Bangladesh

Growth moderated last year, inflation declined, and the current account returned a larger surplus. This year, growth will slip again, reflecting slower expansion in exports, falling worker remittances, and political unrest before parliamentary elections. Higher inflation and a modest current account deficit are expected. The garment industry faces challenges in adopting tough compliance and safety standards. Growth should improve in the following year, but a major boost will come only with ramped up investment in infrastructure.

Economic performance

As officially estimated, GDP in FY2013 (ended 30 June 2013) grew by 6.0%, less than the 6.2% recorded in FY2012 (Figure 3.15.1). Agriculture growth slipped to 2.2% from 3.1% in FY2012 as crop output was held down by higher input costs, lower output prices, and unfavorable weather. Services growth slowed to 5.7% from the previous year's 6.0% owing to stagnant imports and frequent political demonstrations that disrupted supply chains and affected retail and wholesale trade. Industry growth rose slightly to 9.0% from 8.9% in FY2012, with contributions from construction and small-scale manufacturing.

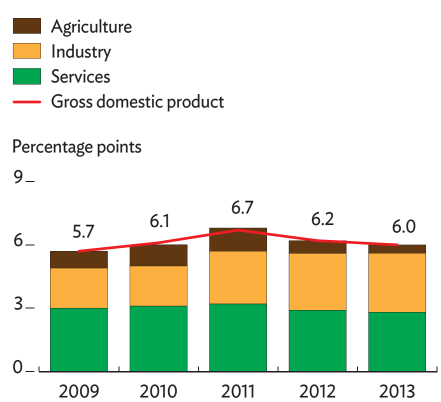
On the demand side, net foreign trade and services added to growth as garment sales grew briskly. Growth in private consumption accelerated, fueled by healthy remittance inflows, though expansion in private credit slowed. Investment rose only slightly to 26.8% of GDP from the previous year's 26.5%. Private investment declined to 19.0% of GDP from 20.0% in FY2012, while public investment rose to 7.9% of GDP from 6.5% in FY2012. Private investment was constrained by electricity and gas shortages and a weaker investment climate. Foreign direct investment inflows rose only slightly.

Year-on-year inflation rose to 8.1% in June 2013, reflecting escalating food prices as the demonstrations disrupted supplies. The rise in government-administered power and fuel prices also contributed (Figure 3.15.2). Nonfood prices fell, responding to slower credit growth and the appreciation of the Bangladesh taka. Average inflation slowed to 6.8% from 8.7% in FY2012.

In September 2012 the government raised power tariffs for bulk consumers by 17.0% and for retail consumers by 8.0%. It also raised diesel, kerosene, and gasoline prices by 5.3%–11.5% in January 2013, but the price of furnace oil, used mostly to generate electricity, was not increased.

Although the central bank's monetary policy was accommodative, money and credit growth slowed in FY2013. Broad money growth eased to 16.7% in June 2013 from 17.4% a year earlier (Figure 3.15.3).

3.15.1 Supply-side contributions to growth

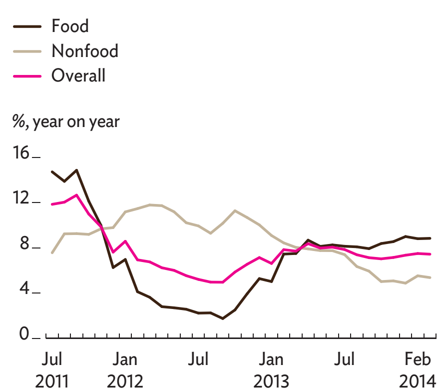


Note: Years are fiscal years, ending on 30 June of the same calendar year.

Source: Bangladesh Bureau of Statistics. 2013. *National Accounts Statistics*. June.

Click here for figure data

3.15.2 Monthly inflation



Sources: Bangladesh Bank. 2014. *Monthly Economic Trends*. February. http://www.bangladesh-bank.org; Bangladesh Bureau of Statistics. http://www.bbs.gov.bd/

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

Private credit growth slowed markedly to 10.9% from 19.7% in June 2012, as net credit to the government grew by 20.1% in June 2013, down from 24.9% a year earlier and well below its peak expansion in the middle of FY2012. As imports remained unchanged, net foreign assets shot up, accounting for nearly half of monetary expansion.

In easing monetary policy, the central bank in March 2013, cut repo and reverse repo rates by 50 basis points. The weighted average yield on the 91-day Treasury bill fell to 8.3% by June 2013 from 11.4% a year earlier. Banks' weighted average lending rate, however, declined only marginally to 13.7% from 13.9% in June 2012, but the weighted average deposit rate rose to 8.5% from 8.1%, narrowing banks' interest rate spread by 0.6 percentage points to 5.2%.

Revenue growth was less than the FY2013 budget target of 21.6% as import-based taxes yielded less than expected. Growth in domestic indirect taxes also slowed, although income taxes were buoyant. At 12.4% of GDP, revenue collection in FY2013 remained essentially at the previous year's level, but public spending rose to 16.9% from 16.6% in FY2012 (Figure 3.15.4). The fiscal deficit widened to 4.5% of GDP from 4.1% in FY2012 but remained within the budgeted 5.0% of GDP. Domestic sources financed about two-thirds of the deficit.

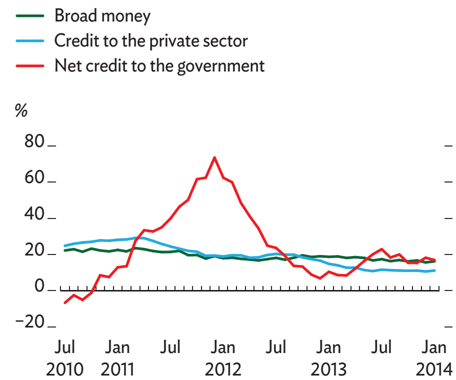
Exports expanded by 10.7% in FY2013, up from the previous year's 6.2%, with higher demand from both traditional and newly developed markets for the country's low-end garments. Earnings from readymade garments rose by 12.7%, doubling the figure a year earlier. Growth in import payments fell to 0.8% from 2.4% in FY2012, as imports of rice, sugar, edible oil, fertilizer, petroleum products, and capital goods declined. Remittance inflows rose to 12.6%, up from 10.2% in FY2012 because of improved banking services and the lagged impact of large placements of Bangladeshi workers a year earlier.

With higher remittances and a narrower trade deficit, the current account sharply improved to a surplus of $2.5 billion (1.9% of GDP) in FY2013 from a deficit of $447.0 million in FY2012 (Figure 3.15.5). The combined capital and financial accounts showed a surplus of $3.4 billion, strengthening from $1.9 billion in FY2012, as net disbursements of medium- and long-term loans were higher, as were net inflows on account of trade credit. The overall balance grew tenfold to a surplus of $5.1 billion in FY2013 from $494.0 million in FY2012. Gross foreign exchange reserves, adjusted for valuation changes, rose sharply to $15.3 billion at the end of June 2013 from $10.4 billion a year earlier, providing cover for 4.6 months of imports.

The taka appreciated by 5.2% against the dollar in FY2013, reflecting weak import demand and strong growth in both exports and remittances (Figure 3.15.6). The taka had appreciated in real effective terms by 11.1% year on year by the end of June 2013 because of its nominal appreciation and higher domestic inflation relative to trading partners, indicating some loss of export competitiveness.

The stock market continued to be volatile in FY2013, with abrupt price movements. The Dhaka Stock Exchange general index fell by 4.1%, though market capitalization grew marginally by 1.6% (Figure 3.15.7). The price–earnings ratio rose from 12.5 in June 2012 to 14.6 in June 2013. Net foreign portfolio investment in FY2013 rose

3.15.3 Growth of monetary indicators



Source: Bangladesh Bank. 2014. *Monthly Economic Trends.* February. http://www.bangladesh-bank.org

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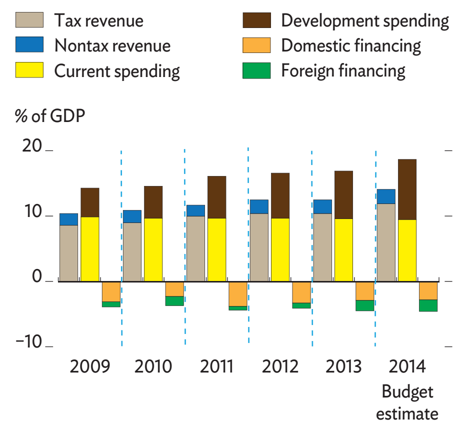
3.15.4 Fiscal indicators



Note: Years are fiscal years, ending on 30 June of the same calendar year.

Source: Asian Development Outlook database.

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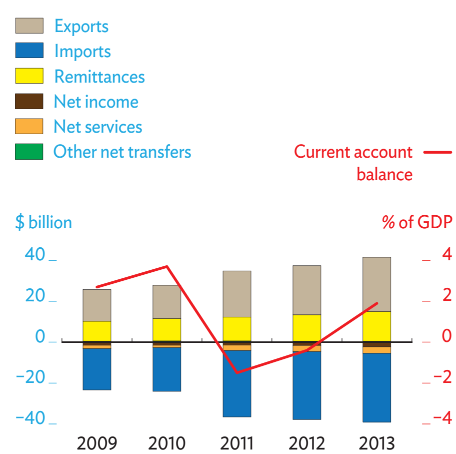
3.15.5 Current account components



Note: Years are fiscal years, ending on 30 June of the same calendar year.

Source: Bangladesh Bank. *Annual Report 2012–2013.* http://www.bangladesh-bank.org

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to $287 million from $240 million in FY2012. Parliament passed the Demutualization Act in April 2013 with a view to separating ownership from management and converting both of the country's stock exchanges into shareholder-owned corporate entities, as the authorities sought to boost investor confidence in stock dealing and to stabilize the market.

Economic prospects

The forecasts for FY2014 and FY2015 rest on several assumptions: Political stability will be restored following the January 2014 national elections, improving consumer and investor confidence. The central bank will be watchful, in line with the January 2014 monetary policy statement, to keep inflation in check while helping direct steady credit flows to the private sector. Electricity and fuel prices will be raised to lower subsidy costs. It will be possible to mobilize more foreign financing, thus limiting government bank borrowing. Food grain and oil prices will remain stable on the international market. And the weather will be normal.

GDP growth is expected to slow to 5.6% in FY2014, owing to a decline in remittances (which have been equivalent to about 15% of private consumption spending) and as export growth tapers off in the coming months (Figure 3.15.8). Domestic demand was depressed in the first half of the year because the prolonged political unrest ahead of parliamentary elections in January 2014 dented consumer and investor confidence. This is reflected in lower private credit growth, a decline in imports of consumer goods and capital machinery, and modest growth in imports of raw materials. Growth is expected to rebound to 6.2% in FY2015, aided by higher remittance and export growth, as well as by prospects for continued economic recovery in the US and the euro area. A likely rise in consumer and investor confidence as the political situation stabilizes is also expected to stimulate demand and strengthen growth momentum.

Industry growth is expected to slow to 8.0% in FY2014 because of the output lost to political unrest in the first half of the year, and as weaker domestic demand depresses production. Production by the readymade garment industry may also be affected if foreign buyers postpone orders in response to delays in implementing agreed fire and building safety standards to prevent further industrial accidents. Industry growth is expected to increase to 9.0% in FY2015 with a pickup in domestic and external demand, better safety standards and compliance in garment factories, and gains in power generation.

Agriculture growth is projected to rebound to 3.0% in FY2014, aided by favorable weather in the early months of the year and reflecting the previous year's low base. Growth in FY2015 is expected to strengthen to 3.5%, about on trend.

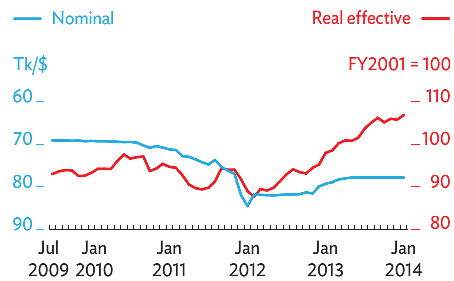
Services growth in FY2014 is projected to slip to 5.4% due to lost sales during the pre-election unrest and slower industrial activity. Sluggish demand in retail and wholesale trade, hotels and restaurants, transport, and tourism—and the fall in commercial banks' operating profits on weak credit flows—evidence a slow expansion. With the expected rebound in industry and agriculture, services growth is expected to recover to 5.7% in FY2015.

3.15.1 Selected economic indicators (%)

	2014	2015
GDP growth	5.6	6.2
Inflation	7.5	6.5
Current account balance (share of GDP)	–0.5	–1.5

Source: ADB estimates.

3.15.6 Exchange rates



Source: Bangladesh Bank. 2014. *Monthly Economic Trends.* February. http://www.bangladesh-bank.org
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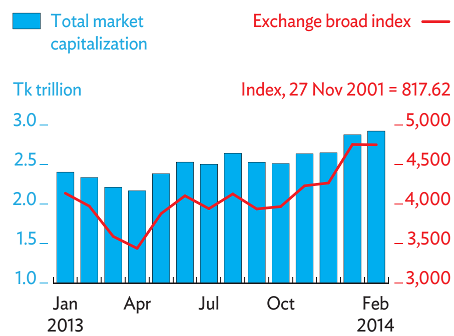
3.15.7 Dhaka Stock Exchange indicators



Sources: Bangladesh Bank. 2014. *Major Economic Indicators: Monthly Update.* February. http://www.bangladesh-bank.org; Dhaka Stock Exchange. http//:www.dsebd.org
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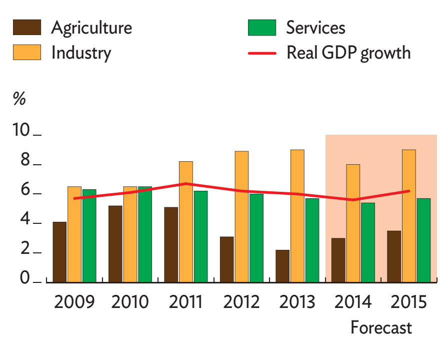
3.15.8 GDP growth by sector



Note: Years are fiscal years, ending on 30 June of the same calendar year.
Sources: Bangladesh Bureau of Statistics. 2013. *National Accounts Statistics.* June; ADB estimates.
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Inflation is expected to rise to average 7.5% in FY2014 because of the effects of supply disruptions, rising wages in both the public and the private sector, and expected increases in electricity and fuel prices. With the easing of supply constraints, continued prudent monetary policy, and better crop outlook, inflation is expected to moderate to 6.5% in FY2015.

Exports grew by 21.2% in the first quarter of FY2014 and then slowed to 14.0% in the first 8 months of the year (Figure 3.15.9). Garment exports grew by 16.7%. Other exports (about 20% of the total) were up by only 3.4%, with performance little improved from a year earlier. Earnings from frozen food and leather rose strongly, but exports of jute goods, petroleum products, raw jute, and engineering products declined. In the first 7 months, earnings on exports to the European Union grew by 19.6%, to the US by 9.1%, and to newly developed markets by 14.2%. With momentum declining during the middle months, growth in exports is expected to moderate to 9.0% in FY2014. Then, with stronger external demand in FY2015, export growth is projected to recover to 12.0%.

Import payments grew by 13.9% in the first half of FY2014, mainly to pay for higher imports of rice and wheat, while imports of sugar, edible oil, machinery, fertilizer, and petroleum products declined. With moderation in the second half, imports are expected to increase by 10.0% in FY2014 and pickup to 14.0% in FY2015 on projected higher demand.

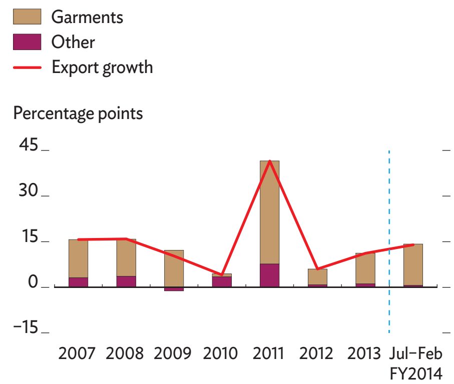
Worker remittance inflows declined by 6.9% in the first 8 months of FY2014, reflecting reduced employment overseas, especially in the Middle East. Action against illegal workers in Saudi Arabia and taka appreciation contributed to the lower remittance inflows. Overseas jobs for Bangladeshi workers fell by 13.1% in the first 8 months of FY2014 (Figure 3.15.10). Remittances are expected to decline by 3.0% for all of FY2014 but then grow by 7.0% in FY2015, as more jobs are created by the government's efforts to engage with recruiting countries.

With a somewhat larger trade deficit and falling remittances, the current account is expected to reverse to a small deficit of 0.5% of GDP in FY2014. The current account is projected to slide further to a deficit of 1.5% of GDP in FY2015, as remittance growth is inadequate to offset the projected wider trade gap.

Growth in revenue collection slowed to 10.0% during the first 7 months of FY2014, underperforming the 19.9% budget target because economic activity was disrupted and growth in dutiable imports was low. Income tax collection, boosted by automation in tax administration, grew strongly by 18.2%, but the gains were offset by lower growth in import duties and in value-added tax at both the import and the domestic production stage. The ratio of revenue to GDP is expected to rise slightly to 12.6% in FY2014.

Budget spending is expected to remain unchanged at 16.9% of GDP. Current spending will be contained by cuts to low-priority items and expected adjustments to electricity and fuel prices to lower subsidy costs to 2.2% of GDP from 3.1% in FY2013. Annual development program spending will increase as the government steps up project implementation to fulfill election pledges. The expected fiscal deficit of 4.3% of GDP in FY2014 will be within the budget target. Domestic sources, mostly banks, are expected to cover two-thirds of financing.

3.15.9 Contributions to export growth



Note: Years are fiscal years, ending on 30 June of the same calendar year.

Sources: Export Promotion Bureau; ADB estimates.

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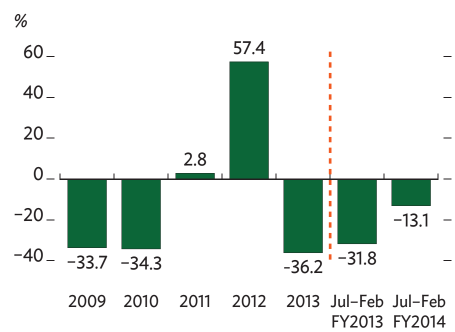
3.15.10 Overseas employment growth



Note: Years are fiscal years, ending on 30 June of the same calendar year.

Source: Bangladesh Bank. 2014. *Monthly Economic Trends.* February. http://www.bangladesh-bank.org

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Policy challenge—reviving and upgrading economic growth

Bangladesh needs to boost investment in infrastructure and skills development to raise the economy's productive capacity if it hopes to upgrade economic growth to a 7%–8% trajectory. Investment has remained virtually stagnant at around 25%–26% of GDP over the past several years and needs to be raised to the 32%–33% range, as envisaged in the Sixth Five-Year Plan, FY2011–FY2015 (Figure 3.15.11). Actual output closely follows the track of potential output (Figure 3.15.12). This suggests that little scope exists for raising GDP growth without stoking inflation, unless potential GDP is bolstered through higher investment.

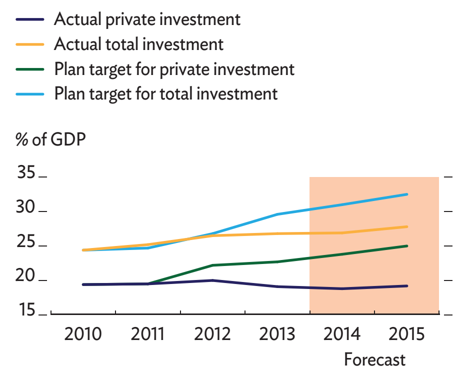
Clearly, more public resources should be mobilized to finance large infrastructure investment requirements in electric power, gas, ports, railways, roads, and urban services—and to enhance the skills base to strengthen the garment industry (Box 3.15.1), help diversify the economy, and strengthen global competitiveness and growth. Bangladesh's tax effort is, at 10.4% of GDP in FY2013, low compared with other South Asian countries. It needs to be raised through tax measures that include axing exemptions and exclusions, and through improved tax administration achieved by simplifying laws and procedures, improving logistics and automation, and reducing scope for evasion with the introduction of advanced auditing and enforcement techniques. Moreover, fiscal space needs to be expanded by cutting subsidies, which requires raising electricity prices to reflect the cost of production vis-à-vis other options, and by aligning fuel prices with international oil prices. Gas prices need to be set keeping in view gas prices on the international market and the cost of alternative fuels. The resources freed up could be allocated for infrastructure and human resource development.

Public sector capacity for project design and administration, procurement, audit, and financial management must be enhanced to make project implementation more efficient. In addition, projects under public–private partnerships need to be advanced by developing capacity in line agencies to design, bid, and award such contracts.

Banks are the main financing source for private investment. However, weak governance in state-owned commercial banks has undermined their strength and efficiency. In line with the latest memorandum of understanding between these banks and the central bank, performance is to be improved by adopting stronger risk management and controls, and by placing ceilings on credit growth for each bank based on its performance and financial soundness. Ongoing capital market reforms to enhance market stability and governance need to be deepened, including through the development of a liquid bond market, to expand sources for private sector financing.

To improve the business climate, the trade regime needs to be liberalized through tariff and nontariff reform. Import duties need to be cut, and the dispersion in rates and average level of protection lowered to boost competitiveness and reduce biases against exports. Trade infrastructure and logistics, including port services and automation, need to be improved to lower transaction costs and facilitate the faster clearance of goods.

3.15.11 Actual investment versus Sixth Five-Year Plan investment targets



Notes: Years are fiscal years, ending on 30 June of the same calendar year. Actual investments for FY2014 and FY2015 have been estimated.

Sources: Bangladesh Bureau of Statistics. *National Accounts Statistics*. June 2013; Planning Commission. *Sixth Five Year Plan FY2011–FY2015;* ADB estimates.

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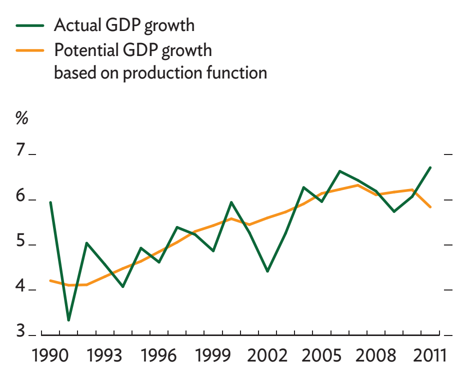
3.15.12 Actual versus potential GDP growth



Note: Years are fiscal years, ending on 30 June of the same calendar year.

Source: ADB estimates.

Click here for figure data

3.15.1 Toward a better garment industry in Bangladesh

Bangladesh's garment industry is in transition. With 5,400 factories employing 4.0 million workers, mostly women, and with export earnings at $20 billion, or 16.6% of GDP in FY2013, the industry is the backbone of the economy and a major force for inclusive growth. However, it has a mixed safety history. Following major industrial accidents in 2012 and 2013, the industry—in collaboration with the government, foreign buyers, and development partners—has agreed to and is in the process of adopting internationally accepted safety and compliance standards. Success in this endeavor will be difficult, as it will require major changes and substantial financing. To comply with international standards, about half of the country's garment factories, mostly small and medium-sized ones that depend on subcontracting from large factories, will be hard pressed to adapt. Operating on small profit margins and lacking financial resources, many of these factories will likely need to close or be absorbed by larger companies.

An operating manual was developed with the assistance of the International Labour Organization (ILO) for assessing structural integrity and fire and electrical safety. Factory inspections have begun under the Accord on Fire and Building Safety in Bangladesh, the signatories of which are European buyers and trade unions, and the Alliance for Bangladesh Worker Safety, an initiative of US buyers. In March, the first batch of detailed inspection results under the accord was made public. The two groups have pledged to provide loans to qualifying companies for safety upgrades. In January 2014, the Rana Plaza Donors Trust Fund was established and began to receive contributions from buyers and private donors to assist victims of that 2013 building collapse and their families.

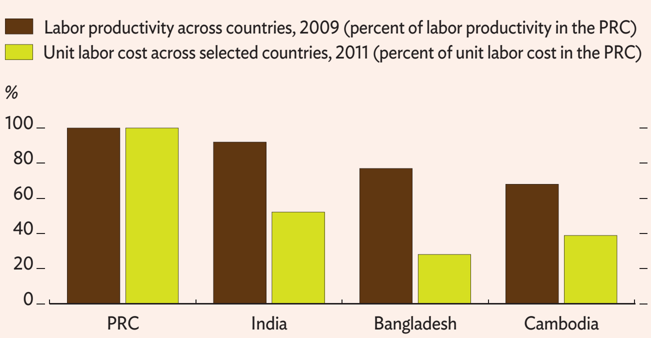
Under the National Action Plan, development partners—Canada, the European Union, Japan, the United Kingdom, and the US—have started providing funds as part of their long-term initiatives to ensure labor safety and factory standards while involving local and international nongovernment organizations and trade unions in their efforts. Low-cost loans are made available through support from the Japan International Cooperation Agency and the International Finance Corporation (IFC). In addition, the government has decided to cover 3 percentage points of commercial bank lending rates for export loans, to enable garment factories affected by political unrest to cut their losses.

The ILO and the IFC have announced, in partnership with the government, the Better Work Program as a component of the program Improving Working Conditions in the Ready-Made Garment Sector. In addition to providing financial support to the victims and their families, and to ensuring treatment for injured workers, the government took initiatives to reemploy affected workers and implement suggestions for ensuring workplace safety.

The minimum wage was raised to Tk5,300 per month from Tk3,000 in November 2013. Even with this increase, Bangladesh will continue to be the most wage-competitive of major garment producers in Asia, having maintained the least-cost pattern from 2001 to 2011, according to recent research (box figure 1). Moreover, estimates place Bangladesh labor productivity at 80% of that in the People's Republic of China (PRC). This suggests that unit labor costs are about half that of India and Cambodia, two main Asian competitors for production moving from the PRC to lower-cost venues.

The continued dynamism of Bangladesh's garment industry will depend on its ability to raise productivity, boost value addition, and move upmarket. Major challenges include upgrading safety standards to maintain strong buyer market access, improving inadequate electricity and transport-related infrastructure and logistics (box figure 2), and developing skilled candidates for middle and senior management needed both to improve labor relations and to raise production efficiency through better quality control, labeling, and shipment.

1 Comparison of labor productivity and unit labor costs



PRC = People's Republic of China.

Note: Data refer to calendar years.

Source: ADB estimates based on (i) McKinsey & Company's *Bangladesh's ready-made garments landscape: The challenge of growth*, November 2011; and (ii) wage data for 2011 published in *Global Wage Trends for Apparel Workers, 2001–2011*, Workers Rights Consortium, July 2013, Center for American Progress. http://www.americanprogress.org

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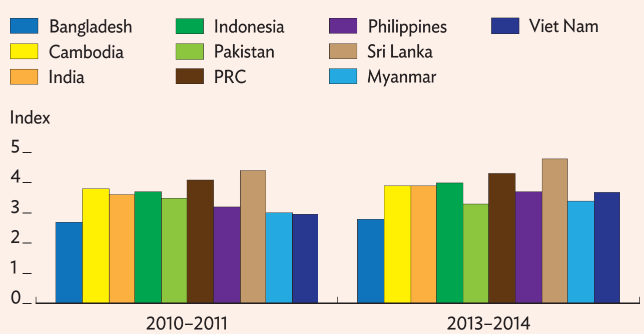
2 Quality of infrastructure in selected developing Asia countries



PRC = People's Republic of China.

Note: Data refer to calendar years. Index scale varies from 0 to 7, the best.

Sources: World Economic Forum. *Global Competitiveness Report 2010–2011 and 2013–2014.*

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