand.

Recent serious fires in garment factories have prompted the government, employers, and buyers to consider how to improve worker safety and working conditions, and some steps in this direction have been announced. Bangladesh’s share of the global garment market has been growing. It is the second-largest exporter to the European Union, with a 12.0% market share in FY2012, when exports surged by 21.6%, substantially benefiting from a change in Generalized System of Preferences rules of origin that became effective in January 2011. Bangladesh also had a significant 4.6% share of the US market. Exports of high-end garments are rising, and garment sales to Australia, Canada, the People’s Republic of China, India, Japan, Turkey, and other emerging markets in Asia and South America are expanding briskly.

Imports declined by 3.3% in the first 7 months of FY2013, mainly reflecting reductions in capital goods, rice, and other food items. Lower export growth stemmed imports of inputs to export industries. Although the import bill is expected to rise in the remainder of the year, mainly for fuel, imports are still expected to decline overall by 2.0% in FY2013, before growing again, by 6.0%, in FY2014.

Remittances grew by 17.3% to $9.9 billion in the first 8 months of FY2013. More workers going to the Middle East in 2011, substantial sales of government bonds to expatriate Bangladeshis, and better banking services contributed to the large gain. Remittance growth is expected to decelerate in the remainder of the year and stand at 12.0% in FY2013 and 10.0% in FY2014 as fewer workers go overseas, their numbers down by 31.8% in the first 8 months of FY2013 (Figure 3.15.10).

The current account is projected to show a larger surplus of 2.0% of GDP in FY2013 as the trade deficit narrows (Figure 3.15.11).
exchange reserves rose to $13.8 billion at the end of February from $10.4 billion at the end of June 2012 (Figure 3.15.12), as the current account balance moved from a large deficit in the first 7 months of FY2012 to a sizeable surplus in the same period of FY2013 and the combined capital and financial account balance also rose slightly from $2.0 billion to $2.1 billion. Net inflows of foreign assistance rose sharply and FDI inflows improved. Pressure on the balance of payments will remain low in FY2014, though the current account surplus is expected to shrink to 1.0% of GDP as economic recovery revives imports.

Revenue collection grew by 15.1% in the first 7 months of FY2013, probably too slowly to meet the budget’s target improvement of 21.6%. The budget set public spending growth at 18.9%. Annual development program spending will rise as the government seeks to address infrastructure deficits ahead of the elections but will nonetheless remain below the budget target. The government is holding current spending on subsidies in check by setting fuel and electricity prices higher. The overall deficit is expected to stay within the targeted 5.0% of GDP (Figure 3.15.13). Domestic financing, mainly from banks, will cover 2.7% of GDP, and foreign sources the remaining 2.3%.

Under the 3-year extended credit facility agreed with the International Monetary Fund, the government plans to pursue sound fiscal and debt management through reform to tax policy and administration, public financial administration, and debt management. Parliament passed a value-added tax law in November 2012 for implementation by 2015, which will help modernize the tax system and boost revenues to support Bangladesh’s medium-term development priorities. To contain subsidy costs, a formula to automatically adjust fuel prices will be introduced.

There are downside risks to projections. Economic developments in the euro area and the US may prove to be much weaker than assumed in the Asian Development Outlook baseline, materially affecting exports from Bangladesh. Another risk is budget revenues weakening if political unrest intensifies enough to markedly disrupt economic activity. Extreme spending policies to brighten reelection prospects could compromise monetary and fiscal discipline. Natural disasters pose perennial risks.

## Development challenge—removing constraints on growth

Bangladesh needs to give priority to enhancing its business climate, which the World Bank’s Doing Business 2013 shows deteriorating in the past year (Figure 3.15.14). The country also lags in South Asia in terms of infrastructure quality, as seen from the World Economic Forum’s Global Competitiveness Report 2012–2013 (Table 3.15.2). In addition to improved infrastructure and trade logistics, the trade regime needs to become more open to force manufacturers to improve their productivity and global competitiveness. This would accelerate economic growth and create more and better jobs. The depth and efficiency of the financial sector needs to be developed more fully to expand private access to financing and create a source of long-term lending for infrastructure.
Bangladesh’s acute shortage of skills constrains productivity growth in manufacturing and limits economic diversification. With 30% of the population younger than 15 years old, Bangladesh is poised to reap a strong demographic dividend. A major challenge, however, is to transform the vast young population into a trained human resource base in short order by boosting education quality and developing the specific skills industry demands.

Land shortage is emerging as a major constraint on infrastructure and industrial development. Unplanned urbanization is compounding the problem of finding suitable locations for enterprises, which are excessively concentrated in the capital. Dhaka generates over a third of the country’s GDP with less than a tenth of its population, and congestion in Dhaka and Chittagong, the country’s second city, hampers international competitiveness. The absence of developed connectivity and basic services in other cities and towns robs them of favorable production opportunities and attractive living conditions.

Policy makers need to identify new growth drivers, notably promoting labor-intensive manufacturing for export and expanding industry to serve domestic markets. With the country’s abundant supply of low-cost labor and advantageous location, strong potential exists for a number of sectors: pharmaceuticals, shipbuilding, electronics, leather, textiles, home furnishings, ceramics, agro-processing, jute, footwear, light engineering, plastics, information and communication technology, and business processes outsourcing.

Climate change poses huge risks for this low-lying, flood-prone country. An emerging challenge is to expand capacity and mobilize financing to cope with and help mitigate climate change.

3.15.2 Comparison of infrastructure quality, 2012

<table>
<thead>
<tr>
<th>Country ranking*</th>
<th>Overall infrastructure</th>
<th>Electricity</th>
<th>Roads</th>
<th>Railroads</th>
<th>Ports</th>
<th>Air transport</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>131</td>
<td>2.8</td>
<td>1.8</td>
<td>2.8</td>
<td>2.5</td>
<td>3.3</td>
</tr>
<tr>
<td>China, People’s Rep. of</td>
<td>69</td>
<td>4.3</td>
<td>5.2</td>
<td>4.4</td>
<td>4.6</td>
<td>4.4</td>
</tr>
<tr>
<td>India</td>
<td>87</td>
<td>3.8</td>
<td>3.2</td>
<td>3.5</td>
<td>4.4</td>
<td>4.0</td>
</tr>
<tr>
<td>Pakistan</td>
<td>105</td>
<td>3.4</td>
<td>2.3</td>
<td>3.9</td>
<td>2.6</td>
<td>4.4</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>50</td>
<td>4.8</td>
<td>5.3</td>
<td>4.6</td>
<td>3.8</td>
<td>4.9</td>
</tr>
</tbody>
</table>

* Ranking out of 142 countries.

Note: 1 = extremely underdeveloped, 7 = extensive and efficient by international standards.