Bangladesh

Economic growth in FY2011 continued strong. Macroeconomic imbalances, however, have emerged: the balance of payments is under strain from high commodity prices, increased oil imports for power generation, and weakened exports; rising subsidy costs, mainly for fuel, are intensifying fiscal pressures and domestic borrowing, and inflation is at a multiyear high. Growth is expected to slow as the country grapples with these imbalances. Lifting growth in the medium term entails removing infrastructure bottlenecks, mobilizing additional budget resources, attracting greater investment, and upgrading labor skills.

Economic performance

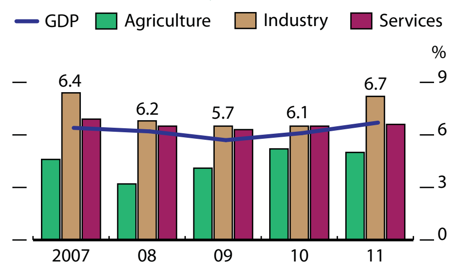
Growth picked up slightly to 6.7% in FY2011 (ended June 2011) from 6.1% (Figure 3.15.1). The upturn reflected a robust industrial expansion at 8.2% because of a strong rebound in export-oriented manufacturing and better performance by domestic market-based industries. More reliable power supply to industry helped performance, as contracted, private small plants began supplying power to the national grid. Agriculture maintained strong growth of 5.0%, aided by favorable weather and better access to credit and extension services. An expansion in trade activities helped maintain services growth of 6.6%.

On the demand side, private consumption, supported by a surge in credit, was the key growth driver in FY2011. Total fixed investment rose only slightly to 24.7% of GDP, from 24.4% in the previous year. Foreign direct investment (FDI) remained very low, at less than $1 billion.

Average annual inflation rose to 8.8% from 7.3% in FY2010 owing to the marked rise in global food and commodity prices, a strong expansion in domestic credit, and depreciation of the taka in the latter half of the fiscal year. Price pressures have intensified in FY2012 and year-on-year inflation climbed slightly from 10.2% in June 2011 to 10.4% in February 2012; nonfood inflation more than doubled to 13.6% but food inflation edged down to 8.9% (Figure 3.15.2). In addition to the rapid expansion in credit, stronger price pressures came from upward adjustments in domestic administered fuel and electricity prices, and from sharper taka depreciation because of continued high import demand, especially fuel imports.

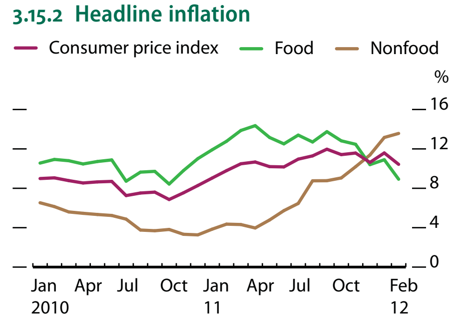
Net credit to government, which grew rapidly by 35.0% in FY2011, shot up to 62.4% in the 12 months to January 2012 (Figure 3.15.3), coinciding with a rapid rise in the cost of subsidies financed by the budget. Credit to the private sector, which climbed by 25.8% in FY2011, slowed to 18.9% by January 2012, although it remained higher than the annual monetary program target of 18.0%. The central bank raised policy rates to rein in the credit expansion and attendant domestic demand pressures, but it

3.15.1 GDP growth by sector



Source: Bangladesh Bureau of Statistics. 2011. *National Accounts Statistics*. May.

3.15.2 Headline inflation



Source: Bangladesh Bank. 2012. *Monthly Economic Trends*. February. http://www.bangladesh-bank.org

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

also provided occasional liquidity support to the commercial banks, partly countering these measures' impact.

Revenue collection was buoyant in FY2011, with the revenue-to-GDP ratio rising to 11.6% from 10.9% in FY2010, owing to the pickup in economic activity and improvement in tax administration. Total government spending increased by nearly 25% to 15.9% of GDP from 14.6% in the previous year, as current spending mounted because of a rise in subsidies for food, fuel, fertilizer and electricity. The budget deficit (4.3% of GDP) nonetheless, remained below target (5.0%), largely because implementation of the annual development program was weak, reflecting continued capacity constraints in key line agencies. The bulk of the budget financing came from domestic sources (3.4% of GDP), mostly from the banking system (Figure 3.15.4), as sales of national saving certificates fell off from the high level a year earlier and foreign financing was lower than expected (0.9%).

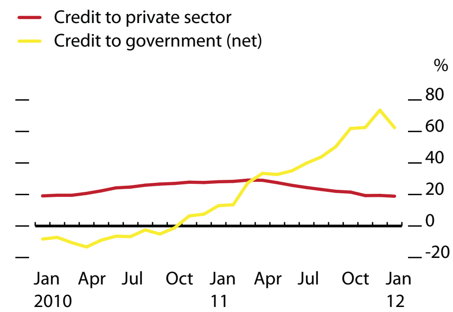
Export growth jumped to 41.7% in FY2011, reflecting a sharp recovery in garment demand in the main markets in the European Union (EU) and the United States (US) and a pickup in garment exports to new markets though these remain a small part of total sales. Garment export earnings grew by 43.4%, buoyed in part by higher export prices following the rise in prices of cotton, yarn, and accessories. Exports of other products also grew rapidly with a rise in demand and also reflecting the low base in the previous year.

Imports grew in step by 41.8% owing to larger import costs of raw materials for the garment industry, higher global commodity prices—especially for foodgrains, fertilizer, and fuel—and the generally strong domestic demand conditions. Foodgrain imports rose very steeply, buoyed by larger volumes as well as price, as the government sought to build large stocks to bolster food security. Because the base for imports is much larger than that for exports, even with similar growth rates, the trade deficit widened by 2.0% of GDP. Worker remittances, the main offset to the trade deficit, expanded by only 6.0% however, down from 13.4% the previous year.

The larger trade deficit and slower growth in remittances took the current account surplus down sharply to only \$995.0 million (0.9% of GDP) in FY2011 from \$3.7 billion (3.7%) the previous year (Figure 3.15.5). The combined capital and financial accounts recorded a deficit of \$984.0 million in FY2011, versus the deficit of \$139.0 million in FY2010, because of the larger outflows on account of trade credit and lower net inflows of foreign assistance. The overall deficit was \$925.0 million in FY2011, a sharp turnaround from the surplus of \$2.9 billion in FY2010.

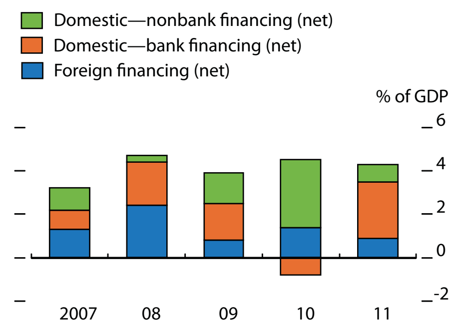
Because of rapidly growing import demand, the exchange rate came under pressure, especially in the second half of FY2011, and the taka depreciated by 6.3% against the dollar during the year. Balance-of-payments pressures continued in the first 7 months of FY2012 and the taka depreciated further by 12.2% (Figure 3.15.6). The real effective exchange rate depreciated by 9.0% in the year to January 2012, implying some gain in export competitiveness, as nominal depreciation of the currency offset higher inflation than in major trading partners.

3.15.3 Credit growth



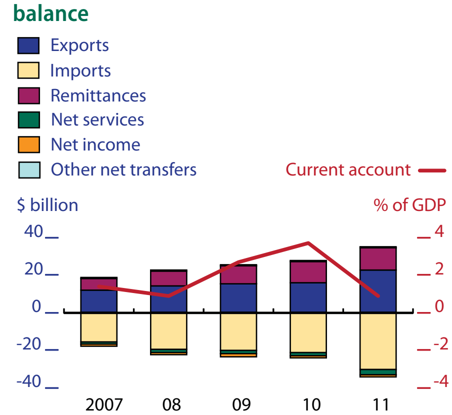
Source: Bangladesh Bank. 2012. *Monthly Economic Trends*. February. http://www.bangladesh-bank.org

3.15.4 Budget deficit financing



Source: Asian Development Outlook database.

3.15.5 Components of the current account balance



Source: Bangladesh Bank. *Annual Report 2010–2011*. http://www.bangladesh-bank.org

Economic prospects

The forecasts for FY2012 and FY2013 assume that it will be hard to contain inflation in FY2012, despite policy tightening. It is expected that credit tightening measures announced in the central bank's January 2012 Monetary Policy Statement would more effectively damp inflation in FY2013. It is also assumed that the government will further raise fuel and electricity prices, and mobilize more foreign financing of the budget, as part of its efforts to eliminate external and domestic imbalances and put the economy on a sustainable higher growth path. Finally, political stability and normal weather are expected to prevail.

GDP growth in FY2012 is projected to slow to 6.2%. The performance of exports, a key growth driver, is weakening as the year progresses, largely because of weaknesses in its key market, the eurozone, which is in a prolonged period of adjustment to its debt crisis. Export growth slowed sharply to 13.0% in the first 8 months of FY2012, from 40.3% in the year-earlier period, which will also affect production in export-linked domestic industries. The rise in interest rates is expected to moderate domestic demand. GDP growth in FY2013 is expected to slip to 6.0% as interest rates are raised to bring down inflation, and as export growth slows further.

Agricultural growth in FY2012 will moderate to 4.4%, crimped by rising irrigation costs (reflecting higher fuel and electricity prices) and because of the high base in the previous year. In FY2013, sector growth is projected to rise slightly to 4.5% in response to better procurement prices, as the government steps up food procurement programs and strengthens policy support.

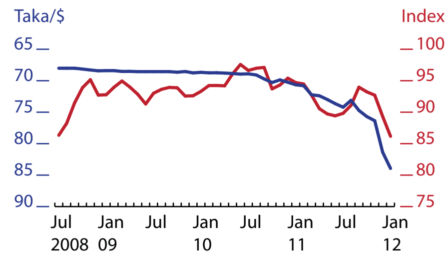
Industrial growth is expected to slow to 7.8% in FY2012, mainly reflecting falling export demand. Higher interest rates and labor costs as well as the expected increases in fuel and electricity prices will further raise the cost of production and squeeze profit margins. Higher interest rates will also weaken the construction industry and investment activity. Industrial growth is projected to ease to 7.5% in FY2013 reflecting policies to eliminate imbalances in the economy taking greater hold, and weakening domestic and external demand conditions.

In FY2012, services growth will slip to 6.2%, as growth in agriculture and industry slows. With industry activity slowing further in FY2013, expansion in services will ease to 6.0%.

Annual average inflation will edge up to 11.0% in FY2012. While food inflation has traditionally driven up the headline rate, the sharp rise in nonfood prices from July 2011 has emerged as a major policy concern. To rein in inflation, the central bank continued the previous year's credit-tightening measures and raised its policy rates in September 2011 and January 2012 by 100 basis points each, to 7.75% and 5.75%, respectively. They are expected to be raised more. In January 2012, the central bank abolished the cap on commercial bank lending rates to more effectively transmit its policy to the private sector. Inflation is projected to slow to 8.5% in FY2013 as monetary tightening takes greater hold.

Overseas workers remitted $8.4 billion in the first 8 months of FY2012, 12.2% more than in the equivalent period a year earlier, reflecting a steep rise in the number of workers leaving for overseas jobs since June 2011 (Figure 3.15.7). The upturn in worker placements and remittances is a welcome financial development that will both help sustain family incomes

3.15.6 Exchange rates

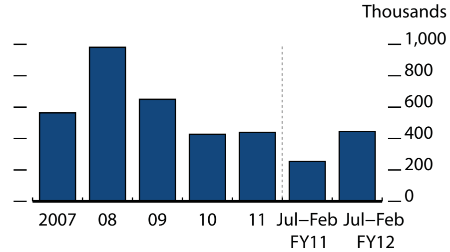


Source: Bangladesh Bank. 2012. *Monthly Economic Trends*. February. http://www.bangladesh-bank.org

3.15.1 Selected economic indicators (%)		
	2012	2013
GDP growth	6.2	6.0
Inflation	11.0	8.5
Current account balance (share of GDP)	-0.5	-1.0

Source: ADB estimates.

3.15.7 Out-of-country employment



Source: Bangladesh Bank. 2012. *Monthly Economic Trends*. February. http://www.bangladesh-bank.org and domestic consumption, and contain the current account deficit. Most Bangladeshi overseas workers go to Gulf countries and are largely recruited to fill low-skill jobs. Remittances are expected to grow by 10.0% in FY2012, from 6.0% a year earlier, and rise further by 12.0% in FY2013.

Export growth is projected to slow to 12.0% in FY2012 and further to 10.0% in FY2013, mainly reflecting weak demand for garments (over three-fourths of exports) from the eurozone and from the US, which is experiencing a slow recovery from its financial crisis. In the first 8 months of FY2012, growth in knitwear exports declined sharply to 8.7%, from 43.9% in the year-earlier period, although growth in woven fabric exports held up well at 22.2% (Figure 3.15.8), benefiting from the EU's relaxed rules of origin (from January 2011). Growth in other export items also slowed markedly. While taka depreciation should favor exporters, the benefits are being largely negated by the lower prices negotiated by garment buyers. Although garment exports to new (mainly developing country) markets are becoming more important, they are yet to become major markets to offset declining exports to the EU and US, the two dominant traditional markets.

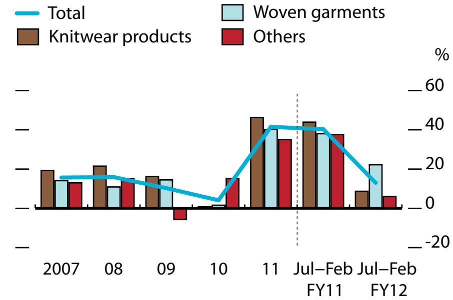
Imports grew by 15.6% in the first 7 months of FY2012. Growth in imports of foodgrains, consumer goods, capital machinery and industrial raw materials moderated from a year ago, although some intermediate goods, especially fuel and fertilizer, grew very strongly. Imports are forecast to grow by 17.0% in FY2012 and stay robust at 15.0% in FY2013 to cover fuel requirements for what is becoming a more reliable power generation, even as economic growth moderates.

The current account is projected to move to a deficit of 0.5% of GDP in FY2012 and to 1.0% in FY2013 as the trade deficit widens further (Figure 3.15.9). Foreign exchange reserves declined further in the first 8 months of FY2012 (Figure 3.15.10) as the current account surplus nearly halved and a large deficit was still recorded in the capital and financial accounts. Net inflows of foreign assistance declined, although FDI inflows rose marginally. Pressure on the balance of payments is expected to intensify in the forecast period, with larger import payments relative to export and remittance receipts. The government is seeking to adopt policies to address the growing imbalances, including discussing a 3-year program with the International Monetary Fund under its Extended Credit Facility.

The FY2012 budget aimed at revenue growth of 24.4%, although revenue collection in the first 7 months of the fiscal year indicates that this target is unlikely to be met. The budget set growth in public spending at 25.8%. While current spending is likely to greatly exceed the budgeted amount because of the rapid rise in subsidies, utilization of the annual development program will again fall short of allocation, which is expected to keep the fiscal deficit within the budgeted 5.0% of GDP (Figure 3.15.11). Domestic financing, mainly from banks, was set to cover 3.7% of GDP, while the remaining 1.3% was planned to come from foreign financing.

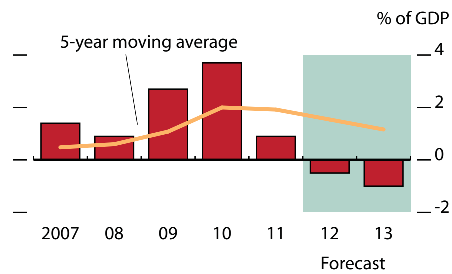
Subsidies are putting increasing pressure on the budget. The government has raised fuel and electricity prices in phases to cut them, but these adjustments are too small to cover rising costs. Indeed, spending on subsidies is expected to increase from the previous year's 2.2% of GDP to 3.4% in FY2012, or more than a quarter of projected revenue collection for the year.

3.15.8 Growth in exports and components



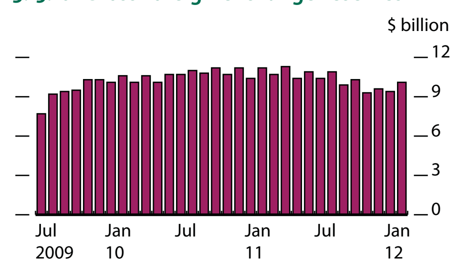
Sources: Bangladesh Bank. 2012. *Major Economic Indicators: Monthly Update*. February; *Annual Report 2010–2011*. http://www.bangladesh-bank.org

3.15.9 Current account balance



Sources: Bangladesh Bank. *Annual Report 2010–2011*. http://www.bangladesh-bank.org; ADB estimates.

3.15.10 Gross foreign exchange reserves

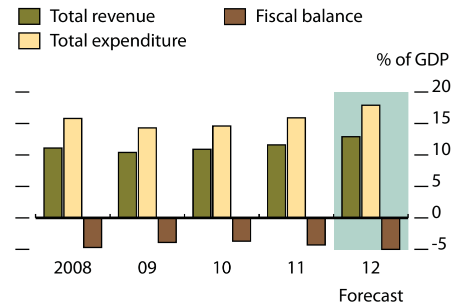


Source: Bangladesh Bank. 2012. Monthly Economic Trends. February. http://www.bangladesh-bank.org

The state-owned Bangladesh Petroleum Corporation is facing challenges in mobilizing foreign exchange to pay for its fuel import bill, which is projected to rise by more than half in FY2013. It has obtained a $2.5 billion loan from the Islamic Development Bank, but unless further timely adjustments in fuel prices are made, this loan will ultimately have to be repaid from budgetary resources.

The projections are subject to various downside risks. The global economic slowdown may be more severe than expected, while policy tightening could be compromised by political considerations: the government may find it politically costly to further raise fuel and electricity prices.

3.15.11 Government budget trends



Source: Asian Development Outlook database.

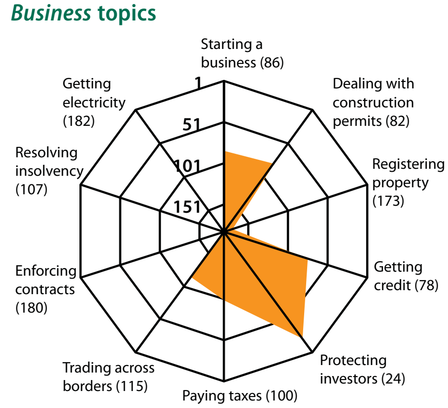
Policy challenge—strengthening growth policies

In the short term, Bangladesh needs to reduce its growing fiscal and external imbalances. It needs to cut subsidies by adjusting fuel and electricity prices, creating space for more—acutely needed—outlays on infrastructure and human development, and reducing the budget's excessive domestic borrowing. The effort to expand the economy's productive capacity will also require higher domestic revenue, which could be raised by strengthening tax reforms and attracting more concessional financing. Monetary policy tightening would need to continue to reduce inflation and eliminate pressure on reserves through reducing import demand. Exports need to be raised through broadening the export base and deepening access to new markets.

Over the long term, the government needs to substantially improve the business climate (Figure 3.15.12) in order to scale up private investment, including FDI, as highlighted in the World Bank's *Doing Business 2012*. As shown in the World Economic Forum's *Global Competitiveness Report 2011–12*, Bangladesh lags far behind other countries in South Asia in infrastructure (Table 3.15.2). To mobilize resources needed for closing these wide infrastructure gaps, greater private participation in infrastructure development, including public–private partnerships, is essential to supplement finite public resources. The capital market also needs to be developed as a source of long-term infrastructure financing.

Bangladesh has a raft of strategic advantages, including cheap labor and a location in a fast-growing region, which can help attract large FDI inflows into light industry. In several countries in Asia, labor costs are rising fast, opening up prospects for foreign investors to relocate investment to Bangladesh. To attract greater FDI, however, it is essential to remove infrastructure bottlenecks, make land readily available, upgrade skills of the labor force, and remove administrative delays and impediments.

3.15.12 How Bangladesh ranks on *Doing Business* topics



Note: Numbers in parentheses show ranking out of 183 countries worldwide, 1 = best.

Source: The World Bank. Doing Business database. http://www.doingbusiness.org/data (accesssed 14 March 2012).

3.15.2 Comparison of infrastructure quality, 2011

	Country ranking[a]	Overall infrastructure	Electricity	Roads	Railroads	Ports	Air transport
		1 = extremely underdeveloped, 7 = extensive and efficient (by international standards)					
Bangladesh	129	2.8	1.6	2.9	2.5	3.4	3.5
China, People's Rep. of	69	4.2	5.5	4.4	4.6	4.5	4.6
India	86	3.8	3.1	3.4	4.4	3.9	4.7
Pakistan	109	3.5	2.2	3.7	2.8	4.1	4.3
Sri Lanka	48	4.7	5.0	4.5	3.8	4.9	4.9

[a] Ranking out of 142 countries, 1 = best.

Source: 2011 World Economic Forum, *The Global Competitiveness Report 2011–2012*.