INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/147

BANGLADESH

June 2017

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with Bangladesh, the following documents have been released and are included in this package:

- A **Press Release**.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on lapse of time basis, following discussions that ended on March 9, 2017, with the officials of Bangladesh on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 12, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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COMMUNICATIONS DEPARTMENT

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June 8, 2017

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2017 Article IV Consultation with Bangladesh

On May 26, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the 2017 Article IV Consultation with Bangladesh, and considered and endorsed the staff appraisal without a meeting.[1]

Steady monetary policy management and fiscal discipline have supported macroeconomic stability, allowing the economy to benefit from favorable external demand, high remittances, and low commodity prices. The result has been strong output growth, falling inflation, moderate public debt, and a rebuilding of external resilience.

Supported by both domestic and external demand, real GDP growth in FY16 accelerated to 7.1 percent, from 6½ percent in the previous fiscal year. Headline inflation continued to ease, falling below 6 percent by the end of 2016, helped in part by favorable agricultural production and falling global commodity prices. International reserves have risen further, and the public debt-to-GDP ratio has remained largely stable at a moderate level. Tax revenue performance has improved somewhat, with revenues-to-GDP ratio increasing moderately. The strengthening of economic growth has been supported by a moderate acceleration of money supply and credit to the private sector.

In FY17, output growth is expected to remain close to 7 percent. As global commodity prices pick up, inflation is projected to increase somewhat from the lowest level in five years, although with moderate money and credit growth, stable inflation expectations, and temperate private wage growth, it is projected to remain close to the target rate of the Bangladesh Bank. Over the medium term, maintaining output growth of around 7 percent per year would require increased public and private investment, as well as reforms to support capital market development and improved investment efficiency. A robust growth supported by increased investment would be expected to lead to higher investment-related imports, pushing the current account into a modest but manageable deficit. The planned launch of the modern value added tax (VAT) in July 2017,

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the presence of an IMF arrangement, such as the Extended Credit Facility arrangement that Bangladesh had with the IMF between April 2012 and October 2015, Article IV consultations take place every two years. As part of the consultation, a staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

together with improvements in tax administration, are expected to boost tax revenues, providing space for increased public investment and social spending.

Executive Board Assessment

Executive Directors commended the Bangladesh authorities for the continued strong macroeconomic performance. Growth has been stable and robust, social indicators have improved, inflation has declined, external reserves have risen and fiscal deficits remained moderate. Directors shared staff's assessment that while the outlook remains broadly positive, maintaining the output growth would become more challenging and would require not only prudent macroeconomic policies, but also upgrading the macroeconomic policy-making practices and institutions to support the country's ambition to reach middle-income status.

Directors commended the Bangladesh Bank for a prudent monetary policy conduct. They noted that inflation has been reduced and is likely to remain close to the Bank's target. Broad money growth, too, is in line with the Bank's target, and the exchange rate has been consistent with maintaining competitiveness and rebuilding reserve buffers. However, Directors noted that the Bangladesh Bank has been sterilizing only part of the liquidity from the external inflows, and called for an increased sterilization efforts, to contain financial sector risks and to head off the need in the future of a more abrupt and disruptive policy tightening.

Directors welcomed the authorities' commitment to launch the modern VAT on July 1, 2017. They emphasized that mobilizing domestic revenue should be a policy priority, to allow increasing public investment and strengthening social safety nets. To this effect, Directors emphasized that in addition to modernizing the VAT, efforts should continue to improve the income tax regime and to strengthen tax administration. Director broadly concurred with staff that monetary policy is better placed to manage short-term demand fluctuation and that fiscal policy should focus on keeping the public debt to GDP ratio broadly stable.

Directors noted that the FY17 budget was based on overly ambitious projections for revenue growth and equally ambitious capital spending targets, and that the actual outcomes usually deviate significantly from the budget targets. They noted that there is scope to improve the credibility of the budgeting process, by improving budget formulation and execution.

For Bangladesh to reach middle-income status, Directors underscored the need to boost investment, and to modernize policy-making practices and institutions. In this context, Directors shared staff's emphasis on the pivotal role of developing capital markets, to improve the intermediation of the country's underutilized pool of savings over longer horizons. They called on the authorities to reduce the increasing reliance on high-cost National Savings Certificates as a financing vehicle for the government budget. Directors recommended that better targeted and less costly alternatives should be considered that achieve the government's social policy goals without distorting financial markets.

Bangladesh: Selected Economic Indicators, FY2013–17 1/

I. Social and Demographic Indicators

Population (FY16, millions; estimate)	161	Infant mortality (2015, per thousand live births)	31
GDP per capita (FY16, U.S. dollars)	1357	Life expectancy at birth (2014, years)	72
Labor force participation rate (FY10, percent; national measure)	59	Adult literacy (2015, percent of people)	62
Poverty headcount ratio (2010, national measure, percent)	32	Population dependency ratio (2015, percent)	52
Gini index (World Bank estimate)	32	Population growth (FY16, y/y, percent; estimate)	1.3

II. Macroeconomic Indicators

	FY13	FY14	FY15	FY16	FY17
				Est.	Staff proj.
National income and prices (annual percent change)					
Real GDP	6.0	6.1	6.6	7.1	6.8
GDP deflator	7.2	5.7	5.9	6.6	7.0
CPI inflation (annual average)	6.8	7.3	6.4	5.9	6.8
CPI inflation (end of period)	8.1	7.0	6.3	5.5	6.8
Nonfood CPI inflation (end of period)	7.7	5.4	6.2	5.2	5.5
Central government operations (percent of GDP)					
Total revenue and grants	11.2	10.9	9.9	10.4	10.8
Total revenue	10.7	10.4	9.6	10.3	10.6
Tax	9.0	8.6	8.5	8.8	9.1
Nontax	1.8	1.8	1.1	1.5	1.5
Grants	0.5	0.5	0.3	0.1	0.2
Total expenditure	14.6	14.0	13.8	13.8	15.6
Current expenditure	8.3	8.2	7.8	8.3	9.4
Annual Development Program (ADP)	4.2	4.1	4.3	4.4	4.4
Other expenditures 2/	2.1	1.7	1.7	1.1	1.7
Overall balance (including grants)	-3.4	-3.1	-3.9	-3.4	-4.7
(Excluding grants)	-3.9	-3.5	-4.2	-3.5	-4.9
Primary balance (excluding grants)	-1.9	-1.5	-2.1	-1.6	-2.8
Total central government debt (percent of GDP)	34.5	33.9	33.9	33.1	33.7
Money and credit (end of fiscal year; percent change)					
Credit to private sector by the banking system	10.8	12.3	13.2	16.8	14.0
Reserve money 3/	15.0	15.4	14.3	30.1	9.4
Broad money (M2)	16.7	16.1	12.4	16.3	15.1
Balance of payments (billions of U.S. dollars)					
Exports, f.o.b.	26.6	29.8	30.7	33.4	35.3
(Annual percent change)	10.7	12.1	3.1	8.9	5.6
Imports, f.o.b.	-33.6	-36.6	-37.7	-39.7	-43.3
(Annual percent change)	0.8	8.9	3.0	5.5	9.0
Current account balance 4/	2.4	1.4	2.9	3.7	-0.9
(Percent of GDP)	1.6	0.8	1.5	1.7	-0.4
Capital and financial account balance	3.5	3.5	2.4	2.1	3.1
Of which: Foreign direct investment	1.7	1.5	1.8	2.0	2.1
Overall balance	5.1	5.5	4.4	5.1	2.1
Gross official reserves (billions of U.S. dollars) 5/	15.1	21.4	24.9	30.2	32.3
In months of prospective imports of goods and services	4.1	5.8	6.5	7.2	7.0
Exchange rate (taka per U.S. dollar; period average)	79.9	77.7	77.7	79.3	…
Exchange rate (taka per U.S. dollar; end-period)	77.8	77.6	77.8	81.3	…
Nominal effective rate (2010=100; period average)	86.9	89.7	95.4	100.4	…
Real effective rate (2010=100; period average)	99.3	107.7	120.4	132.7	…
Memorandum item:					
Nominal GDP (billions of taka)	11,989	13,437	15,158	17,296	19,764

Sources: Bangladesh authorities; World Bank, *World Development Indicators*; and IMF staff estimates and projections.

1/ Fiscal year begins July 1. `

2/ Includes non-ADP capital spending, net lending, food account surplus (-)/deficit (+), and extraordinary expenditures.

3/ Reserve money excludes liabilities arising from banks' foreign currency clearing accounts at Bangladesh Bank (BB) and nonbank deposits at BB.

4/ Imports are based on customs data.

5/ Excludes deposits held in offshore accounts of resident financial institutions, noninvestment grade sovereign bonds, and foreign exchange overdrafts provided by BB to domestic banks.

BANGLADESH

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

May 12, 2017

KEY ISSUES

Outlook and risks. Steady monetary policy management and fiscal discipline have strengthened macroeconomic stability, allowing the economy to benefit from favorable external demand, high remittances, and low commodity prices. The result has been strong output growth, falling inflation, moderate public debt, and a rebuilding of external resilience. This solid macroeconomic performance is set to continue this year, with growth projected to remain close to current levels and inflation broadly in line with Bangladesh Bank's target. Downside risks to the near-term outlook include a resumption of political unrest, security concerns affecting confidence and investment, a protracted slowdown in key export markets, and weaker remittances. Excess liquidity in the banking sector poses a latent risk to macroeconomic stability. Looking ahead, maintaining the economy's past growth performance will become increasingly challenging and require upgrading the macroeconomic policy-making practices and institutions to support the country's ambition to reach middle-income status.

Policy assessment. With growth solid and inflation stable, monetary policy should focus on sterilizing excess liquidity. This year's budget is appropriately consistent with keeping the public debt ratio broadly stable. The exchange rate should be allowed to adjust as needed to keep foreign exchange reserves at levels sufficient to buffer the economy against external shocks. Launching the VAT in July 2017 as planned is a key fiscal priority. Banking sector reforms should aim to further improve regulation and supervision and address balance sheet weaknesses in loss-making state-owned banks. Modernizing the macroeconomic policy framework would require moving toward a more price-based monetary and exchange rate policy and increasing the transparency and credibility of budget practices. Capital market development is a key structural reform priority, calling for steps to remove financial sector distortions and develop further the government bond market.

Approved By
Kenneth Kang and Peter Allum

Discussions took place in Dhaka during February 26–March 9, 2017. The staff team comprised Brian Aitken (head), Jiri Jonas, Jayendu De, Stella Kaendera (Resident Representative) and Muhammad Imam Hussain (Resident Representative office) (all APD). Subir Gokarn and Mohua Roy (OED) participated in the discussions. Cormac Sullivan and Sharlin George (APD) assisted in preparing this report.

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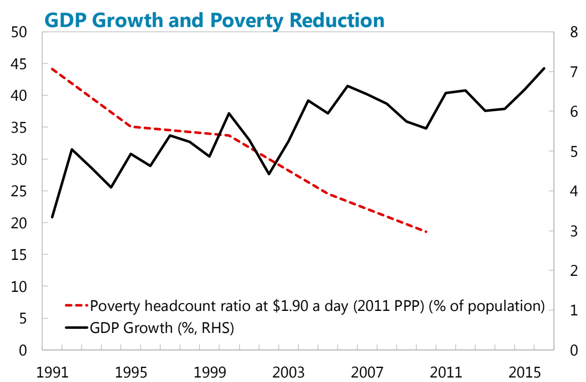
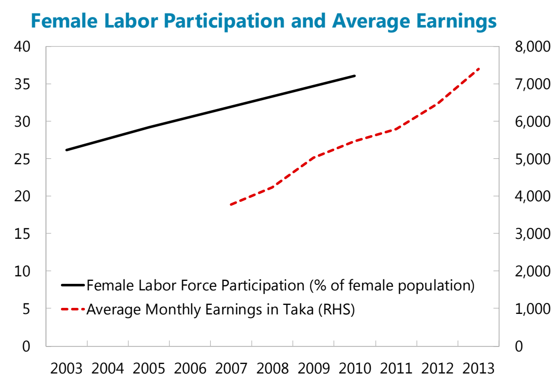
CONTEXT

1. **Growth performance.** Bangladesh's export-led growth over the last two decades has been supported by an abundance of low-cost labor, an increase in female labor force participation, and productivity gains from a shift away from agriculture to manufacturing. As a result, per capita income has risen steadily, with Bangladesh now emerging from low-income status, and social indicators have markedly improved. More recently, sound macroeconomic policies and favorable external conditions—in particular, strong export demand, high remittances, and low commodity prices—have combined to yield solid output growth, falling inflation, moderate public debt, and greater resilience to external shocks.



Sources: WDI and WEO



Sources: WDI and Bangladesh Bank

2. **Challenges.** But maintaining the economy's past growth performance will become increasingly challenging. The threat of political instability and the rise in religious extremism affecting security have held back business activity, and the economy is increasingly strained by lack of basic infrastructure. With Bangladesh ranking near the bottom globally in commercial access to electricity, roads, and rail, a significant increase in public investment is needed. Overcoming these obstacles will be essential to generating the increase in private investment needed to sustain high growth. In addition, while poverty has declined significantly, social safety nets remain weak, particularly in the areas of pension and unemployment support. Strengthening these will require both policy reforms and public resources.[1]

3. **Policy reforms.** Beyond these challenges, Bangladesh is also outgrowing its policy-making practices and institutions, many of which now stand in the way of stable, resilient growth. Reforms should focus on upgrading the policy framework to support macro-stability, maintain competitiveness, build buffers against external shocks, mobilize resources needed for public investment, and promote a financial sector that maximizes the country's savings potential.

4. **Political context.** An impasse between the main political parties continues to contribute to uncertainty, holding back activity. Lately organized protests by the opposition have been subdued but religious fundamentalism is on the rise reflected in the targeted killings of secular bloggers,

[1] The World Bank is supporting reforms to further improve the social safety net (Annex VI).

minorities, and foreigners during 2016, prompting the authorities to take additional security steps against the increased threat of terrorism.

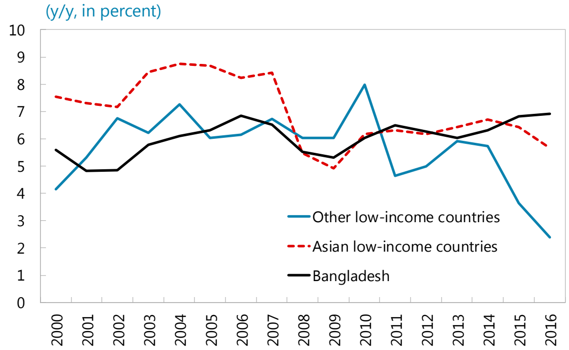
RECENT DEVELOPMENTS

5. Output. Official statistics reported output growth rising to 7.1 percent in FY16 from 6½ percent in the preceding fiscal year, supported by both robust domestic demand—particularly government consumption and private investment—and external demand.[2] On the supply side, growth was driven mainly by industry and services with the sectoral composition of economy's output continuing to shift away from agriculture.

6. Inflation. Headline CPI inflation (annual average) fell to 5½ percent by end-2016, below the 5.8 percent FY17 target, helped in part by favorable agricultural production and falling global commodity prices. Nonfood inflation has declined as well to 4½ percent in December 2016, compared to 7 percent a year ago.

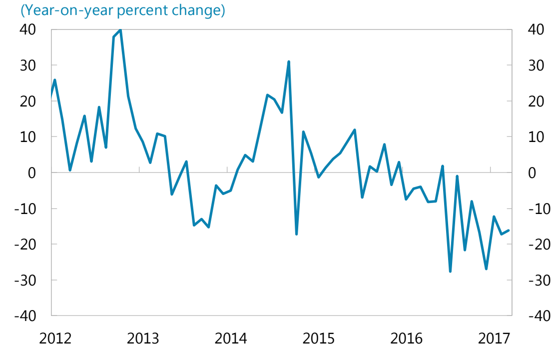
***7.* Balance of payments.** Key revisions to the FY16 balance of payments data have changed the performance assessment. Exports held up as projected, but imports were revised down resulting in a $4½ billion improvement to the previously estimated trade deficit. This plus similar changes to the services and income accounts led to a significant upward revision to the FY16 current account surplus, from ½ percent of GDP to the current estimate of 1.7 percent. These changes improved the overall balance of payments from what was previously estimated.

Bangladesh: Real GDP Growth
(y/y, in percent)



Source: World Economic Outlook

Workers' Remittances
(Year-on-year percent change)



Source: Bangladesh Bank

8. Policy developments. During FY16 and in the first nine months of FY17, the Bangladesh Bank kept its policy rate, the cash reserve ratio, and statutory liquidity ratio unchanged. In FY16 reserve money growth reached 30 percent, double the Bank's target, but with the money multiplier falling because of increases in the currency deposit and reserve deposit ratios (corresponding to an increase in liquidity in the banking sector discussed below), broad money growth was close to the target. This provided room for somewhat faster-than-projected growth in credit to private sector, allowing it to reach levels that support robust economic activity. As in previous years the FY16 fiscal outturn differed markedly from the original budget, with underperformance for both revenue and

[2] The fiscal year ends in June.

spending netting a deficit of 3½ percent of GDP compared to the budgeted 5 percent. A similar trend continued in FY17, with both revenues and spending growing less than budgeted. Public debt has been stable, at around 33 percent of GDP.

OUTLOOK AND RISKS

9. Outlook. The macroeconomic situation is likely to remain broadly stable in FY17. Output growth is expected to be robust at around 6¾ percent. Inflation, following a decline to its lowest level in five years, is projected to increase somewhat as global commodity prices pick up. However, with moderate money and credit growth, stable inflation expectations, and temperate private wage growth, inflation is projected to remain close to the Bangladesh Bank's target. Over the medium-term, growth of 7 percent per year is achievable, but only with an increase in public and private investment and reforms that underpin capital market development and improve investment efficiency. Without these, growth is likely to fall off considerably—if investment levels stay as they are and capital markets remain underdeveloped, medium-term growth could fall to as low as 5 percent. If investment does increase in line with the high-growth scenario, investment-related imports would be expected to push the current account into a modest but manageable deficit.

10. Risks.[3] The main downside risks to the outlook are a resumption of political unrest as the next election cycle approaches, a rise in extremism, a further deterioration in the security situation affecting confidence and investment, a protracted slowdown in key export markets (particularly the EU), and a further weakening of remittances (Box 1). A sustained appreciation of the U.S. dollar could require adjustments to the nominal exchange rate to avoid harming export competitiveness. Excess liquidity in the banking sector presents a latent risk to macroeconomic stability (below). At the same time export demand and remittances could surprise on the upside.

11. Authorities' views. The authorities broadly agreed with the thrust of the staff's outlook. However, they saw the FY17 growth reaching 7.2 percent, somewhat higher than the staff's projection. Looking ahead, they foresee a stable environment in the run up to the elections and no threat of political instability in the near to medium term. They argued that the reform initiatives to improve the business climate and address the infrastructure bottlenecks should boost productivity and potential growth. The Bangladesh Bank agreed that the projected increase in global commodity prices will exert upward pressure on prices, but still saw domestic inflation staying within the Bank's projection. The authorities shared staff's concern about the potential impact on growth and the balance of payments of weaker remittances, but argued that much of the slowdown is likely to be a result of measurement gaps related to a shift away from banking toward informal channels for transferring funds.

[3] Risk Assessment Matrix, Annex I.

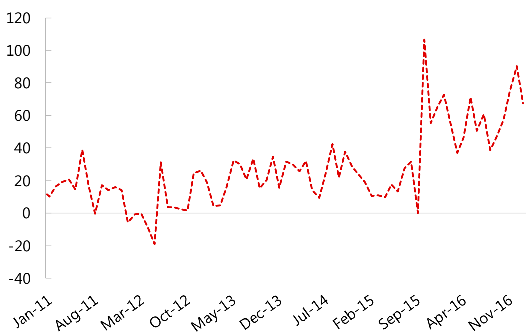
MACROECONOMIC POLICY MANAGEMENT

A. Near-term Policies

12. Monetary policy. The Bangladesh Bank operates a quantity-based policy regime, aiming to keep broad money growth in line with its inflation objective. At the same time, a relatively closed capital account allows the Bank to maintain a managed peg to the U.S. dollar.[4] So far, both external and internal balances have been achieved—inflation has stabilized in the 6–7 percent range, credit growth has reached levels sufficient to support economic activity, broad money is in line with the Bank's target, and the exchange rate has been consistent with maintaining competitiveness and rebuilding reserve buffers.

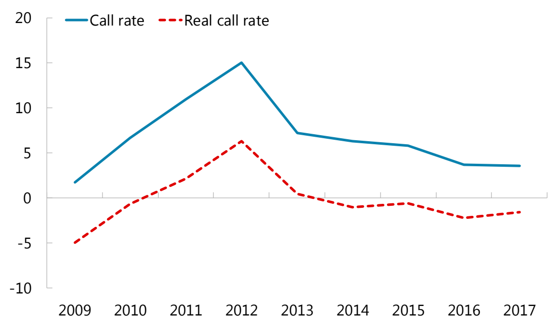
13. Credit risks. At the same time, the Bank has taken a passive approach to domestic liquidity management—preferring to minimize the losses from open market operations when possible, the Bank has been sterilizing only part of the liquidity from the external inflows.[5] This has kept market interest rates low and short-term real rates negative for some time. The concern is that the sustained low interest rate environment might be encouraging banks to take excessive risks and loosen lending standards, and could lead to an unsustainable credit boom as in 2011. The Bank should increase its sterilization efforts now through open market operations to contain financial sector risks and to head off a more abrupt and disruptive tightening which might be needed down the road. The fiscal costs of sterilization are a necessary result of good monetary and exchange rate policy, and the Bank would need to be able to focus on carrying out this policy without concern for its balance sheet.

Excess Reserves
(Billions of Taka)



Sources: Bangladesh Bank, Staff Calculation

Interest Rates
(Percent)



Sources: Bangladesh Bank, staff calculation

14. Fiscal policy. With monetary policy better placed to address short-run fluctuations in aggregate demand, fiscal policy should continue to be oriented toward keeping the public debt ratio broadly stable. This year's budget deficit target of 5 percent of GDP is consistent with this principle, with moderate public debt and good medium-term growth prospects giving scope for some

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[4] Bangladesh's de jure exchange rate regime is a float, but is classified as a "stabilized arrangement" by the IMF.

[5] A shortage of Treasury bills and bonds (for reasons discussed below) has resulted in the Bank needing to sterilize using its own instruments and bear the costs on its balance sheet.

cautious deficit spending. As in previous years however, the budget is based on overly ambitious projections for revenue growth and correspondingly ambitious capital spending targets, with the realized shortfalls for both likely to offset each other to some extent.[6] This together with the large deviation in last year's outturn from that planned in the budget shows that the scope to improve the credibility of the budgeting process remains large. The public debt-to-GDP ratio is projected to increase but remain below 40 percent of GDP. This favorable debt outlook is sensitive to the assumption of continued robust growth and revenue gains from the upcoming VAT launch.

15. Authorities' views. The Bangladesh Bank stressed that the current policy stance is consistent with its inflation objective, as broad money and credit growth are within the Bank's targets. They acknowledged that domestic liquidity from less-than-full sterilization of external inflows has kept has kept interbank market rates low, but emphasized that they are watching closely for incipient inflationary pressures. They noted that the liquidity has been declining in recent months as credit growth has picked up and the current account surplus eased. The Bank stressed its readiness to adjust its policy and liquidity management using the necessary tools as credit growth picks up further and approaches the ceiling set in their monetary program. On fiscal policy, the authorities agreed that the budget should be focused on maintaining the public debt broadly stable, and that monetary policy is better suited for short-term cyclical management.

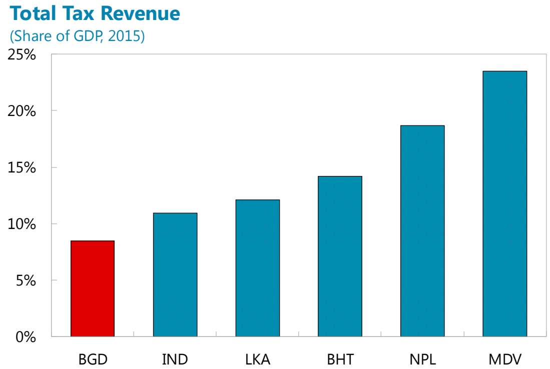
B. Macroeconomic Policy Reforms

16. The monetary and exchange rate policy framework. The current framework—broad money targets and a managed exchange rate peg—has worked well but is not suitable for a middle-income country with a more developed financial sector and globally integrated economy. A price-based framework—interest rate targeting and a more market-based exchange rate—would allow a more agile response to changing domestic and external circumstances. The transition to such a framework will take time and require certain pre-conditions to be met, but preparatory steps can include deepening the foreign exchange market by phasing out any remaining surrender requirements and allowing more two-way exchange rate movements to incentivize hedging. The Bangladesh Bank could also begin using its repo/reverse-repo interest rate corridor more actively to enhance its signaling powers and speed the transmission of policy changes.

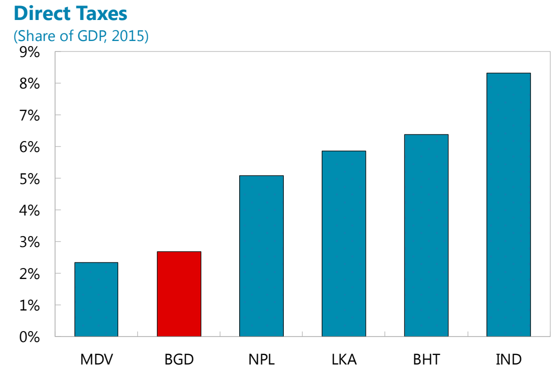
17. Fiscal sustainability and revenue mobilization. Prudent fiscal policy has kept public debt moderate. But raising public investment and social spending to levels consistent with the government's growth ambitions without compromising fiscal sustainability will require boosting Bangladesh's low budget revenue and modernizing the tax system. The new VAT will be central to this effort, and a successful launch in July 2017 would be an important signal that the government is determined to persevere with needed structural reforms. But beyond its direct revenue benefits (estimated at 1 percent of GDP per year), the law will also improve compliance and reduce tax

[6] Historically, the government has submitted budgets that purposefully overstate the likely revenue and capital spending outturns for political economy reasons, a practice discouraged by the Fund in surveillance and technical assistance.

evasion across the board, and serve as a key building block for future tax policy reforms.[7] As a next step, there is considerable scope to broaden the direct tax base through a modern Direct Tax Code.



Sources: Government Finance Statistics (GFS)



Sources: Government Finance Statistics (GFS)

18. Improving budget practices. Budget transparency and credibility will become much more important as Bangladesh moves into middle-income status and begins to access external capital markets.[8] At present the government conducts many operations whose costs are not reflected as budget primary expenditure but are often hidden or borne by other non-fiscal agents. These include state-owned enterprise losses, policy-based lending by state-owned commercial banks, and subsidies to retirees' savings. Where possible these should be transformed into explicit fiscal expenditures and reflected on-budget through a more comprehensive reporting of fiscal operations outside the central government. Finally, better transparency would call for consolidating extra-budgetary funds and bringing them into the formal budget net.

19. Authorities' views. The authorities agreed that there is scope for macroeconomic policy-making institutions to be overhauled to match the country's transition toward becoming a middle-income economy. The Bangladesh Bank agreed that with increasing external integration of the economy, the monetary policy framework should shift from targeting monetary aggregates to interest rate targeting, and is actively studying how to make the transition. The authorities observed that the pre-conditions include a more developed capital market to improve the monetary transmission mechanism. They agreed that there is scope for deepening and broadening the interbank foreign exchange market to make room for increased flexibility. The authorities recognized the need for raising the country's low revenue to meet the government's spending needs while keeping public debt relatively modest. They reiterated their commitment to the VAT rollout on July 1, 2017, and noted that the timetable for putting in place the technical preconditions for the rollout is on schedule. The authorities also see a scope for future reforms of the direct tax system. On budget execution, the authorities noted that for political economy reasons budget plans in

[7] The effort to improve tax policies is being accompanied by tax administration reforms. Bangladesh is the first country in the South Asia region to undergo the Tax Administration Diagnostic Assessment (TADAT). A TADAT Performance Assessment Report is expected to identify priorities and guide future efforts to improve tax administration.

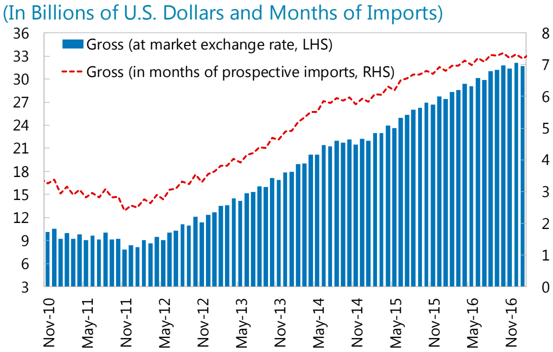
[8] Significant work has been done by the World Bank and the IMF to strengthen public sector transparency, including the 2015 Public Expenditure Review and technical assistance on Strengthening the Budget Formulation Process.

Bangladesh need to be drawn ambitiously, but stressed that in any case there will always be some deviation in execution from the planned budget target.

MAINTAINING EXTERNAL RESILIENCE

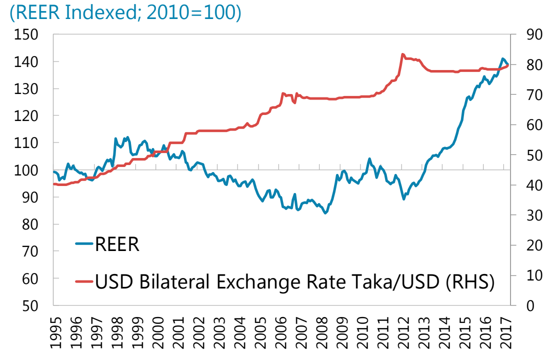
20. Developments. Rapid growth in garment exports and remittances, nearly two-thirds of which originate in the Gulf countries (Box 1 and Annex II), have dominated the balance of payments over the last several years restoring reserves to around seven months of imports. The accompanying productivity growth has also allowed for significant appreciation of the real exchange rate (over 25 percent since 2013 or 6½ percent since the last Article IV Consultation).

International Reserves
(In Billions of U.S. Dollars and Months of Imports)



Source: Bangladesh Bank

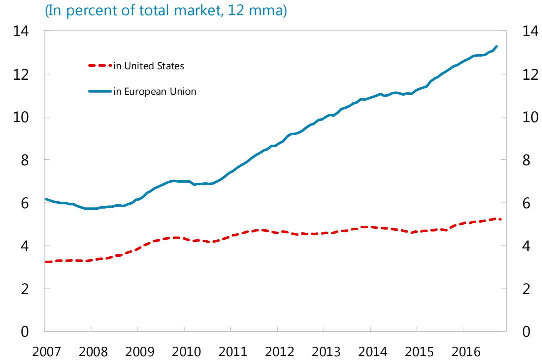
Bangladesh: Exchange Rates
(REER Indexed; 2010=100)



Source: IMF, *Information Notice System* database.

21. Prospects. Despite the real appreciation, Bangladesh's external position remains strong as reflected in adequate reserve levels and current account surpluses. A steady global market share suggests that the country's exports remain competitive.[9] At the current real exchange rate the current account is forecast to decline to a deficit of about 2 percent of GDP over the medium term on the back of higher investment-related imports and moderate remittances inflows.

Shares in Garments Markets
(In percent of total market, 12 mma)



Source: Bangladesh Export Statistics

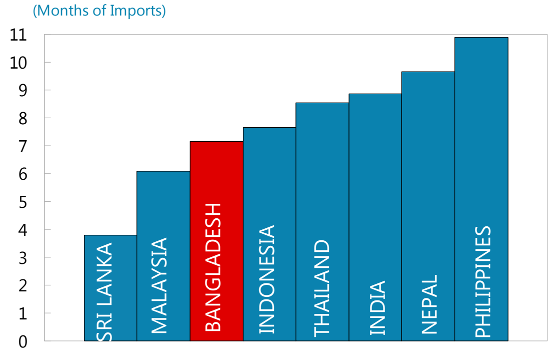
22. Exchange rate management and reserve adequacy. The Bangladesh economy will continue to rely on exports and remittances for growth and remain exposed to global uncertainties and external shocks. It is therefore essential that exchange rate management maintains the country's foreign exchange reserves sufficient to ensure the economy's resilience. Under the baseline scenario the weaker current account will reduce reserve coverage somewhat but stabilize it at a still-adequate level exceeding five months of imports (Annex III). But even modestly weaker-than-projected remittances growth, export demand, or commodity

[9] The External Sector Assessment, based in part on the EBA-lite exercise, has Bangladesh's external position as "moderately stronger than implied by fundamentals and desirable policies" (Annex V). However, poor data quality and the unusually important role of remittances complicates comparisons with other countries, making it difficult to draw conclusions from econometric estimates of current account norms and equilibrium exchange rate levels.

prices could reduce coverage considerably. This calls for the Bangladesh Bank to continue its flexible approach to exchange rate management, actively allowing the level of the nominal rate to adjust—as it has recently—as needed to preserve reserve buffers. More generally, the exchange rate should be the main tool to buffer the domestic economy against sustained external shocks, both positive and negative. If the current account prospects were to turn out stronger than expected for reasons that could be persistent, such as greater-than-expected export demand or remittance inflows, the nominal exchange rate should be allowed to appreciate. But if foreign exchange inflows are the result of temporary shocks, the Bank would be justified in intervening to maintain the nominal peg.

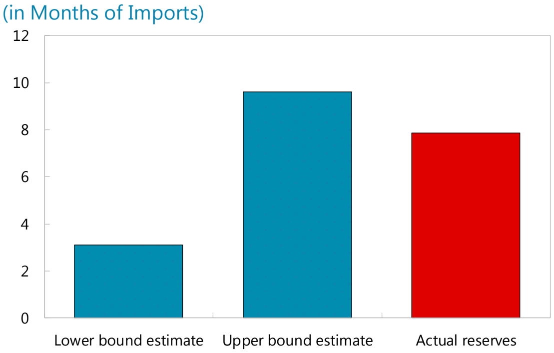
23. Impact of a sovereign wealth fund. The Cabinet recently approved a proposal to create a "sovereign wealth fund" that would make the central bank's reserves available to finance large infrastructure investment projects. The fund would be allocated $2 billion in foreign exchange per year for a maximum allocation of $10 billion (out of $32 billion in total reserves). The government is in the early stages of its thinking and few concrete details of the fund and guidelines on how it would operate have been made public. If this fund were to be launched, care should be taken in its design and execution to prevent it from encumbering reserves in a way that could harm external resilience or hamper the country's ability to tap global capital markets when called for in the future.

Gross Reserves
(Months of Imports)



Sources: WEO and Staff Calculations

Reserve Adequacy Assessment
(in Months of Imports)



Sources: Bangladesh Bank and IMF Staff Calculations (Based on ARA CC Methodology)

24. Authorities' views. The authorities agreed that Bangladesh's external position remains strong, though they acknowledged that the large dependence on remittances is a source of concern. The Bangladesh Bank stressed that their foreign exchange policy allows sufficient flexibility to have the rate adjust as needed, and the Bank will continue managing the rate to smooth out large temporary fluctuations. They emphasized that the Taka has been for some months now steadily depreciating against the dollar reflecting market forces and the balance of payments developments.

MACRO-FINANCIAL STRUCTURAL REFORMS

A. Banking Sector

25. Reforms. Banking sector performance—based on indictors of profitability, capital adequacy, and non-performing loans—differs significantly between private and state-owned banks (table), suggesting scope to strengthen oversight and limit risks for the sector as a whole. Reforms should focus on further improving supervision, containing risks from loan concentration and banks' exposure to capital markets, and improving the legal and financial framework for loan recovery.

		2013	**2014**	**2015**	**December 2016**
Capital Adequacy	SCBs	10.8	8.3	6.4	5.9
Ratio	Private	12.6	12.5	12.4	12.4
Nonperforming	SCBs	19.8	22.2	21.5	25.1
loans	Private	4.5	5	4.9	4.6
Return on assets	SCBs	0.6	-0.6	-0.04	-0.2
	Private	1	1	1	1

26. State-owned commercial banks represent about a quarter of total banking system assets and continue to suffer balance sheet weaknesses. These weaknesses are largely the legacy of loans made to large borrowers who lack the incentive to repay, and limitations in the legal system which hamper the banks' ability to recover these loans. This keeps their non-performing loan ratios high, with the more recent increases reflecting in part improvements in enforcing loan classification and the reclassification of previously restructured loans. These banks are also tasked with carrying out public policy initiatives which have sway over many of their lending decisions. An implicit government guarantee on their deposits keeps them highly liquid and limits their threat to financial stability, but their operations could lead to growing quasi-fiscal losses and are an impediment to modernizing the financial sector. The government's reform strategy to address the banks' losses and improve operations entails improved governance, gradual recapitalization, credit growth limits, and automated financial reporting. To ensure the success of this strategy the government could also introduce legal and regulatory changes to streamline loan recovery, eliminate government influence over lending decisions, and improve incentives for the banks to operate on a commercial basis.

27. Authorities' views. The authorities reiterated their commitment to improve the performance of the state-owned commercial banks, and expected that the coordinated efforts between the banks, the Bangladesh Bank, and the Ministry of Finance to hold the banks to agreed-upon performance criteria will yield results. The Bangladesh Bank emphasized that they will continue to hold the state banks to the same regulatory standard as private commercial banks. The authorities recognized the need to streamline the legal framework for loan recovery given the longstanding non-performing loans and noted that proposals to that effect are being considered, including modifications to the Bank Companies Act. At the same time, they noted that state banks will continue to play an important public policy role by financing certain priority infrastructure projects and improving access to financial services through their extensive branch network.

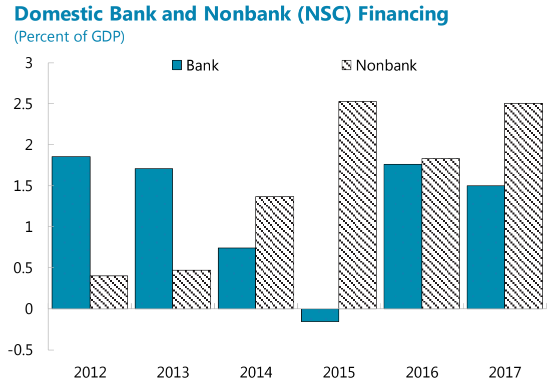
B. Developing Capital Markets

28. Intermediation. Bangladesh's investment needs are large—staff analysis suggests that maintaining growth at its historical pace will require a significant increase in private investment. While there is scope for FDI to play a role, most investments will need to be financed domestically. This will require stepping up intermediation of the country's underutilized pool of savings over longer horizons, where at present firms finance their investments almost fully from their own retained earnings (Box 2). As commercial banks' ability to carry out this function will remain limited, developing capital markets for financing long-term private investment would greatly improve future long-term growth prospects by both by increasing the level of investment and aiding the efficient intermediation of savings (Annex IV).

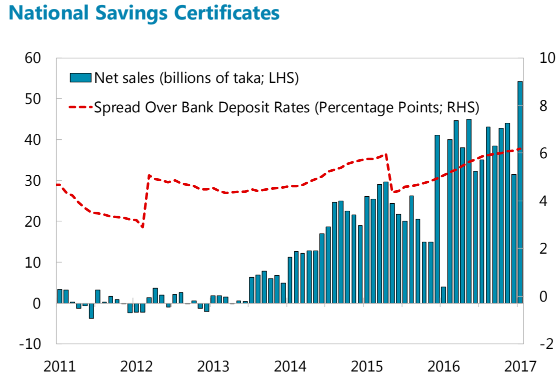
29. Reform efforts. Following the 2011 stock market crisis, the government formulated its Capital Market Development Master Plan that aimed to address institutional weaknesses in the equity market, create an environment fostering new products such as corporate bonds, asset-backed securities, and derivatives, and expand institutional investors to include mutual funds, insurance companies, and pension funds. The government has made progress in some areas, particularly in improving the function and regulation of equity markets. But much remains to be done (Annex IV): the rules and regulations pertaining to capital markets including addressing the slow court system could be strengthened, tax distortions and legal impediments to corporate bond issuance can be eliminated, and coordination among regulatory bodies can be further improved.

30. Preparatory steps. International experience shows that the development of capital markets is a gradual and interactive process, requiring a wide range of coordinated reform efforts across multiple legal, regulatory, and institutional fronts. In particular the economic and legal structure of the country needs to be sufficiently developed before investments in market infrastructure can be expected to pay off (Annex IV). But instruments for long-term intermediation will not evolve without a deep and liquid government bond market that provides a risk-free yield curve benchmark against which the market can price corporate bonds. This in turn requires a clear government bond issuance strategy and debt management framework so that investors can anticipate a reliable supply of fixed-income securities.

31. Budget financing impediments to capital market development. An important and growing impediment to the Ministry of Finance's ability to implement its annual borrowing plan is the approach the government currently takes in financing the budget deficit. The budget has been and will continue to be financed mainly domestically with external financing relatively stable at around 1 percent of GDP. Currently, part of domestic financing is from banks' purchase of treasury bills and bonds. However, non-bank borrowing with what are known as National Saving Certificates (NSCs) has sharply accelerated in recent years and continues to grow (Box 3). Higher-than-budgeted borrowing through NSCs limits the issuance of treasury bills and bonds, preventing the development of a deep and liquid market for government securities needed for capital markets to develop. It also locks up in subsidized instruments a large share of long-term savings which would otherwise be channeled into institutional investor funds.



Sources: Bangladesh Bank, staff calculation



Sources: Bangladesh Bank

32. Other implications. The dominance of the NSC system has many other drawbacks:

- *Cost*. Interest paid on NSCs amounts to about 1 percent of GDP. Given the significantly higher NSC interest rates, the outstanding stock of NSCs issued has already raised the total cost of budget borrowing by an estimated ¼–½ percent of GDP annually, and these costs continue to rise.

- *Liquidity*. Complicates banks' liquidity management by limiting the supply of liquid and safe government securities available for banks to meet their regulatory requirements.

- *Hamstrings the conduct of monetary policy*. With the central bank's operational independence constrained by its need to limit losses on its balance sheet, the prevalence of NSCs can distort monetary policy. For example, the shortage of government securities is a key reason sterilization costs are borne by the central bank.

- *Reduces the effectiveness of monetary policy*. Unlike for government bonds, the absence of a secondary market for NSCs—which force savers to commit their funds for 3–5 years (or face a penalty)—prevents the timely and efficient adjustment of intermediation in response to evolving economic circumstances and slows the transmission of monetary policy changes.

33. Policy recommendations. Addressing these drawbacks would require significantly reducing the budget's reliance on NSCs and gradually phasing out the outstanding stock, replacing it by increasing the issuance of treasury bonds and bills. An effective way to accomplish this would be to dampen household demand for NSCs' by lowering their interest subsidy. Regardless, a mechanism could be considered that automatically links NSC rates to market rates (as has been done for India). The authorities could also consider whether there are more targeted and less costly alternatives to the NSC system—such as expanding the social safety net and reflecting the costs on-budget—that achieve the government's social policy goals without distorting financial markets, hindering monetary policy, and impeding capital market development. Further steps to develop a deep and well-functioning government bond market will be needed, starting with the execution of a reliable government borrowing and debt management strategy and the development of a base of domestic institutional investors. Improving budget planning and monitoring to increase the predictability of the government's cash flow needs would be an integral part of this strategy.

34. Authorities' views. The authorities shared staff's assessment of the importance of developing a stable and well-functioning capital market and noted the progress in carrying out aspects of the government's Capital Market Development Master Plan, particularly in improving the regulation and supervision of the stock market. To minimize the risk of excessive stock market valuations, the authorities emphasized that banks need to improve monitoring of how their loans are used to ensure that these are not diverted from their stated purposes toward stock market share purchases. The Bangladesh Bank has tightened the monitoring of banks to ensure that the statutory limits on exposure to the stock market are observed. The authorities emphasized that NSCs are playing an important social role by providing support to vulnerable segments of the population in the absence of unemployment insurance and wide pension coverage, and eliminating NSCs outright would not be a viable option now. At the same they recognized that excessive reliance on NSCs for budget financing not only impedes capital market development but also hampers monetary policy management. They conceded that the NSCs are currently poorly targeted and misuse of the system is increasing. To combat this, they are working on proposals that would improve monitoring to better understand who is benefiting from NSCs. They are also considering options for aligning NSCs rates with market interest rates, and are open to reviewing the eligibility criteria and limits on purchases of NSCs.

OTHER ISSUES

35. Bangladesh has made some progress in strengthening the anti-money laundering and counter-terrorism financing but gaps remain. The Asia/Pacific Group on Money Laundering (APG) completed its assessment of Bangladesh' anti-money laundering and counter-terrorist financing (AML/CFT) system. The assessment is a comprehensive review of the effectiveness of Bangladesh' AML/CFT system and its level of compliance with the FATF Recommendations. The report was formally adopted by at the APG Annual Meeting in September 2016. Bangladesh has made significant progress since the last Mutual Evaluation Report in 2009, reflecting political commitment and leadership on AML/CFT. But much work is still needed for the framework to be effective at preventing the laundering of proceeds from corruption and other crimes, and to assist in preventing the financing of terrorism. The authorities are preparing an action plan to address the shortcomings.

36. Safeguards assessment. The 2011 update safeguards assessment found that the governance and legal structure needs to be undated to strengthen autonomy and thus better safeguard resources. Since then the Bangladesh Bank has implemented a number of key recommendations and continued the efforts in modernizing its internal audit function. The FY16 financial statements have been audited by the two local firms that are members of the global network of independent audit firms, and have provided unqualified (clean) audit reports with emphasis of matter paragraph where management explains why it believes funds paid out through unauthorized transactions in February 2016 are recoverable. The Bank's audit committee was reestablished in April 2017.

STAFF APPRAISAL

37. Steady monetary policy management and fiscal discipline have strengthened macroeconomic stability, allowing the economy to benefit from favorable external demand, high remittances, and low commodity prices. The result has been strong output growth, falling inflation, moderate public debt, and a rebuilding of external resilience. This solid macroeconomic performance is set to continue this year, with growth projected to remain close to current levels and inflation broadly in line with Bangladesh Bank's target.

38. Looking ahead, maintaining the economy's past growth performance will become increasingly challenging over the medium term, and will require upgrading the macroeconomic policy-making practices and institutions to support the country's ambition to reach middle-income status.

39. The near-term growth outlook is subject to risks. These include a resumption of political unrest, security concerns affecting confidence and investment, a protracted slowdown in key export markets, and weaker remittances. The Bangladesh Bank should increase its efforts to mop up excess liquidity in the banking sector which could be increasing financial sector risks and poses a latent risk to macroeconomic stability.

40. The monetary policy stance should be adjusted as needed to keep inflation broadly stable. Broad money and credit growth are currently consistent with this objective, but the Bangladesh Bank should be prepared to tighten its stance if credit growth begins to accelerate.

41. It is essential to preserve foreign exchange reserves buffers to ensure resilience, as the economy will continue to rely on exports and remittances for growth. The exchange rate should continue to be managed flexibly as needed to accomplish this.

42. Modernizing the tax system will be needed to boost Bangladesh's low budget revenue and allow room for public investment and social spending to increase to levels consistent with the government's growth ambitions without compromising fiscal sustainability. Launching the new VAT in July 2017 as planned will be central to this effort.

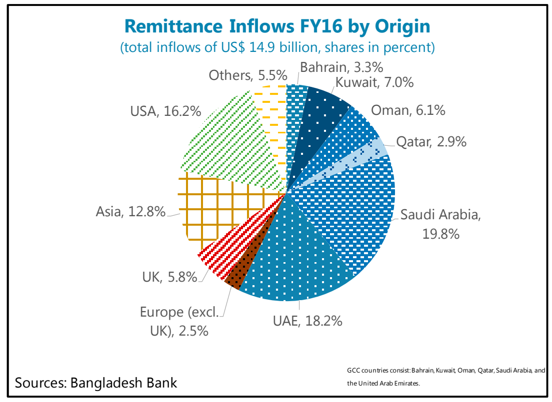
43. Bangladesh's investment needs are large, and will require stepping up intermediation of the country's underutilized pool of savings over longer horizons. As commercial banks' ability to carry out this function will remain limited, policies that develop the country's capital markets for financing long-term private investment would greatly improve future growth prospects.

44. An important impediment to modernizing the financial sector arises from the increasing reliance on high-cost National Savings Certificates as a financing vehicle for the government budget, which prevents the development of a deep and liquid market for government securities. Consideration could be given to better targeted and less costly alternatives that achieve the government's social policy goals without distorting financial markets.

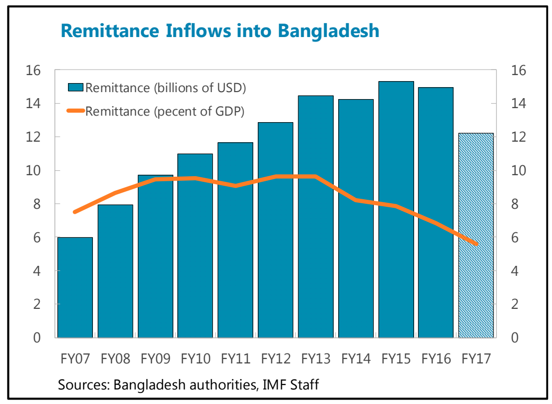
45. Staff recommends that the next Article IV consultation be held on the standard 12-month cycle.

Box 1. The Rise and Fall of Remittances to Bangladesh

Remittance inflows into Bangladesh have more than doubled from $6 billion to $15 billion over the last ten years (compared to goods exports of $33 billion). Over the same period, remittances accounted for 8½ percent of GDP on average, close to eight times the foreign direct investment flow into Bangladesh. Over half of remittances come from workers in Gulf countries (GCC), particularly Saudi Arabia.

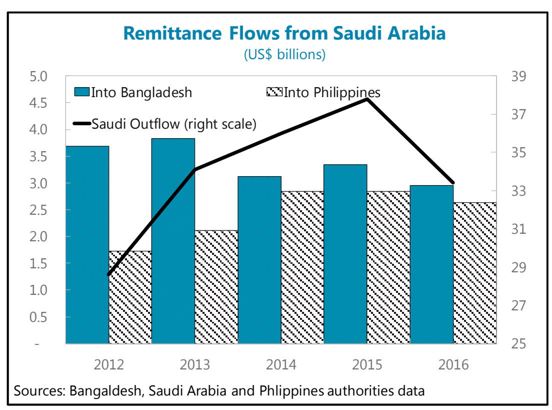


Despite this strong growth, remittances have been declining as a share of GDP over the past five years and have begun falling in absolute terms. The slowdown was the largest from the GCC countries (a 5 percent decline). Inflows are projected to drop further to just over $12 billion in 2017.



The GCC is one of the largest employers of foreign workers in the world and a major destination for South Asian migrants. Indeed, migrant workers from Bangladesh to the GCC countries have been growing steadily over the last several years. But sustained low oil prices have led to slower growth, weakening of fiscal and external positions, and a tightening of monetary and financial conditions in these countries, with government spending on major infrastructure projects seeing delays. This has likely led to less employment opportunities and higher costs of living for migrant workers, reducing their ability to save and remit income home. The slowdown has affected not only Bangladesh but also other large remittance dependent economies such as Nepal and the Philippines.

Another reason for the decline in remittances, while difficult to measure, could be related to a shift away from banking towards informal channels for transferring funds. With falling costs of transferring income from overseas and the various policy measures implemented by Bangladesh Bank over the past decade, a larger share of remittances is now transmitted through the formal sector. But informal channels continue to exist in many South Asian countries including Bangladesh and some of the decline in remittances may be explained by a possible shift by remitters to informal channels not captured in official statistics.



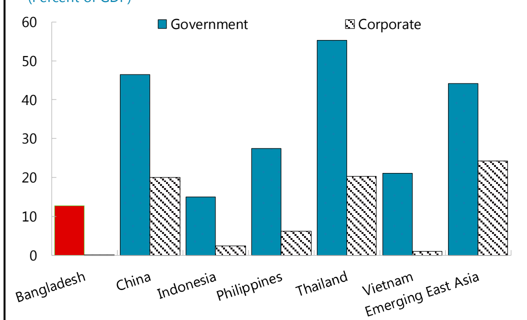
Box 2. Financing Private Investment in Bangladesh

Private investment in Bangladesh needs to increase significantly to maintain growth. The Asian Development Bank estimates that reaching the government's goal of 8 percent growth over the next 5 years would require private investment to increase from 21 percent in 2014 to 28 percent by 2020. This increase can potentially be financed from several sources—firm's own resources, FDI, bank lending, or by tapping local capital markets. FDI is currently low at about 1 percent of GDP and there is scope for an increase to fill some of the gap. But most of the increase will need to be financed domestically. Banks—currently the main agents of intermediation in Bangladesh—are not well equipped to finance the longer-term investment which is needed for growth.

	Financial Market Development	
	Index	Ranking
India	4.4	38
Indonesia	4.3	42
Cambodia	4.1	63
Sri Lanka	4	64
Nepal	3.9	73
Vietnam	3.9	78
Bhutan	3.9	79
Bangladesh	3.5	99

Source: World Economic Forum, 2016

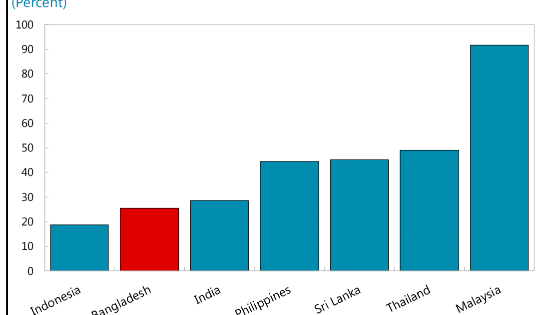
Local Currency Bond Market, 2016
(Percent of GDP)



Sources: Asian Development Bank, Bangladesh Bank

But the country's capital market remains underdeveloped (Annex IV). Relative to its peers, Bangladesh ranks bottom in terms of overall financial market development (table). At about 15 percent of GDP, Bangladesh's stock market capitalization is low even compared to other low income countries. The corporate bond market is nearly non-existent, and even the government bond market is relatively underdeveloped. Thus a large share of private investment is currently financed out of firms' retained earnings, pointing to a lack of effective intermediation—bank loans and issuance of equity and debt finance only about a quarter of private fixed capital formation, a relatively low share in the regional comparison.

Share of Investment Financed by Banks and Capital Market
(Percent)



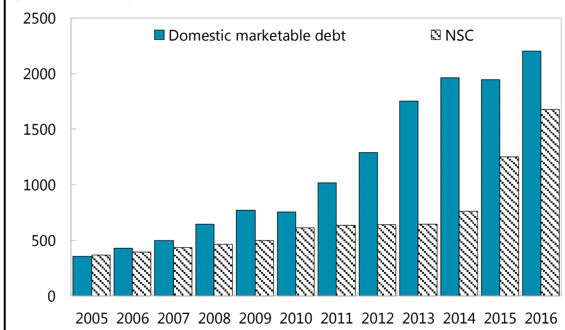
Sources: WEO Database, International Federation of Exchanges and Staff Calculation

Box 3. National Savings Certificates and Budget Financing

National Savings Certificates (NSCs) were introduced as a saving scheme for small savers when the banking system was less developed, and to provide a safety net for certain groups of population (senior citizens, women, retired government employees, non-resident Bangladeshis, and physically challenged people). To incentivize savings, NSCs pay a higher interest rate than the market rates on bank deposits and government securities with similar maturity. There are about a dozen different instruments with maturity 3–5 years, available on demand, and investors pay a penalty if they withdraw money before the end of the term. To ensure that the scheme mainly attracts small savers, a single-lender ceiling has been set at Tk3 million (about $40K). The scheme does not, however, prohibit participation of a person based on income.

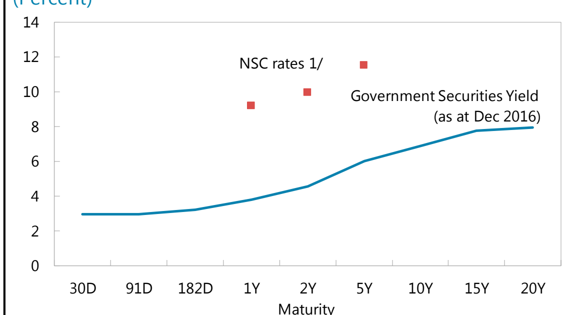
NSCs' role in financing the budget has sharply accelerated in recent years and continues to grow, with the outstanding stock of these instruments reaching over 40 percent of total domestic public debt, or nearly 10 percent of GDP. This growth can be explained by several factors. Since the issuance of NSCs is determined by public demand for these certificates and not the budget borrowing plans of the Ministry of Finance, an increase in the interest rate spread relative to deposits will increase the stock. But sporadic downward revisions of NSC rates have not kept pace with falling inflation and market interest rates, increasing NSC's implicit subsidy. This has been particularly the case in the current environment of excess liquidity and low rates paid on bank deposits. Abuse of the NSC system is also difficult to prevent, as single-lender limits are easy to circumvent.

Government Domestic Debt
(Billions Taka)



Sources: Bangladesh Bank

Government Securities, Deposit Rates and NSC Yield
(Percent)



Sources: Bangladesh Bank; Bangladesh Post Office
1/ In May 2015, NSC rates were reduced by about 2 percentage points

Figure 1. Bangladesh: Ongoing Structural Transformation

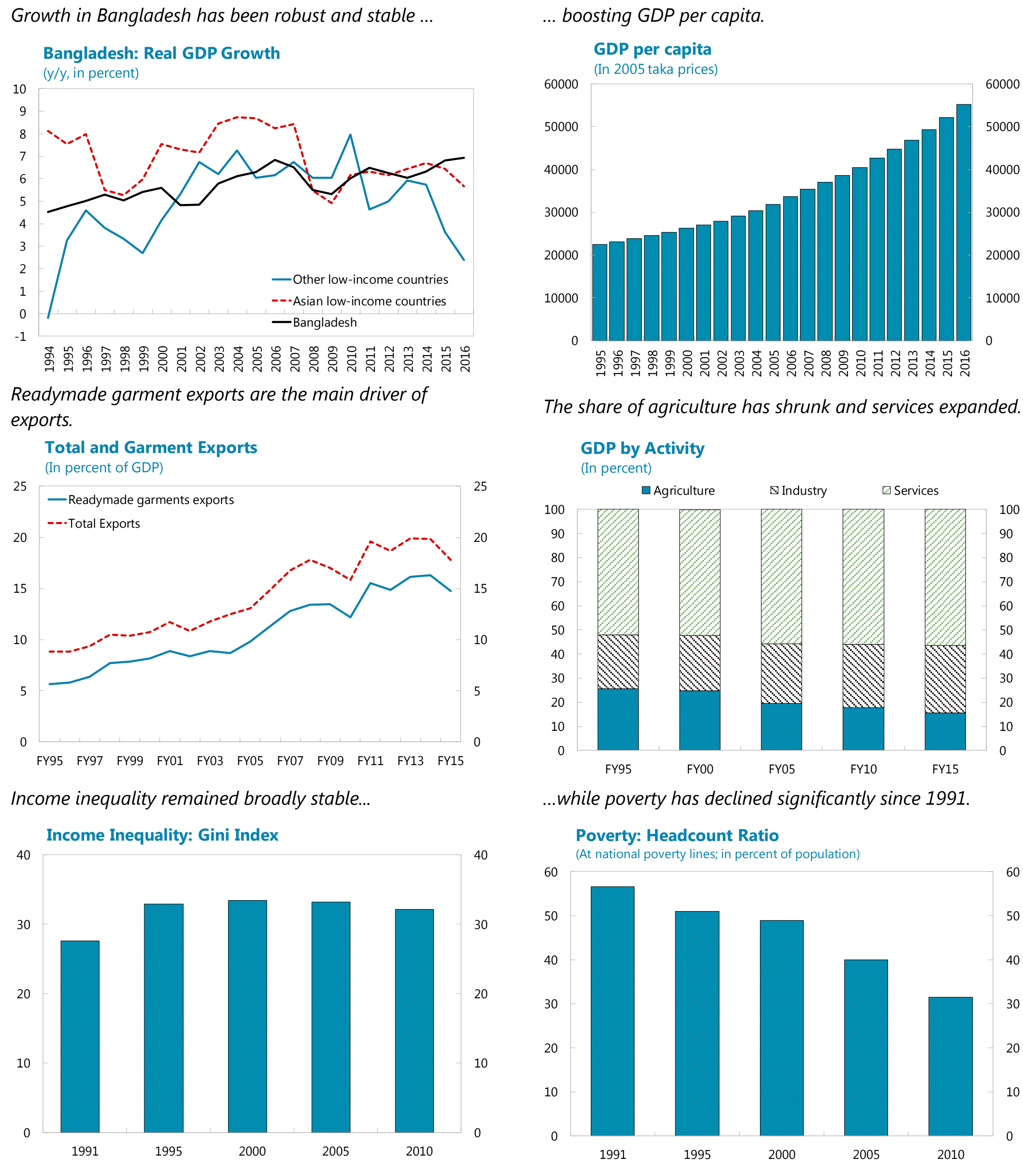
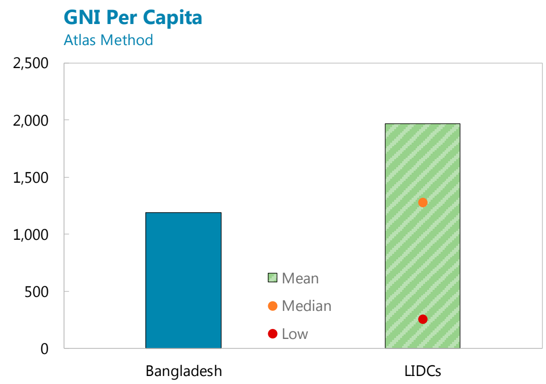


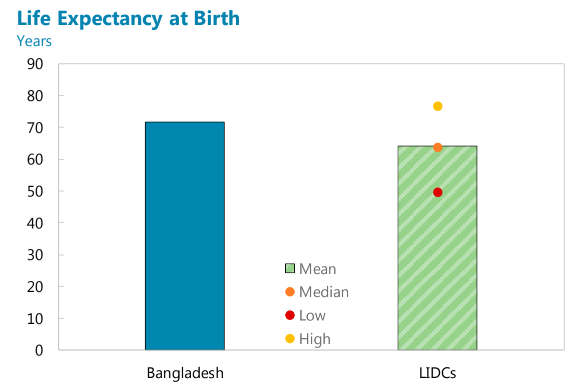
Figure 2. Bangladesh: Selected Social Indicators

While Bangladesh's income per capita is in line with the median for low-income developing countries (LIDCs)…

….the country does better than the median on a broad range of key social indicators, including life expectancy at birth…



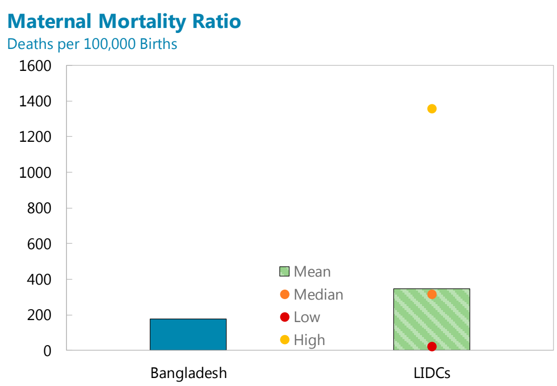
Source: WDI



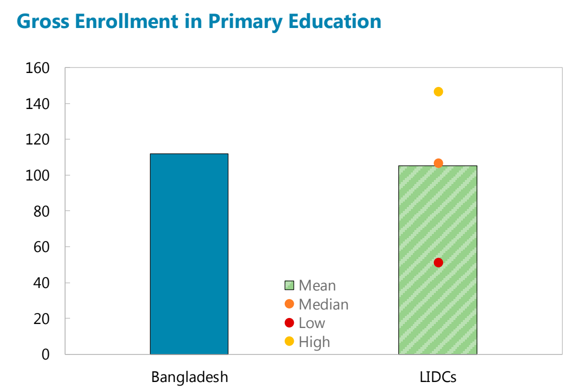
Source: WDI

…maternal mortality…

… primary school enrollment…



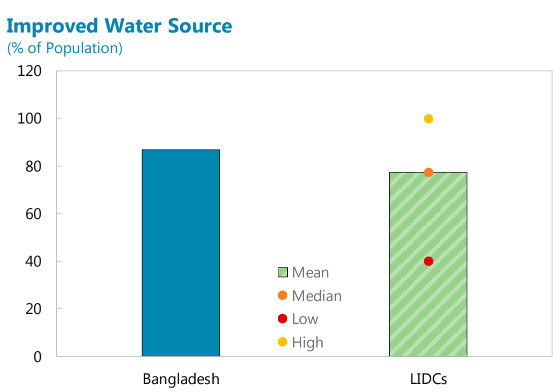
Sources: WDI



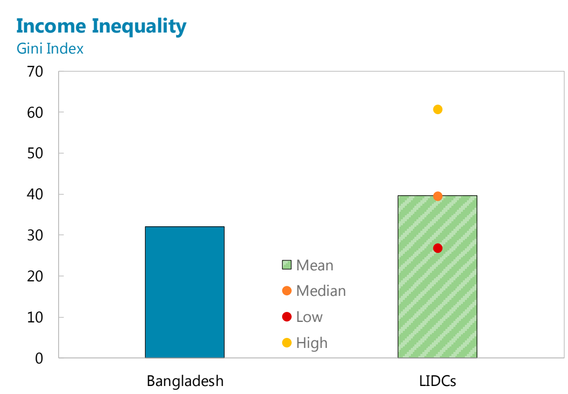
Sources: WDI

…and access to water.

Moreover, Bangladesh's income inequality is one of the lowest among LIDCs, whether measured by the Gini index or the income share of the bottom quintile.



Sources: WDI

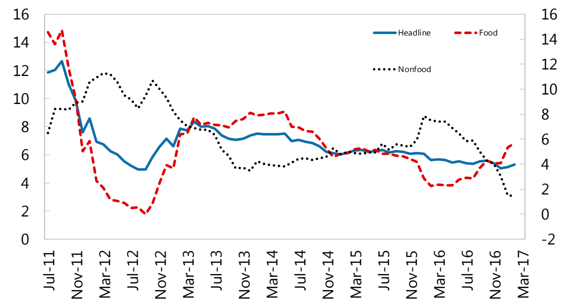


Sources: WDI

Figure 3. Bangladesh: Recent Macroeconomic Developments

Headline inflation has eased significantly …

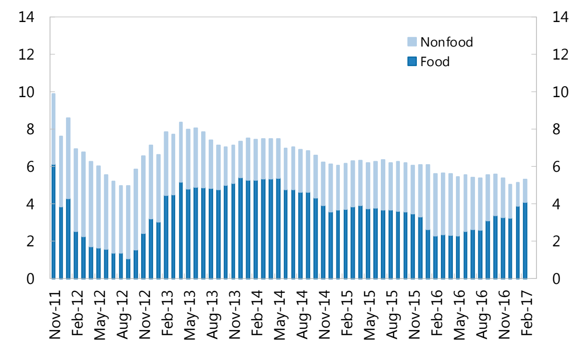
Bangladesh: Consumer Price Index,
Jul. 2011–Mar. 2017 (Year-on-year percent change)



Source: Bangladesh Bureau of Statistics.

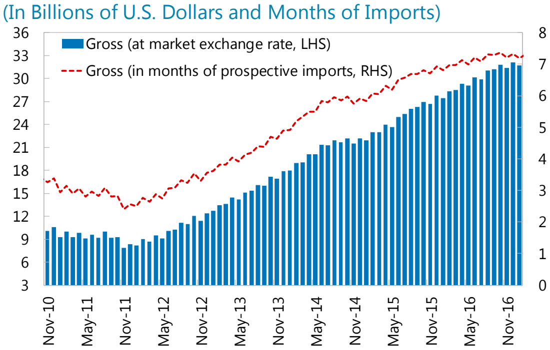
…with nonfood declining but food prices picking up slightly recently.

Contributions to Headline Inflation
(y/y, in percentage points)



Foreign exchange reserves have reached about 7 months of prospective imports.

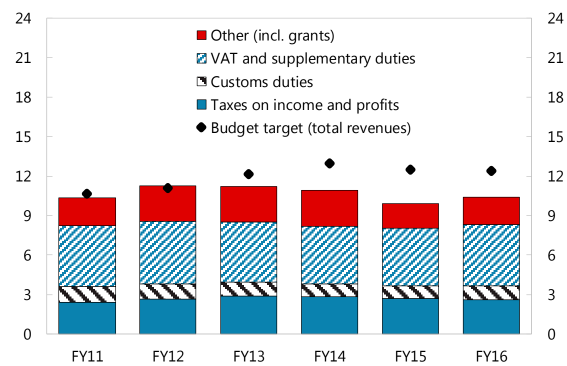
International Reserves
(In Billions of U.S. Dollars and Months of Imports)



Source: Bangladesh Bank

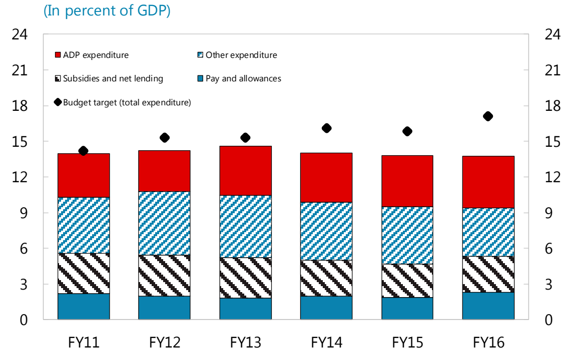
Fiscal revenues have declined and fell short of budget targets in recent years.

Central Government Revenue
(In percent of GDP)



Current expenditure have been restrained and capital spending was less than budgeted.

Central Government Expenditure
(In percent of GDP)



Source: Bangladesh Authorities and Staff Calculations

The public debt as percent of GDP has been declining steadily.

Public Debt
(In percent of GDP)

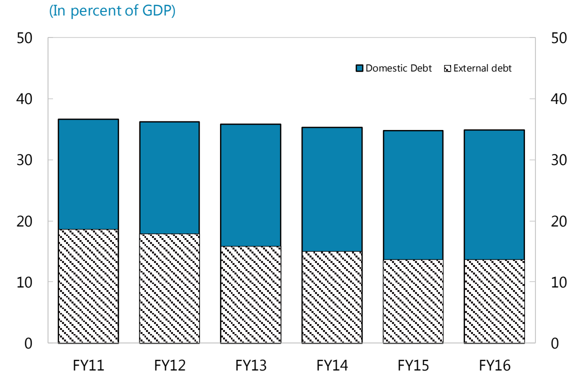
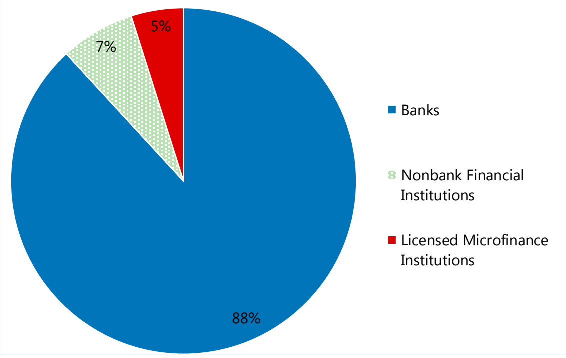


Figure 4. Bangladesh: Credit to the Private Sector

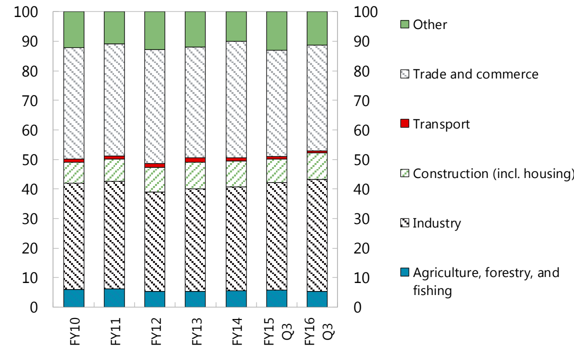
The bulk of outstanding credit is provided by banks …

Share in Loans and Advances, 2016
(In percent of total)



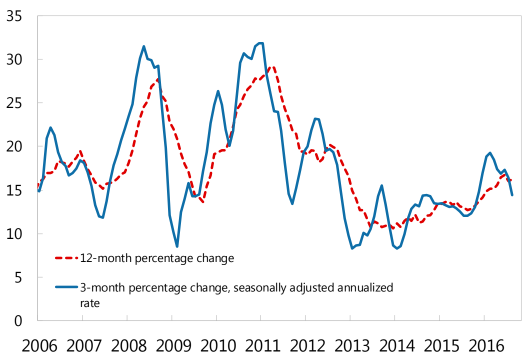
… and goes to manufacturing and services.

Share in Bank Advances by Economic Purposes
(In percent)



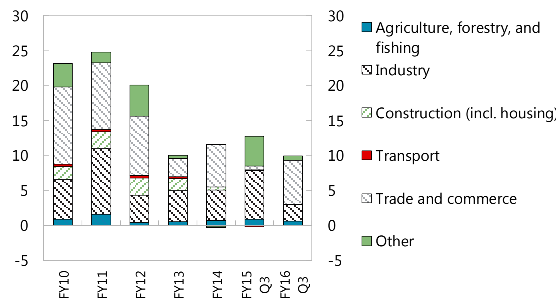
Credit to private sector picked up recently but remains moderate…

Bank Credit to Private Sector
(Percent change)



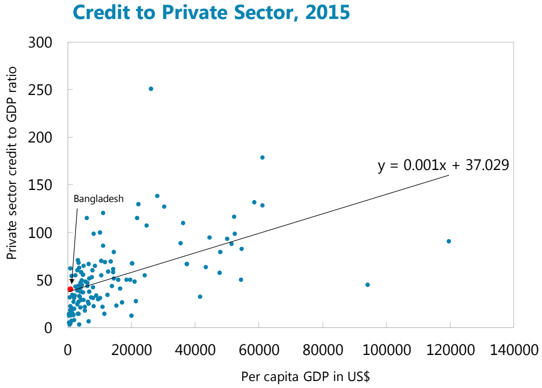
…with trade and industry receiving a significant share of loans.

Contribution to Growth in Bank Advances by Economic Purposes
(In percentage points; y/y)



Credit to private sector as percent of GDP in Bangladesh …

Credit to Private Sector, 2015



… is broadly in line with countries at similar income level.

Bangladesh: Bank Credit to Private Sector

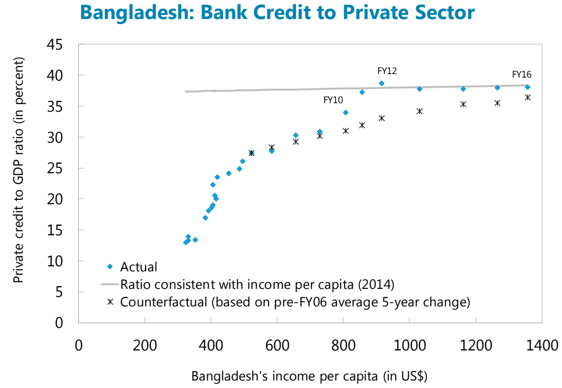
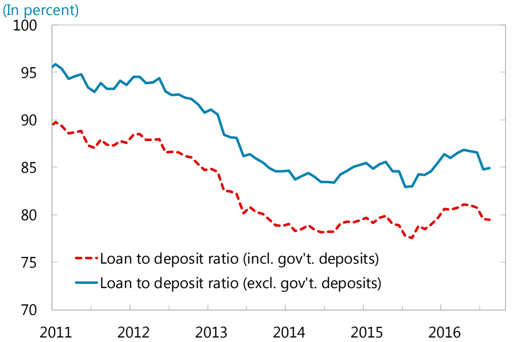


Figure 5. Bangladesh: Banking Sector Liquidity Conditions

Bank's loan/deposit ratio has remained broadly stable in recent years.

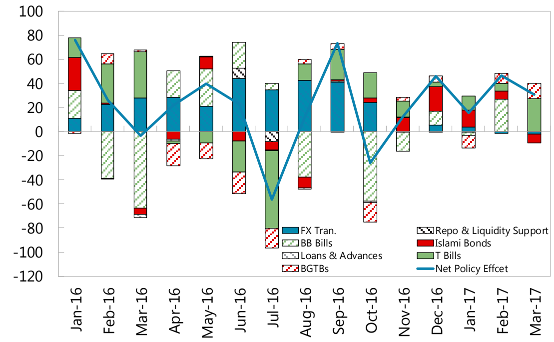
Loan-to-Deposit Ratio, Jan. 2011-Feb. 2017
(In percent)



Sources: Segoe UI - Size 18

With improved banks' liquidity, central bank liquidity support to banks has declined.

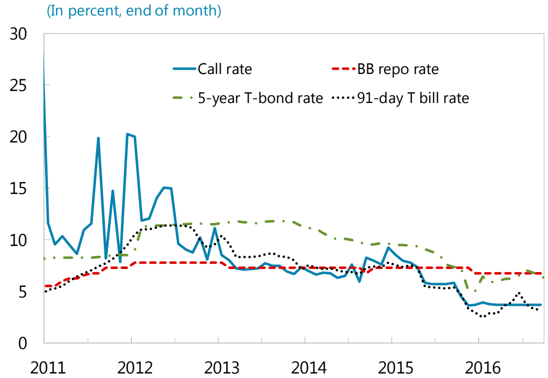
Bangladesh Bank Liquidity Operations by Instrument
(Billions of Taka)



Source: Bangladesh Bank

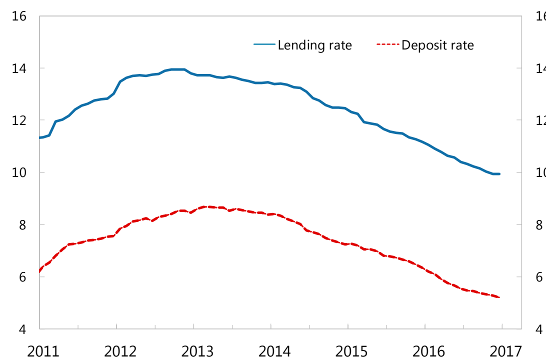
Market interest rates have eased...

Interest Rates
(In percent, end of month)



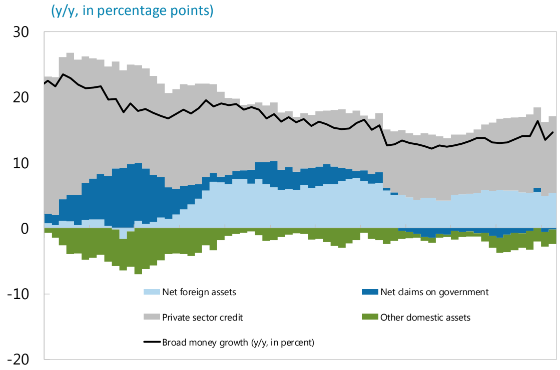
...and falling inflation and improving liquidity have pushed down banks' deposit and lending rates.

Bank Interest Rates, Jan. 2011–Dec. 2017
(In percent, end of month)



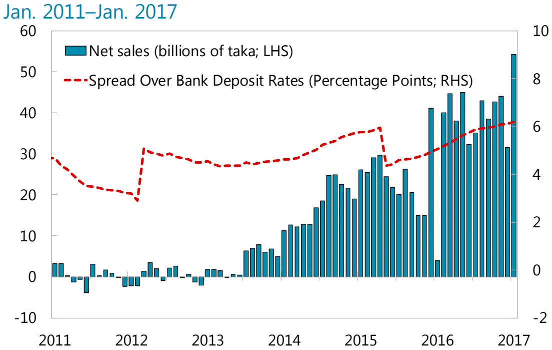
Broad money growth has been moderate and stable.

Contributions to Broad Money (M2) Growth
(y/y, in percentage points)



With falling bank deposit rates, the issuance of national savings certificates has increased.

National Savings Certificates,
Jan. 2011–Jan. 2017

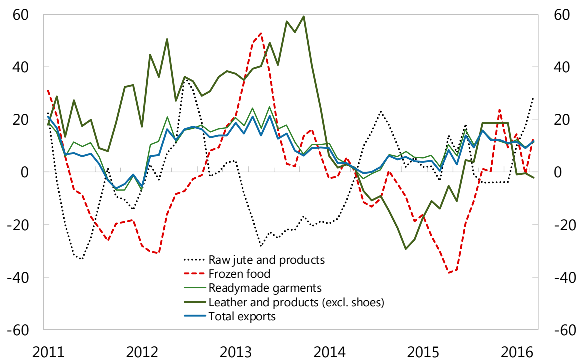


Sources: Bangladesh Bank

Figure 6. Bangladesh: External Sector Developments

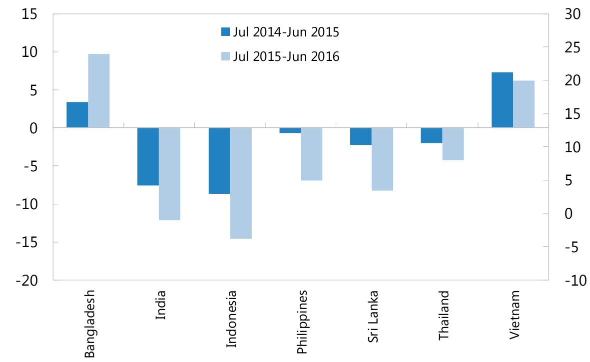
Export growth has picked up recently....

Exports by Main Commodities, Sep. 2011–Jun. 2016
(Year-on-year percent change, 3mma)



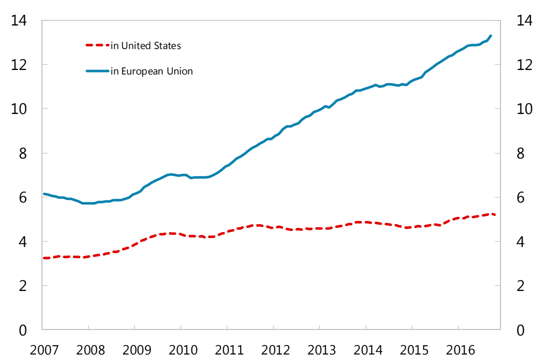
... in contrast to a slowdown in Bangladesh's regional competitors.

Selected Asia: Exports of Goods
(Year-on-year percent change)



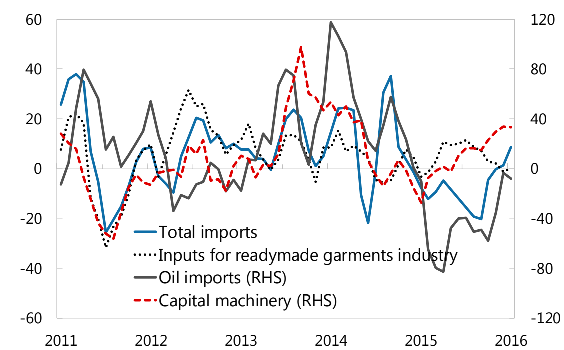
Bangladesh's garment export to the European union have been particularly strong.

Shares in Garments Markets, Jan. 2007–Dec. 2016
(In percent of total market, 12 mma)



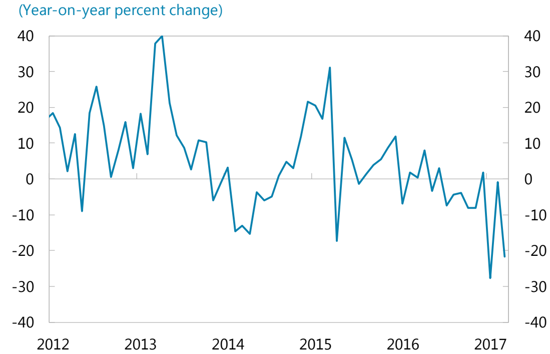
Import growth has been picking up as well.

Imports by Selected Categories, Sep. 2011–Sep 2016
(Year-on-year percent change, 3mma)



Inbound remittances have weakened notably.

Workers' Remittances, Jan. 2012– Mar. 2017
(Year-on-year percent change)



Sources: Bangladesh Bank

The current account surplus has diminished.

Current and Financial Account Balances, FY11 – FY16
(In percent of GDP)

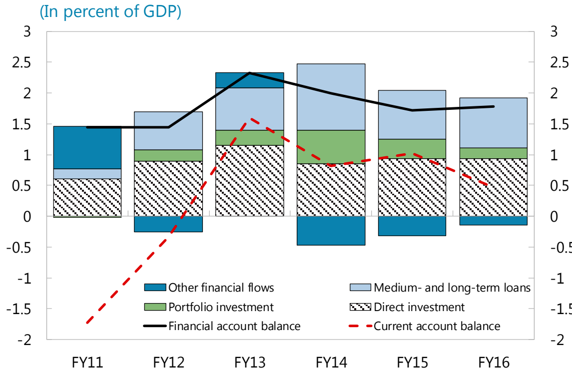


Table 1. Bangladesh: Selected Economic Indicators, FY2013–17 1/

I. Social and Demographic Indicators

Population (FY16, millions; estimate)	161	Infant mortality (2015, per thousand live births)	31
GDP per capita (FY16, U.S. dollars)	1357	Life expectancy at birth (2014, years)	72
Labor force participation rate (FY10, percent; national measure)	59	Adult literacy (2015, percent of people)	62
Poverty headcount ratio (2010, national measure, percent)	32	Population dependency ratio (2015, percent)	52
Gini index (World Bank estimate)	32	Population growth (FY16, y/y, percent; estimate)	1.3

II. Macroeconomic Indicators

	FY13	FY14	FY15	FY16	FY17
				Est.	Staff proj.
National income and prices (annual percent change)					
Real GDP	6.0	6.1	6.6	7.1	6.8
GDP deflator	7.2	5.7	5.9	6.6	7.0
CPI inflation (annual average)	6.8	7.3	6.4	5.9	6.8
CPI inflation (end of period)	8.1	7.0	6.3	5.5	6.8
Nonfood CPI inflation (end of period)	7.7	5.4	6.2	5.2	5.5
Central government operations (percent of GDP)					
Total revenue and grants	11.2	10.9	9.9	10.4	10.8
Total revenue	10.7	10.4	9.6	10.3	10.6
Tax	9.0	8.6	8.5	8.8	9.1
Nontax	1.8	1.8	1.1	1.5	1.5
Grants	0.5	0.5	0.3	0.1	0.2
Total expenditure	14.6	14.0	13.8	13.8	15.6
Current expenditure	8.3	8.2	7.8	8.3	9.4
Annual Development Program (ADP)	4.2	4.1	4.3	4.4	4.4
Other expenditures 2/	2.1	1.7	1.7	1.1	1.7
Overall balance (including grants)	-3.4	-3.1	-3.9	-3.4	-4.7
(Excluding grants)	-3.9	-3.5	-4.2	-3.5	-4.9
Primary balance (excluding grants)	-1.9	-1.5	-2.1	-1.6	-2.8
Total central government debt (percent of GDP)	34.5	33.9	33.9	33.1	33.7
Money and credit (end of fiscal year; percent change)					
Credit to private sector by the banking system	10.8	12.3	13.2	16.8	14.0
Reserve money 3/	15.0	15.4	14.3	30.1	9.4
Broad money (M2)	16.7	16.1	12.4	16.3	15.1
Balance of payments (billions of U.S. dollars)					
Exports, f.o.b.	26.6	29.8	30.7	33.4	35.3
(Annual percent change)	10.7	12.1	3.1	8.9	5.6
Imports, f.o.b.	-33.6	-36.6	-37.7	-39.7	-43.3
(Annual percent change)	0.8	8.9	3.0	5.5	9.0
Current account balance 4/	2.4	1.4	2.9	3.7	-0.9
(Percent of GDP)	1.6	0.8	1.5	1.7	-0.4
Capital and financial account balance	3.5	3.5	2.4	2.1	3.1
Of which: Foreign direct investment	1.7	1.5	1.8	2.0	2.1
Overall balance	5.1	5.5	4.4	5.1	2.1
Gross official reserves (billions of U.S. dollars) 5/	15.1	21.4	24.9	30.2	32.3
In months of prospective imports of goods and services	4.1	5.8	6.5	7.2	7.0
Exchange rate (taka per U.S. dollar; period average)	79.9	77.7	77.7	79.3	…
Exchange rate (taka per U.S. dollar; end-period)	77.8	77.6	77.8	81.3	…
Nominal effective rate (2010=100; period average)	86.9	89.7	95.4	100.4	…
Real effective rate (2010=100; period average)	99.3	107.7	120.4	132.7	…
Memorandum item:					
Nominal GDP (billions of taka)	11,989	13,437	15,158	17,296	19,764

Sources: Bangladesh authorities; World Bank, *World Development Indicators*; and IMF staff estimates and projections.

1/ Fiscal year begins July 1.
2/ Includes non-ADP capital spending, net lending, food account surplus (-)/deficit (+), and extraordinary expenditures.
3/ Reserve money excludes liabilities arising from banks' foreign currency clearing accounts at Bangladesh Bank (BB) and nonbank deposits at BB.
4/ Imports are based on customs data.
5/ Excludes deposits held in offshore accounts of resident financial institutions, noninvestment grade sovereign bonds, and foreign exchange overdrafts provided by BB to domestic banks.

Table 2. Bangladesh: Near and Medium-Term Indicators, FY2014–21 1/

	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
			Est.			Staff proj.		
			(Annual percent change)					
Real GDP	6.1	6.6	7.1	6.8	7.0	7.0	7.0	7.0
GDP deflator	5.7	5.9	6.6	7.0	6.2	5.7	6.2	5.7
CPI inflation (annual average)	7.3	6.41	5.9	6.8	6.0	5.5	5.5	5.7
CPI inflation (end of period)	7.0	6.3	5.5	6.8	6.0	5.5	5.5	5.7
Credit to private sector (end of period)	12.3	13.2	16.8	14.0	14.8	14.2	14.8	14.2
			(In percent of GDP)					
Gross national savings	29.2	29.0	30.3	27.2	28.7	28.9	28.8	28.9
Public national savings	2.7	2.1	2.1	1.4	2.7	3.2	3.5	3.8
Private national savings	26.5	26.9	28.2	25.8	26.1	25.7	25.3	25.1
Gross investment	28.6	28.9	29.4	27.6	29.7	30.4	30.8	31.1
Public investment	6.5	6.8	7.6	7.8	9.7	10.5	10.8	10.8
Private investment	22.0	22.1	21.8	19.8	20.1	19.9	20.0	20.3
Net exports of goods and services	-6.5	-7.4	-5.0	-4.8	-5.1	-5.4	-5.6	-5.6
Exports of goods and services	19.0	17.3	16.3	16.5	16.2	16.0	15.9	15.9
Imports of goods and services	25.5	24.7	21.2	21.3	21.3	21.4	21.5	21.6
Current account balance	0.8	1.5	1.7	-0.4	-1.0	-1.6	-2.0	-2.2
Central government operations								
Total revenue and grants	10.9	9.9	10.4	10.8	11.9	12.3	12.8	13.1
Of which : Tax revenue	8.6	8.5	8.8	9.1	10.0	10.5	10.9	11.2
Total expenditure	14.0	13.8	13.8	15.6	16.2	16.6	16.9	16.8
Of which : Annual Development Program (ADP)	4.1	4.3	4.4	4.4	5.6	6.1	6.3	6.3
Overall balance (including grants)	-3.1	-3.9	-3.4	-4.7	-4.4	-4.2	-4.1	-3.7
(excluding grants)	-3.5	-4.2	-3.5	-4.9	-4.7	-4.6	-4.4	-4.0
Primary balance (excluding grants)	-1.5	-2.1	-1.6	-2.8	-2.5	-2.5	-2.2	-1.9
Public sector total debt 2/	35.3	34.5	34.7	36.0	36.6	37.4	37.9	38.1
Of which : central government debt	33.9	33.9	33.1	33.7	34.0	34.3	34.3	34.1
Public sector external debt	15.0	13.4	13.4	13.5	13.5	13.8	14.1	14.4
Memorandum item:								
Nominal GDP (in billions of taka)	13,437	15,158	17,296	19,764	22,452	25,383	28,838	32,602

Sources: Bangladesh authorities; and IMF staff estimates and projections.

1/ Fiscal year begins July 1.

2/ Includes central government's gross debt, including debt owed to the IMF, plus domestic bank borrowing by nonfinancial public sector and public enterprises' external borrowing supported by government guarantees, including short-term oil-related suppliers' credits.

Table 3. Bangladesh: Balance of Payments, FY2014–20 1/

(In millions of U.S. dollars, unless otherwise indicated)

	FY14	FY15	FY16	FY17	FY18	FY19	FY20
			Est.		Staff proj.		
Current account balance 2/	1,406	2,875	3,706	-944	-2,558	-4,417	-6,200
Trade balance	-6,794	-6,965	-6,274	-7,962	-9,269	-10,679	-12,014
Exports (f.o.b.)	29,777	30,697	33,441	35,327	37,916	40,871	44,330
Of which : Ready-made garment sector	24,492	25,491	28,094	29,499	31,564	33,931	36,730
Imports (f.o.b.) 2/	-36,571	-37,662	-39,715	-43,289	-47,185	-51,550	-56,344
Of which : Crude oil and petroleum products	-3,100	-2,153	-2,376	-3,112	-2,865	-3,190	-3,449
Services	-4,099	-3,186	-2,793	-3,455	-4,046	-4,730	-5,519
Income	-2,635	-2,869	-2,582	-2,265	-2,425	-2,651	-2,920
Transfers	14,934	15,895	15,355	12,738	13,182	13,642	14,254
Official current transfers 3/	83	75	68	50	50	50	50
Private transfers	14,851	15,820	15,287	12,688	13,132	13,592	14,204
Of which : Workers' remittances	14,228	15,170	14,717	12,215	12,643	13,085	13,674
Capital and financial account balance 4/	3,515	2,421	2,106	3,093	4,660	6,160	7,334
Capital account	598	496	478	481	750	820	895
Financial account	2,917	1,925	1,628	2,612	3,910	5,340	6,439
Foreign direct investment	1,474	1,830	2,001	2,135	2,341	2,558	2,794
Portfolio investment	937	379	124	305	334	365	399
Medium- and long-term loans, net	1,863	1,527	2,048	2,402	3,144	3,944	4,386
Government, net	1,386	1,562	2,055	2,158	2,580	3,118	3,352
Disbursements	2,404	2,472	2,904	3,170	3,772	4,300	4,550
Amortization	-1,018	-910	-849	-1,012	-1,192	-1,182	-1,198
Other long-term loans, net	477	-35	-7	244	564	826	1,034
Other capital	-1,357	-1,811	-2,545	-2,230	-1,910	-1,527	-1,140
Short-term loans and trade credits, net	-445	-2,613	-2,545	-1,880	-1,560	-1,177	-790
Commercial banks, net	-241	802	0	-350	-350	-350	-350
Other items, net	-671	0	0	0	0	0	0
Errors and omissions	624	-923	-758	0	0	0	0
Overall balance	5,545	4,373	5,054	2,149	2,102	1,742	1,134
Financing items	-5,545	-4,373	-5,054	-2,149	-2,102	-1,742	-1,134
Change in gross international reserves (GIR) (+ = increase)							
Contribution from financing	5,545	4,373	5,054	2,149	2,102	1,742	1,134
Net use of IMF resources	198	-56	218	-5	-26	-89	-128
Change in GIR excluding valuation changes	5,744	4,317	5,272	2,144	2,076	1,653	1,006
Valuation changes	256	-692	...	...	...	...	...
Total change in GIR (excluding Asian Clearing Union liabilities)	5,999	3,625	5,272	2,144	2,076	1,653	1,006
Memorandum items:							
Current account balance (percent of GDP)	0.8	1.5	1.7	-0.4	-1.0	-1.6	-2.0
Exports (annual percent change)	12.1	3.1	8.9	5.6	7.3	7.8	8.5
Imports (annual percent change)	8.9	3.0	5.5	9.0	9.0	9.3	9.3
Remittances (annual percent change)	-1.6	6.6	-3.0	-17.0	3.5	3.5	4.5
Foreign direct investment (percent of GDP)	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Medium- and long-term external public debt	24,845	24,919	27,633	30,008	33,149	37,004	41,262
(Percent of GDP)	14.4	12.8	12.7	12.6	12.7	13.0	13.3
Gross official reserves 4/	21,385	24,946	30,161	32,305	34,382	36,035	37,041
(In months of imports of goods and services)	5.8	6.5	7.2	7.0	6.8	6.5	6.1
Gross official reserves (excluding Asian Clearing Union liabilities) 4/	20,417	24,043	29,315	31,459	33,535	35,188	36,195
(In months of imports of goods and services)	5.6	6.3	7.0	6.8	6.6	6.3	5.9
Net international reserves 4/	18,860	24,352	28,665	29,183	30,923	32,665	33,800
Nominal GDP	172,887	195,046	218,088	237,243	260,056	284,206	310,425

Sources: Bangladesh authorities; and IMF staff estimates and projections.

1/ Fiscal year begins July 1.

2/ Imports are based on customs data.

3/ Excludes official capital grants reported in the capital account.

4/ Gross and net international reserves for the projection period do not include valuation adjustments. Net international reserves are reported at market exchange rates.

Table 4. Bangladesh: Central Government Operations, FY2014–17 1/

	FY14	FY15		FY16		FY17	
		Budget	Actual	Budget	Est.	Budget	Staff proj.
	(In billions of taka)						
Total revenue and grants	1,467	1,892	1,504	2,142	1,799	2,483	2,141
Total revenue	1,404	1,830	1,460	2,084	1,780	2,428	2,096
Tax revenue	1,160	1,553	1,288	1,822	1,519	2,104	1,797
National Board of Revenue (NBR) taxes	1,114	1,497	1,240	1,764	1,462	2,032	1,733
Of which: VAT and supplementary duties	590	763	665	901	807	1,028	928
Taxes on income and profits	378	561	407	650	451	719	546
Customs and excise duties	139	159	158	200	178	269	228
Non-NBR taxes	46	56	48	58	56	73	64
Nontax revenue	243	277	172	262	262	324	299
Foreign grants	64	62	44	58	18	55	44
Total expenditure	1,881	2,505	2,092	2,951	2,381	3,405	3,075
Current expenditure	1,106	1,282	1,190	1,646	1,439	1,890	1,865
Pay and allowances	263	287	288	452	400	508	522
Goods and services	151	164	165	178	183	206	199
Interest payments	282	310	310	351	331	400	427
Subsidies and transfers 2/	407	502	424	642	523	753	714
Block allocations	2	19	2	23	2	23	3
Annual Development Program (ADP)	552	803	652	970	754	1,107	875
Non-ADP capital spending	143	320	139	255	122	330	200
Net lending 3/	77	96	90	78	11	84	80
Other expenditures 4/	3	3	21	2	55	84	55
Overall balance (including grants)	-413	-613	-588	-809	-583	-923	-934
(Excluding grants)	-477	-675	-632	-867	-601	-978	-978
Primary balance (including grants)	-131	-303	-279	-458	-251	-523	-507
(Excluding grants)	-195	-365	-323	-516	-270	-578	-551
Net financing	413	613	588	809	583	923	934
External	90	181	116	243	94	363	180
Disbursements	176	265	190	322	230		264
Amortization	-87	-85	-74	-79	-67		-84
Domestic	283	433	359	566	489	560	754
Banks 3/	99	312	-23	391	147	389	254
Of which: Bangladesh Bank	-179	…	-18	…	92		-95
Nonbanks 4/	184	121	383	175	342	170	500

(continued)

Table 4. Bangladesh: Central Government Operations, FY2014–17 1/ (concluded)

	FY14	FY15		FY16		FY17	
		Budget	Actual	Budget	Est.	Budget	Staff proj.
				(In percent of GDP)			
Total revenue and grants	10.9	12.5	9.9	12.4	10.4	12.7	10.8
Total revenue	10.4	12.1	9.6	12.0	10.3	12.4	10.6
Tax revenue	8.6	10.2	8.5	10.5	8.8	10.7	9.1
NBR taxes	8.3	9.9	8.2	10.2	8.5	10.4	8.8
Of which : VAT and supplementary duties	4.4	5.0	4.4	5.2	4.7	5.2	4.7
Taxes on income and profits	2.8	3.7	2.7	3.8	2.6	3.7	2.8
Customs and excise duties	1.0	1.0	1.0	1.2	1.0	1.4	1.2
Non-NBR taxes	0.3	0.4	0.3	0.3	0.3	0.4	0.3
Nontax revenue	1.8	1.8	1.1	1.5	1.5	1.6	1.5
Foreign grants	0.5	0.4	0.3	0.3	0.1	0.3	0.2
Total expenditure	14.0	16.5	13.8	17.1	13.8	17.4	15.6
Current expenditure	8.2	8.5	7.8	9.5	8.3	9.6	9.4
Pay and allowances	2.0	1.9	1.9	2.6	2.3	2.6	2.6
Goods and services	1.1	1.1	1.1	1.0	1.1	1.1	1.0
Interest payments	2.1	2.0	2.0	2.0	1.9	2.0	2.2
Subsidies and transfers 2/	3.0	3.3	2.8	3.7	3.0	3.8	3.6
Annual Development Program (ADP)	4.1	5.3	4.3	5.6	4.4	5.6	4.4
Non-ADP capital spending	1.1	2.1	0.9	1.5	0.7	1.7	1.0
Net lending 3/	0.6	0.6	0.6	0.4	0.1	0.4	0.4
Other expenditures 5/	0.0	0.0	0.1	0.0	0.3	0.4	0.3
Overall balance (including grants)	-3.1	-4.0	-3.9	-4.7	-3.4	-4.7	-4.7
(Excluding grants)	-3.5	-4.5	-4.2	-5.0	-3.5	-5.0	-4.9
Primary balance (including grants)	-1.0	-2.0	-1.8	-2.6	-1.5	-2.7	-2.6
(Excluding grants)	-1.5	-2.4	-2.1	-3.0	-1.6	-2.9	-2.8
Net financing	3.1	4.0	3.9	4.7	3.4	4.7	4.7
External	0.7	1.2	0.8	1.4	0.5	1.9	0.9
Disbursements	1.3	1.7	1.3	1.9	1.3	…	1.3
Amortization	-0.6	-0.6	-0.5	-0.5	-0.4	…	-0.4
Domestic	2.1	2.9	2.4	3.3	2.8	2.9	3.8
Banks 3/	0.7	2.1	-0.2	2.3	0.8	2.0	1.3
Of which : Bangladesh Bank	-1.3	…	-0.1	…	0.5	…	-0.5
Nonbanks 4/	1.4	0.8	2.5	1.0	2.0	0.9	2.5
Total central government debt (percent of GDP)	33.9	…	33.9	…	33.1	…	33.7
Nominal GDP (in billions of taka)	13,437	15,158	15,158	17,296	17,296	19,610	19,764

Sources: Bangladesh authorities; and IMF staff estimates and projections.

1/ Fiscal year begins July 1. Cash basis, unless otherwise specified.

2/ Comprise budget allocations for safety net programs and other social-related spending, pensions and gratuities, and direct subsidies for food and to the agriculture and export sectors. Other subsidy-related costs (i.e., lending to large energy-related state-owned enterprises (SOEs)) are included in net lending.

3/ Excludes net financing of autonomous and semi-autonomous government bodies, and government lending funds. Includes special bonds issued to the commercial banks for the noncash issued to the state-owned securitization of past subsidy-related loans made to Bangladesh Petroleum Corporation, consistent with the earlier treatment in the fiscal accounts of similar operations.

4/ Includes National Savings Certificates, net purchase of Treausry securities by nonbank entities, and financing through the General Provident Fund.

5/ Includes food account surplus (+)/deficit (-) and extraordinary expenditures.

Table 5. Bangladesh: Monetary Accounts, FY2013–17

	FY13	FY14	FY15	FY16	FY17
					Staff proj.
Bangladesh Bank (BB) balance sheet	(End of period; in billions of taka)				
Net foreign assets	954	1399	1695	2117	2,397
Net domestic assets	168	-104	-216	-191	-283
Net credit to central government 1/	281	102	83	176	81
Credit to other nonfinancial public sector	1	1	12	12	12
Credit to deposit money banks	63	55	48	44	44
Other items, net	-176	-261	-359	-423	-419
Reserve money 2/	1,122	1,295	1,480	1,926	2,114
Currency	754	855	982	1323	1,475
Reserves	368	440	498	603	639
	(Contributions to reserve money growth)				
Net foreign assets	37.5	39.7	22.9	28.5	14.5
Net domestic assets	-22.5	-24.3	-8.6	1.6	-4.7
Of which : Net credit to central government	-7.3	-16.0	-1.4	6.2	-4.9
Reserve money (year-on-year percentage change)	15.0	15.4	14.3	30.1	9.8
	(End of period; in billions of taka)				
Monetary survey					
Net foreign assets	1,139	1,599	1,893	2,331	2,642
Bangladesh Bank	954	1,399	1,695	2,117	2,397
Commercial banks	186	200	197	214	245
Net domestic assets	4,893	5,403	5,979	6,827	7,895
Domestic credit	5,856	6,544	7,230	8,279	9,301
Net credit to central government 1/	1,240	1,340	1,317	1,409	1,663
Credit to other nonfinancial public sector	58	72	111	90	-67
Credit to nonbank financial institutions	37	55	56	70	56
Credit to private sector	4,522	5,076	5,746	6,710	7,650
Other items, net	-964	-1,141	-1,251	-1,452	-1,407
Broad money (M2)	6,032	7,002	7,871	9,158	10,536
	(Year-on-year percent change)				
Net foreign assets	44.2	40.4	18.3	23.2	13.3
Net domestic assets	11.7	10.4	10.7	14.2	15.6
Domestic credit	10.5	11.7	10.5	14.5	12.3
Of which : Net credit to central government	19.8	8.1	-1.7	7.0	18.0
Credit to private sector	10.8	12.3	13.2	16.8	14.0
Broad money (M2)	16.7	16.1	12.4	16.3	15.1
Memorandum items:					
Required domestic cash reserves (in billions of taka)	338	423	471	500	610
Excess domestic cash reserves (in billions of taka)	30	17	28	103	29
Broad money multiplier	5.4	5.4	5.3	4.8	5.0
Broad money velocity	2.0	1.9	1.9	1.9	1.9

Sources: Bangladesh authorities; and IMF staff estimates and projections.

1/ Includes special bonds issued to the commercial banks for the noncash issued to the state-owned securitization of past subsidy-related loans made to Bangladesh Petroleum Corporation. Excludes government lending fund and net credit to autonomous and semi-autonomous government bodies. Excluded items are included in "Other items, net."

2/ Liabilities arising from banks' foreign currency clearing accounts at BB and nonbank deposits at BB are included in "Other items, net."

Annex I. Bangladesh: Risk Assessment Matrix (RAM)[1]

	Shocks and Likelihood (Red= high likelihood; green = low likelihood)	Potential Impact (Red= high; green=low)	Policy Response: Fiscal	Monetary/exchange rate	Financial	Other
Domestic			√	√		
	Resumption of intense political turmoil and a deterioration in security conditions.	Resumption in poltical turmoil and a deterioration in security conditions could adversely affect confidence, investment and growth. Balance of payments (BOP) pressures could emerge from lost export production. Fiscal consolidation efforts could slip and inflation could go up. Companies have announced travel advisories in the recent past, and domestic business leaders have warned about the potential negative impact.	There should be a moderate fiscal easing by allowing automatic stabilizers (mostly on the revenue side) to operate and increasing transfers to the poor as needed. Reserve buffers could be used through sterilized intervention to cushion the shock and smooth exchange rate volatility.			
			√		√	
	Further deterioration in the financial health of state-owned banks (SBs).	SBs have high NPLs, low profitability, and sizeable capital shortfalls (but do not face liquidity pressures). Further deterioration in SB balance sheets would potentially have a negative impact on the fiscal balance.	Recapitalization should be tied to reforms to improve the long-term viability of state banks, including governance reforms, stricter controls over lending activities, and more aggressive recovery of bad loans. State banks should be held strictly accountable to numerical targets agreed with the authorities to improve their financial			
			√			
	Large revenue shortfalls relative to projections.	Continued revenue underperformance would compromise spending on growth-critical investment projects and social safety nets. Failure to launch the new VAT, in particular, would jeopardize debt sustainability .	The new VAT (twice delayed) should be implemented in July 2017 as scheduled. Further reforms to strengthen tax administration are also necessary over the medium term.			
External			√	√		
	Retreat from cross-border integration.	The EU and US account for over 70 percent of exports, and weaker growth, together with retreat from trade liberalization, could adversely affect export growth, mainly the garment industry, with a negative impact on BOP. However, the relatively low-income elasticity of demand for garment exports and Bangladesh's cost competitiveness would act as mitigating factors.	If the shock is temporary, the policy response should be similar to that for a resumption of political violence. If the shock is protracted, the exchange rate should be allowed to adjust and fiscal policy would also require some adjustment to keep the deficit broadly in line with the fiscal anchor, with social spending on the poor protected via restraint in other current expenditure.			
	Structurally weak growth in key advanced and emerging economies (EMs).					
			√	√		
	Significant further strengthening of the US dollar and/or higher rates.	If the taka/US$ rate is kept stable and the US$ continues to appreciate against the euro, Bangladesh's cost advantage in the European market would be eroded and pressures on the BOP could emerge.	Further nominal appreciation against the US$ should be resisted in the near term. If appreciation pressures prolong into the medium term, the exchange rate should be allowed to adjust. Fiscal policy should aim at reducing the defict and financing needs.			
			√	√		
	Lower energy prices	As a net oil importer, Bangladesh benefits from lower oil prices. However, low oil prices could weaken job prospects for Bangladeshi workers in the GCC (from which about two-thirds of remittances originate), and thereby affect remittances. This, in turn, would have a negative impact on domestic demand and the BOP. This impact could potentially outweigh the positive income shock from lower oil prices, as remittances are about four times larger than oil imports.	Fiscal transfers to the poor and vulnerable should be enhanced. The currency should be allowed to depreciate but reserve buffers could be used to smooth exchange rate volatility.			

Source: IMF staff.

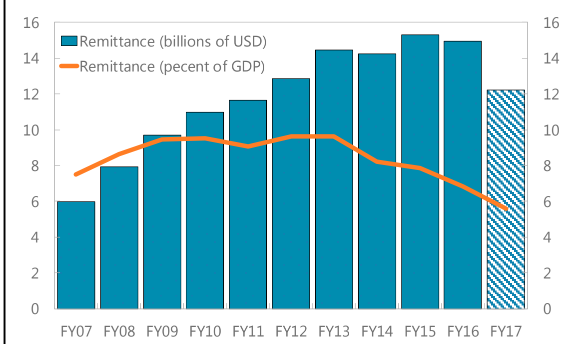
[1] 1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex II. Remittances in Bangladesh

Remittances to Bangladesh have increased significantly over the past decade. They have become instrumental in financing trade deficits allowing Bangladesh to rebuild its foreign exchange reserves in addition to having had a positive impact on economic growth and reducing poverty. Strong inflows continued over the last decade despite a challenging global economic environment. Given their importance in the macro economy, it is useful to understand what underlies the recent slowdown of remittances in Bangladesh.

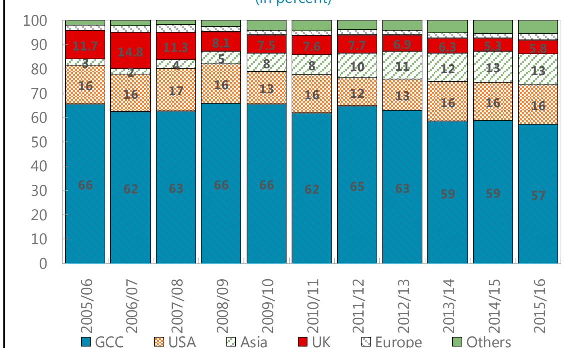
Remittance inflows into Bangladesh have more than doubled from $6 billion to $15 billion over the last ten years. Over the same period remittances have accounted for 8½ percent of GDP on average which is close to eight times the Foreign Direct Investment flow into the country. Despite this strong growth, remittances have been declining as a share of GDP over the past five years. More recently the slowdown is evident in absolute terms as well. The slowdown was the largest from the GCC countries (5 percent decline) which on average have accounted for the largest share (60 percent) followed by the United States (15 percent) and the U.K. (8½ percent). Inflows are forecasted to drop even further in FY17 to 12¼ billion.

Remittance Inflows into Bangladesh



Sources: Bangladesh authorities, IMF Staff

Remittance Inflows by Country of Origin
(in percent)

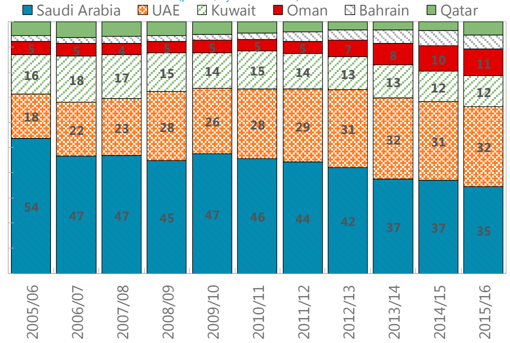


Sources: Bangladesh Authorities

While several possible reasons explain this decline, the strongest argument supporting it is the economic slowdown in the GCC countries reflecting the impact of lower oil prices. The decline may also reflect a shift by remitters to less costly methods of transferring money, including the hawala system, not accounted for in official statistics.

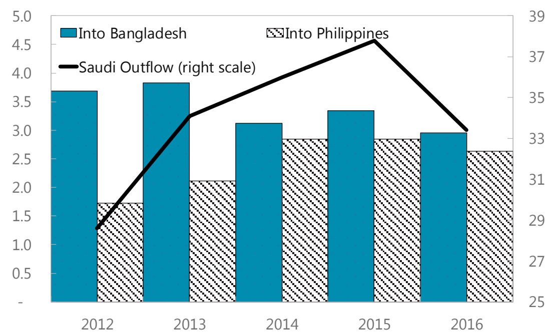
The slowdown in the GCC country growth is likely to have had a profound impact on remittances. Close to ten percent of the outward remittances from the GCC countries in 2016 (estimated at $84 billion) went to Bangladesh. The GCC is one of the largest employers of foreign workers in the world—a major destination for South Asian migrants—and consequently a large source of outward remittances.[1] Indeed, the number of workers from Bangladesh to the GCC countries has been growing steadily. Nevertheless remittance inflows from all GCC countries except for Qatar, witnessed a slowdown in FY16.[2] Sustained low oil prices have led to slower growth, weakening of fiscal and external positions, and tightening of monetary and financial conditions in the GCC countries, and have played a part in slowing down the outflows. This slowdown has affected not only Bangladesh but also other large remittance dependent economies such as Nepal and the Philippines.[3] For example, total outflows to all countries of remittances from Saudi Arabia—the largest source of remittances into Bangladesh—fell from $38 billion in 2015 to less than $34 billion in 2016. Over the same period, remittances from Saudi Arabia dropped by almost twelve percent for Bangladesh and eight percent for the Philippines.

Remittance Inflows from GCC Countries
(percent, by GCC countries)



Sources: Bangladesh authorities

Remittance Flows from Saudi Arabia
(US$ billions)



Sources: Bangaldesh, Saudi Arabia and Phlipines authorities data

A second explanation for the decline, while difficult to measure, is a shift of the method of transferring funds toward informal channels. With falling costs of sending remittances and the various policy measures implemented by Bangladesh Bank over the past decade (Financial Action Task Force, 2016), a larger share of remittances is now transmitted through the formal sector. But informal channels such as the 'hawala / hundi' system continue to exist in many South Asian countries including Bangladesh and some of the decline in measured remittance inflows may be explained by a shift by remitters to informal channels not accounted for in official statistics. These intermediaries continue to prevail given (1) the lack of scrutiny used to avoid taxes, fees

[1] The Cooperation Council for the Arab States of the Gulf, is a regional intergovernmental political and economic union consisting of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates. As of 2014, five out of the six GCC countries employed about 11.8 million foreign workers with over 90 percent working in the private sector.

[2] Amongst the other regions, inflows from Europe including the U.K. picked up in FY16 after having fallen sharply in the previous year. Inflows from Asian economies slowed down.

[3] The 2017 Article IV Consultation Staff Report for Nepal highlighted that the growth rate of remittances slowed sharply to 1 percent in 2015/16 from an annual average of 15 percent during the previous 5 years, citing weak growth in oil-producing host countries. In Sri Lanka, a further slowdown in remittance growth is flagged as a risk. In the Philippines, the historical growth rates of close to 7 percent fell to 4½ percent in 2015 and 2016.

and duties; (2) the convenience and cost; and (3) the lack of access to formal services due to immigration status, or simply because there are no formal means in the country of work.

Looking ahead, remittance inflows into Bangladesh are projected to drop in the short term, and pick up slowly over the medium term in line with the global outlook and that of the GCC countries. Decline in oil prices and production, and geopolitical instability are the main sources of risk to the GCC region's growth prospects in addition to the contractionary impact of fiscal consolidation and tightening liquidity conditions. In addition, some GCC countries are considering levying a tax on outward remittances, although no specific proposals have been developed. The imposition of a remittance tax would have several disadvantages, including reputational risk, and adverse impact on competitiveness of the private sector and financial disintermediation. It may also give rise to an exchange restriction and multiple currency practice subject to Fund approval under Article VIII, Sections 2(a) and 3, respectively. International experiences show that taxes on remittances have been rare and short-lived. Since the growth in the GCC countries is expected to be on the weaker side and given that risks to overall growth in the region remains tilted to the downside, it is expected that the recovery in remittances to historical levels will be slow over the short- to medium term.

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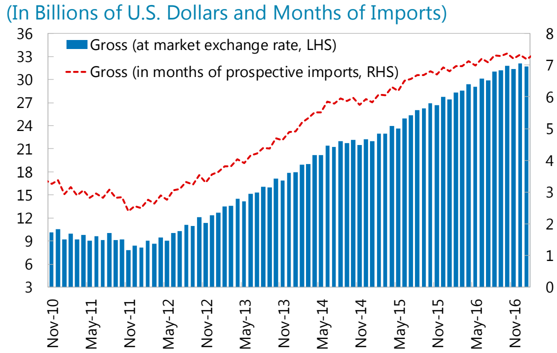
Annex III. Reserve Adequacy in Bangladesh

Over the past four years, Bangladesh's balance of payments surpluses from strong export earnings, remittances, FDI and foreign aid have allowed a strong recovery of foreign exchange reserves. Benchmarking adequate level of reserves is central to designing policies that preserve the country's resilience to external shocks, particularly given Bangladesh's limited access to capital markets. This note evaluates the reserve adequacy for Bangladesh and discusses some of the associated macroeconomic risks.

Over the past five years, Bangladesh has witnessed strong growth in export earnings (over 8 percent), remittances (5 percent) and FDI (14½ percent). As a result, the country's gross international reserves tripled, reaching $32 billion at end–March 2017, from $10 billion in FY12. In terms of coverage, reserves increased from 3 months of prospective imports to 7 months (or around 8 months of current imports).

International Reserves
(In Billions of U.S. Dollars and Months of Imports)



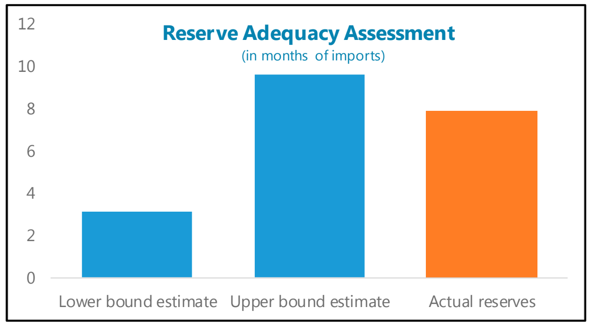
Source: Bangladesh Bank

The previous Article IV consultation had assessed the level of reserves in Bangladesh as adequate. However, this assessment also noted that given the de facto stabilized exchange rate regime, close to 8½ months of imports was the more appropriate level of adequacy instead of the actual six-month import coverage at that time.[1] Since then, several macroeconomic developments have changed the baseline scenario including the current account on which the reserve adequacy assessment is based. The current account has swung from a previously projected deficit of 1.3 percent of GDP in FY16 to a surplus 1.7 percent, mainly on subdued imports. Exports are holding up, but remittances have slowed down. In FY16, remittances dropped to $15 billion (6.8 percent of GDP) from $15¼ billion (7.9 percent of GDP) in FY15. Inflows are predicted to drop further by almost 17 percent in FY17. Reserves are expected to rise – albeit at a more moderate pace than previously estimated – underpinned by export earnings, FDI and external borrowing.[2]

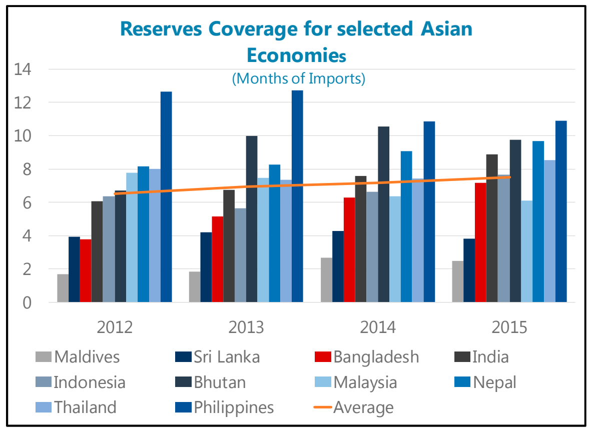
[1] For Bangladesh, this is estimated using the marginal cost of sterilization instruments and the cost of short term external borrowing for oil imports. In both cases the cost, net of returns on investment assets, is close to the regional average of about 7 percent. The de jure exchange rate arrangement in Bangladesh is classified as floating, but central bank interventions in the foreign exchange market keeps the exchange rate relatively stable against the U.S. dollar.

[2] The previous Article IV assumed an eight percent average growth in reserves over the medium to long term. Reserves are now expected to grow at a five percent average.

Despite these changes to the baseline scenario, reserve coverage in Bangladesh continues to be assessed as adequate. Based on IMF methodology for low income countries (LICs), reserves ranging from 3 to 9½ months of imports are assessed as adequate given the country specific characteristics of Bangladesh.[3] With a de facto fixed exchange rate arrangement, coverage close to the higher end of this range is more appropriate. Hence with actual coverage of close to eight months of imports reserve Bangladesh's reserves are adequate but not excessive.

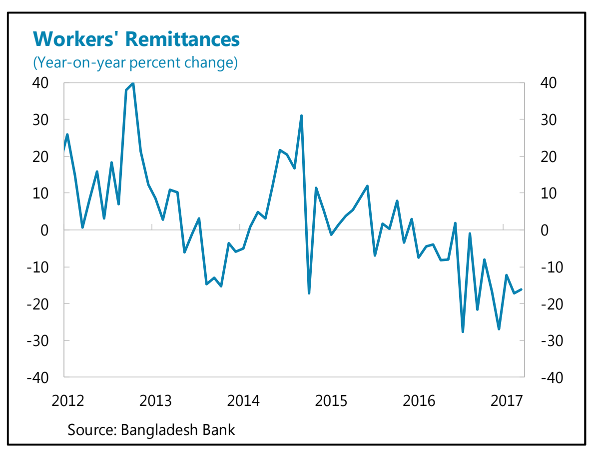


Cross-country comparisons also point to adequate but not excessive reserves—import coverage for Bangladesh is close to the average for LICs in the region but below emerging market economies. In addition to having a larger reserve coverage than Bangladesh, non-LICs are typically not credit constrained by having more access to international debt markets, which makes them more resilient to external shocks.



The adequacy assessment going forward will face possible shocks to the current account, particularly (i) a further, more-than-projected slowdown in remittances, and (ii) lower external demand for Bangladesh exports.

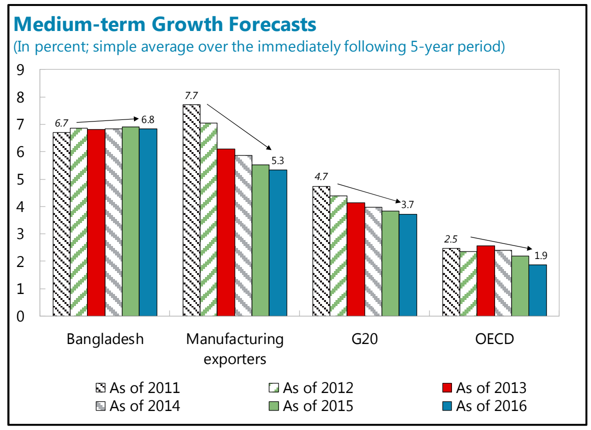
Prospects for remittances are subject to considerable uncertainty, as the recent decline has been particularly pronounced (Annex II). Remittances continue to decline even though the number of



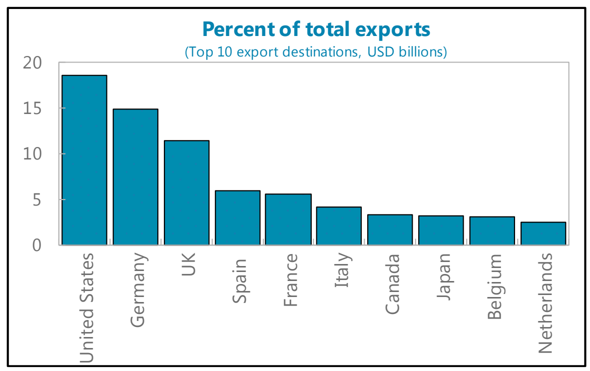
[3] The findings in this note are based on the IMF's methodology described in "Assessing Reserve Adequacy in Credit-Constrained-Economies" ("ARA–CC"). IMF ARA–CC (2013).

Bangladeshi workers abroad have increased steadily in recent years. Total remittances thus far in the fiscal year (July 16–March 17) have dropped by over fifteen percent as compared to the same period in the previous year. This is largely accounted for by the substantial deficit-reduction efforts, low oil prices, and deepening conflicts in Gulf countries—the largest source of overseas income—that continue to weigh in on economic activity and are likely to continue doing so.

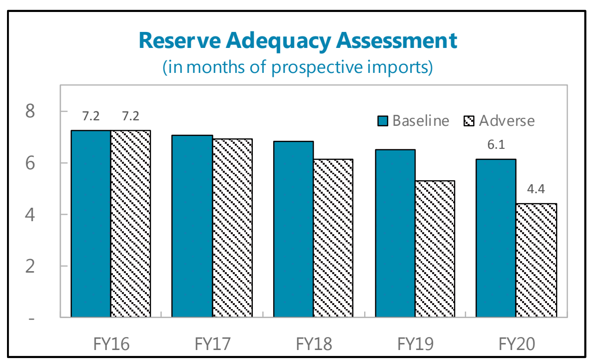
In addition, global growth is more subdued now than in the past.[4] The United States, Germany and the U.K. represent Bangladesh's three main export destinations. Thus, a risk of slowdown in the European Union may hurt exports. Additionally, per media reports, British garment importers have started putting price pressures on exports following the announcement of the Brexit. In the short-term the impact may not be a major concern but in the long term rising inflation expectations in the U.K. from the possible depreciation of the pound will affect exports. General uncertainties over rising protectionist pressures will continued to shadow the outlook for Bangladesh exports.



Medium-term Growth Forecasts
(In percent; simple average over the immediately following 5-year period)



Percent of total exports
(Top 10 export destinations, USD billions)



Reserve Adequacy Assessment
(in months of prospective imports)

Reserve coverage is likely to decline from current levels. Under a baseline medium-term scenario, reserve coverage declines somewhat but stabilizes at a still-adequate level of above 5 months of imports. But even modestly worse assumptions on the external developments reduce coverage considerably. In a scenario where export growth is lowered to 5 percent (from 7 percent) and remittance growth to 2¼ percent (instead of 4½ percent) for three years starting FY18, and keeping all else equal, coverage drops to 4½ months of import. This is driven by the weaker current account deficit, which widens over this period to 3 percent of GDP compared to 2¼ percent in the baseline.

[4] Data per WEO, October 2016.

Annex IV. Capital Market Development in Bangladesh

For low-income countries like Bangladesh that aspire to transition to a middle-income status, the intermediation of savings through capital market to finance investment will become increasingly important to support economic growth. Bank intermediation has thus far played a dominant role in Bangladesh, but the experience from other countries shows that fostering the development of capital markets can lead to a more effective allocation of savings and higher economic growth.

Benefits of developing local capital markets

It has long been recognized that the development of local capital markets brings several benefits to savers and borrowers, including governments (Laeven, 2014 and Regan, 2017):[1]

- For governments, local bond markets allow fiscal deficits to be financed without resorting to financial repression (such as forcing banks to buy government debt) or potentially risky foreign borrowing.

- For private borrowers, firms, and households, the development of local capital markets provides improved access to local currency financing including long-term financing for longer-term investment projects. It allows them to diversify and manage risk, including interest rate and exchange rate risk.

- For savers, local currency bond markets offer an alternative to investment in local currency deposits, thus reducing the dependence on banks.

- For central banks, the existence of a well-developed government securities market improves the monetary transmission mechanism and the effectiveness of monetary policy. A well-established yield curve provided useful information for the conduct of monetary policy.

- For the economy, capital markets reduce the dependency on banks and thus the risk that financing would stop in times of banking sector trouble (capital markets serving as a “spare tire”). In addition, capital markets introduce market discipline through stricter reporting and disclosure requirements and as a source of competition to banks.

Developing a well-functioning capital market can bring substantial benefits but is not a simple, straightforward or quick task. While capital markets have expanded in many high- and middle-income countries, the capitalization of stock markets in low income countries fell from 24 percent of GDP in 1994 to 20 percent of GDP in 2010, and market liquidity has decreased as firms resorted to raising capital in international markets (Laeven, 2014). Thus, many low-income countries’ capital markets remain illiquid and with only few securities actively traded.

[1] Financial markets comprise capital and money markets. Capital markets are where financial instruments (government or private debt, equity) with maturity more than one year are traded. Capital markets can either be primary (where funds are raised) or secondary (where financial instruments are traded). Money markets are where instruments with maturities less than one year are traded.

For a proper functioning of local capital markets, several conditions should be met, including:

- Stable macroeconomic policies and sound macroeconomic frameworks, including monetary policy that does not produce excessive interest rate volatility.
- A clear government debt management and issuance strategy.
- A strong and well-functioning legal and institutional environment with investor-friendly laws and strong contract enforcement, sound taxation, accounting, bankruptcy and competition laws.
- A well-functioning market infrastructure, including trading platforms and the regulatory apparatus that support trading and exchange of information.
- A critical size of the economy and the investor base. Experience shows that local pension funds, insurances, and savings vehicles can provide a significant boost to the development of local debt market. The presence of foreign investors can also support local market development, though foreign investors are not likely to provide as stable market base as domestic institutional investors.

Often, the development of local capital markets proceeds in several stages. The development of local government securities markets can help jumpstart the development of the corporate debt market by establishing a risk-free benchmark yield curve that allows pricing of risker private securities. Highest credit quality issuers, including banks and utilities, are usually the first to issue debt securities.

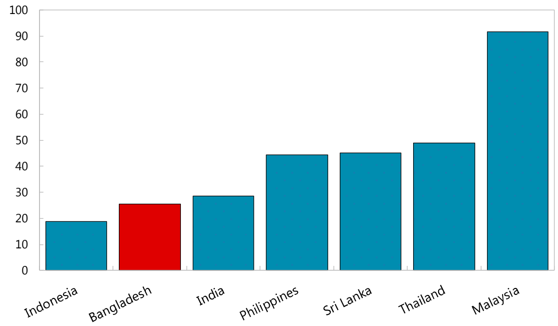
Numerous studies have looked at the impact of capital market developments on economic performance (see Regan, 2017, for an overview of the literature). In general, studies find a positive association between capital market development and economic growth, but also evidence of a two-way association—economic growth also supports capital market development.

The status of capital market development in Bangladesh

Bangladesh's capital market remains relatively underdeveloped, and the banking sector dominates as a source of intermediated financing to companies. In FY16, industrial term loans disbursed by banks and other financial institutions amounted to Taka 655 billion ($8 billion, or around 3½ percent of GDP), compared to a meagre Taka 4 billion in new capital raised by eleven companies in the stock market through private placements and public offerings (Bangladesh Bank, 2017). At the same time, the FY16 public offerings were oversubscribed more than sixteen times, suggesting a strong demand and relative shortage of new securities in the primary market.

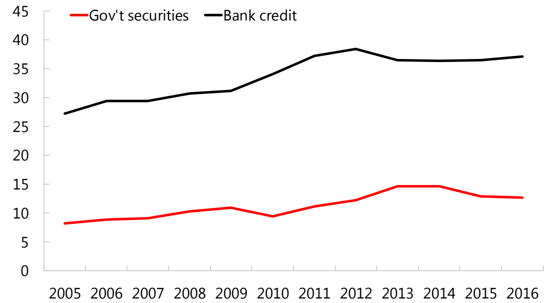
Even with bank lending, the relatively low development of the capital market is why bank loans and the issuance of equity and debt finance combined amount to only one fourth of private fixed capital formation—a relatively low share in the regional comparison (figure). Thus, internal resources in the form of retained earnings play a very large role.

Share of Investment Financed by Banks and Capital Market
(Percent)



Sources: WEO Database, International Federation of Exchanges and Staff Calculation

Bank Credit and Gov't Marketable Securities 1/
(Percent of GDP)

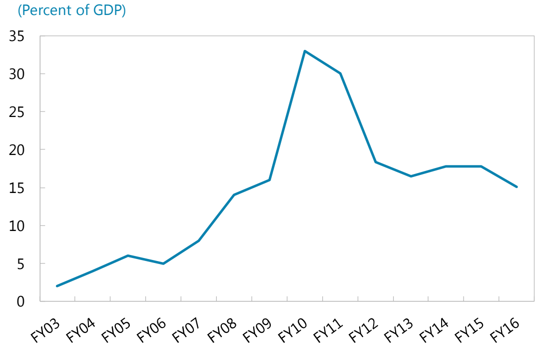


Sources: Bangladesh Bank, staff calculation
1/ Excludes interbank items and foreign bills

Bangladesh stock market

The most developed segment of the capital market in Bangladesh is its stock market, which has had a relatively short and volatile history (figure). A decade ago, the Dhaka Stock Exchange capitalization hovered around 5 percent of GDP, but began growing rapidly in the years to follow. Initially, the growth in the capital market was driven by strong economic fundamentals, but speculative forces pushed the market capitalization and market turnover to unprecedented levels: between 2009 and 2010, market capitalization as a percent of GDP doubled from 16 percent to 33 percent. Market turnover jumped from 19 percent of market capitalization in 2006 to 114 percent at the peak in 2010. This was followed shortly by a major share price correction despite government support and use of public funds to prop up the market. This episode has resulted in significant losses for investors, and prompted the government to formulate a reform plan—the Capital Market Development Master Plan (see below)—to restore public confidence in the stock market.

Dhaka Stock Exchange Capitalization
(Percent of GDP)

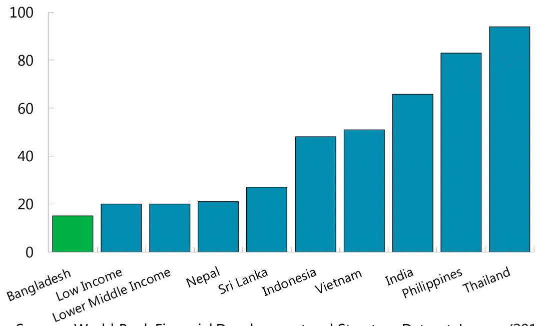


Sources: Bangladesh Bank, Mansur (2014)

	Financial Market Development	
	Index	Ranking
India	4.4	38
Indonesia	4.3	42
Cambodia	4.1	63
Sri Lanka	4	64
Nepal	3.9	73
Vietnam	3.9	78
Bhutan	3.9	79
Bangladesh	3.5	99

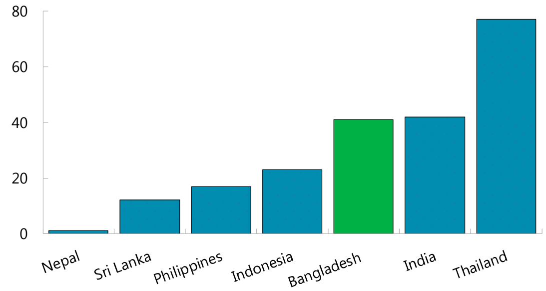
Source: World Economic Forum, 2016

Selected Countries: Stock Market Capitalization
(Percent of GDP)



Sources: World Bank Financial Development and Structure Dataset, Laeven (2014)

Selected Countries: Stock Market Turnover Ratio 1/
(Percent)



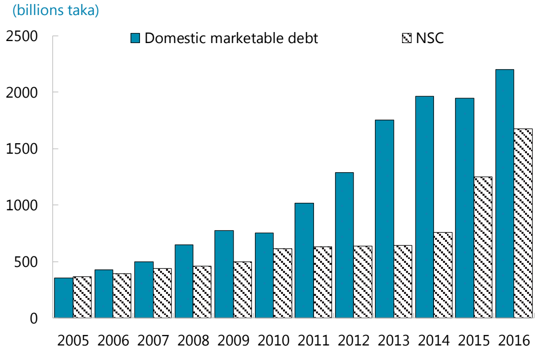
Sources: World Bank Financial Development and Structure Dataset
1/ Annual value of shared traded divided by market capitalization

At about 15 percent of GDP, Bangladesh's current stock market capitalization is relatively low even compared to other low income countries (figure). The average market capitalization in low-income and lower-middle income countries is about 20 percent of GDP, about one fourth higher than in Bangladesh. In other South Asian countries, the stock market capitalization is even higher: for example, in India it is over 60 percent of GDP. However, Bangladesh compares better in terms of stock market turnover rate, which is similar to that of India and higher than other countries in the region. In terms of broader measure of financial market development, too, Bangladesh ranks 99, lower than other countries in the region (table).

Impediments to market development and policies to develop capital market

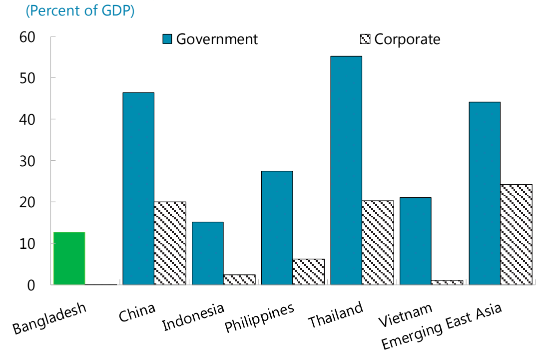
In addition to a relatively low level of capital market development, Bangladesh is also characterized by a high share of non-tradable government securities in the form of National Savings Certificates (NSCs, see Staff Report Box 3) and correspondingly a limited amount of tradable securities. The stock of NSCs in Bangladesh is very high in international comparison—nearly the entire government's budget deficit is currently financed from NSCs, whereas in India, for example, the national savings scheme constitutes about eleven percent of government financing (ADB, 2015). The large issuance of NSCs reduces the demand for Bangladesh government bonds and inhibits the development of other investment vehicles such as mutual funds. Thus, both government and the corporate bond markets are relatively small compared to other countries in the region (figure).

Domestic Government Debt
(billions taka)



Sources: Bangladesh Bank

Local Currency Bond Market, 2016
(Percent of GDP)



Sources: Asian Development Bank, Bangladesh Bank

Beyond the dominance of NSCs, Bangladesh's capital market is still evolving, suffering temporary setbacks from the above-mentioned speculative bubble, regulatory shortcomings, and slack monitoring that led to the 2011 stock market crash and loss of investors' confidence.

After the market crisis in 2011 there was general agreement about the central problems impeding capital market development:

- Limited SEC capability in areas of regulation, surveillance, and enforcement.
- Limited financial stability oversight and policy coordination between SEC, the Bangladesh Bank and the Ministry of Finance.
- Weak regulation, governance and operation of stock exchanges.
- Small institutional investor and mutual fund industry and an underdeveloped insurance industry serving less than two percent of the population.
- Limited supply of bonds and equities.
- Inefficient enforcement of mortgage rights. Despite the creation of Money Loan Courts (1990), judicial execution is very cumbersome and can take more than 10 years.
- More recently, the excessive dependence of budget financing on non-bank borrowing in the form of non-tradable National Savings Certificates became another obstacle to capital market development.

The government has devised a roadmap of institutional reforms that aim to bring transparency and efficiency to the capital market, elaborated in the Capital Market Development Master Plan 2012–22, and the Sixth (2011–15) and Seventh (2016–2020) Five-Year Plans.[2]

The Master Plan laid out five strategic objectives:

- Rehabilitate the SEC by securing its operational and financial independence, strengthening its organizational structure, enhancing the quality and quantity of its staff, and strengthening its information and internal control systems.
- Strengthen the rules and regulations pertaining to the capital markets, including addressing the slow court system.
- Upgrade the financial market infrastructure.
- Create a fertile environment to enable the orderly and sustainable emergence of new products (corporate bonds, asset-backed securities and derivatives);

[2] Asian Development Bank (ADB) has been providing financial and technical support though Capital Market Development Programs, and the World Bank has proposed capital market development as one of the reform areas that could be supported through its Development Policy Credit.

- Ensure a fertile environment to enable the orderly and sustainable expansion of institutional investors' (mutual funds, insurance companies, pension funds) participation in the capital markets.

Since the launch of the Master Plan, and with the ADB support, the government has made progress in some areas, particularly stock market functioning and regulation. Importantly, the two stock exchanges, Dhaka Stock Exchange and Chittagong Stock Exchange, have been demutualized. The government has also been working to improve the coordination between regulators to enhance financial stability, and has taken steps to improve investors' protection and regulation of the equity market. The government adopted a National Insurance Sector Development Policy (2014) that can provide a stronger domestic investor base. But many challenges remain, including the need to strengthen limited regulatory capacity, improve the poor quality of financial information, and the development of a deep and liquid government securities market.

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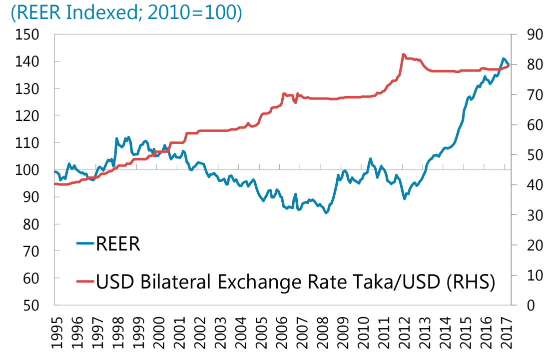
Annex V. Bangladesh: External Sector Assessment

The external position is moderately stronger than implied by fundamentals and desirable policies. The policy mix should aim to boost both private and public investment necessary to maintain competitiveness, which in turn would help reduce the current account (CA) surplus.

CA Norm: EBA Lite Analysis (in percent of GDP)	
(1) CA-Actual	0.9%
(2) CA-Norm (from model)	-5.0%
(3) CA-Norm (adjusted)	-1.0%
(4) CA-Gap	1.9%
(5) Real Exchange Rate Gap	-9.0%

Current account. In FY2016, the CA is estimated to continue to remain in surplus as in the previous fiscal years. Exports and imports of goods and services grew by an estimated 9.5 percent and 4.8 percent respectively while remittances dropped by 3.0 percent. The fitted CA equation from the EBA-lite methodology estimates a norm for the CA as a deficit of 5.0 percent of GDP. This fitted equation continues to systematically underestimate the actual CA suggesting that the methodology does not fully capture country characteristics (such as high propensity to save and low investments, low levels of FDI etc.) pertinent to the Bangladeshi economy.[1] These characteristics are also important to understand the persistent CA surplus' (compared to other countries in the sample) in an economy that continues to save instead of investing. Adjusting for these fundamentals, staff estimate the CA norm to be -1.0 percent of GDP.

Bangladesh: Exchange Rates
(REER Indexed; 2010=100)

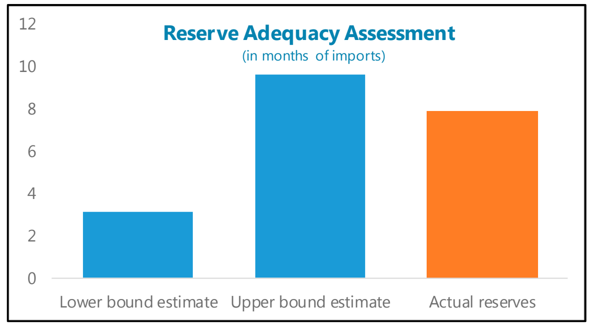


Source: IMF, *Information Notice System* database.

Real exchange rate. The U.S., Germany and the U.K. represent Bangladesh's three main export destinations. The expected protracted slowdown in the European Union along with the recently announced Brexit could hurt exports. Anecdotal evidence suggests that British garment importers have started putting price pressures on exports following the announcement of the Brexit. In the short-term, the impact may not be a major concern (exports are based on U.S. dollars) but in the long term rising inflation expectations in the U.K. from the expected depreciation of the pound will affect exports. Additionally, large uncertainty on the future of global trade persists and adds to external risk. The taka real exchange rate continues to appreciate vis a vis trading partners and despite weakened global external demand, exports held up. While, the possibility that the growing inflation differentials between trading partners could erode competitiveness exists, the REER model

[1] Studies done by think tanks and research institutions in Bangladesh point to a high propensity to save given credit constraints, investment opportunities and a large migrant worker population employed mostly on short term contracts. These studies are referenced here Center for Policy Dialogue and here Remittances Development Dynamics of Remittances in Bangladesh, Barai (2012).

regression, suggests a further appreciation of a similar magnitude as the CA model given country fundamentals.[2]



Reserve adequacy. Over the past four years, Bangladesh has witnessed strong growth in export earnings and remittances, and gross international reserves have doubled from US$ 15.1 billion (4.0 months of prospective imports) in FY13 to US$ 30.1 billion (7.2 months of prospective imports) at end FY16. The previous Article IV consultation had assessed the level of reserves as adequate. The IMF's ARA-CC approach for LICs suggests an adequacy ranging from 3.1 (floating exchange rate) to 9.6 (fixed exchange rate) months of imports given the country specific characteristics of Bangladesh.[3] The de jure exchange rate arrangement is classified as floating, but the central bank intervenes in the foreign exchange market to keep the exchange rate relatively stable against the US dollar. Therefore, with the de-facto fixed exchange rate a reserve coverage close to top end of the range would seem appropriate. Hence the actual reserve coverage of close to eight months of imports at end FY2016, continues to assess the reserve adequacy in Bangladesh as adequate.

[2] Based on available data and Staff judgement. With public and private external debt broadly matched by gross international reserves (both around 14 percent of GDP), a wide range of current account norms would be consistent with a sustainable external position. Accordingly, the external sustainability model has not been used for purposes of estimating the current account gap in the case of Bangladesh.

[3] Based on the cost of holding reserves set at the regional average (7.15 percent). Traditional measures that assess reserve adequacy – 3-month import rule, 20 percent broad money coverage, and 100 percent short-term debt coverage – remain important tools to measure reserve adequacy but they may not necessarily reflect country specificities.

Annex VI. Key Reforms under the World Bank and Asian Development Bank Programs with Bangladesh

1. Reforms under the World Bank's Country Partnership Framework (CPF)

World Bank's strategy is reflected in the Country Partnership Framework (CPF) for FY16–20. The CPF, which is aligned with the Government's Seventh Five Year Plan, is anchored in the Bangladesh Systematic Country Diagnostic (SCD), which was completed in 2015. The SCD identified five transformational investments needed for Bangladesh to create more and better jobs and to accelerate poverty reduction. These are in the areas of energy; inland connectivity and logistics; regional and global integration; urbanization; and adaptive delta management. In addition, the SCD identified three foundational priorities which represent important prerequisites for growth and where policy attention must be sustained: macroeconomic stability; human development; and institutions and business environment.

The Bank is focused on the following reform areas:

Tax policy and administration. WB continues to provide financial support for several aspects of implementing the VAT law, including designing organizational reforms and new administrative processes, which are urgent priorities. The WB has also provided TA to the implementation process.

Public financial management (PFM). WB has provided assistance through its administration of the Strengthening Public Expenditure Management Program (SPEMP), supported by a multi-donor trust fund. SPEMP focused on core PFM issues in the executive branch of government, as well as strengthening public expenditure oversight functions in parliament and audit institutions. IDA is also taking the lead on public procurement reform and capacity building.

Debt management. The IMF and WB continue working jointly in this area, including on the DSA, with the IMF coordinating views on main macroeconomic assumptions and outlook and supporting structural reforms on debt management through Article-IV consultations, and IDA providing technical support on debt management capacity through the Public Expenditure and Revenue Analysis (PERA) work, Analytical Support Activity on Public Financial Management (PFM) reforms as well as a Debt Management Performance Assessment (DeMPA).

Monetary and exchange rate policies. The WB is supporting reforms to strengthen payments systems at Bangladesh Bank (BB).

Financial sector reforms. WB is providing support to improve the regulatory and oversight capacity of BB and help strengthen the SOCBs through automation/improved management systems and business process reengineering, including potential governance reforms, and laying the foundation for a well-functioning insurance and pension sector.

Energy sector reform. The WB is leading the policy dialogue and investment in this area. While spending on subsidies has come down as a share of GDP, further price adjustments are needed, including through adoption of systematic adjustments to domestic fuel prices in line with international price movements. Reducing financial and operational inefficiencies in state owned enterprises in the energy sector is also critical. Finally, going forward, proper incentives are needed for stepped-up private investment in the energy sector including through institutionalization of transparent and competitive procurement processes.

Social protection. The WB is supporting reforms to further improve targeting and consolidation of a large number of programs through the development of the National Household Database to be used for objective beneficiary selection and for improved management and administration of social safety nets.

Trade and investment climate reform. Following completion of a Diagnostic Trade Integration Study the IFC is targeting incremental reforms with the aim of improving legal and administrative procedures. A joint IDA–IFC unit, will address institutional and policy reforms (including those addressed in the Diagnostic Trade Integration Study) to boost trade and sectoral competitiveness and will provide IDA financing for development of special economic zones.

Statistical policy. WB has a sustained engagement in improving statistics focused mostly on poverty, social, development statistics, and statistical infrastructure including IT needs and currently working on a modality to ramp up support in the area.

The WB and the government of Bangladesh are also exploring modalities for cooperation through a Development Policy Credit. Discussions on reforms to support the instrument are ongoing (see note below from the WB).

2. Reforms under ADB's Country Partnership Strategy

The Country Partnership Strategy (CPS) 2016–2020, approved on September 28, 2016, focuses on the following priority investments for projects and programs: (i) easing infrastructure constraints in key sectors such as energy, transport and urban development; (ii) improving human capital through better education and skills development; (iii) promoting economic corridor development; (iv) improving rural livelihoods; and (v) providing climate and disaster resilient infrastructure and services. The CPS is closely aligned with the government's Seventh Five-Year Plan (FY2016–FY2020) priorities and aims to contribute to faster, inclusive and environmentally sustainable economic growth. Under the CPS, ADB aims for lending totaling $8 billion for the period of 2016–2020.

The CPS prioritizes the drivers of change—higher private sector participation, addressing institutional capacity constraints and improving governance, deepening regional cooperation and integration, promoting gender equality and capital market development. The CPS will combine financial support with technical assistance.

INTERNATIONAL MONETARY FUND

BANGLADESH

May 12, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By	Asia and Pacific Department (With inputs from other departments, the World Bank, and the Asian Development Bank)

CONTENTS

FUND RELATIONS

(As of March 31, 2017)

Membership Status

Joined August 17, 1972; accepted the obligations under Article VIII, Sections 2, 3, and 4 on April 11, 1994.

General Resources Account

	SDR Million	Percent Quota
Quota	1,066.60	100.00
Fund holdings of currency (exchange rate)	932.64	87.44
Reserve tranche position	133.99	12.56

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	510.40	100.00
Holdings	968.44	189.74

Outstanding Purchases and Loans

	SDR Million	Percent Quota
ECF arrangements	639.96	60.00

Latest Financial Arrangements

(In millions of SDRs)

Type	Date of Arrangement	Expiration Date	Amount Approved	Amount Drawn
ECF	Apr. 11, 2012	Oct. 29, 2015	639.96	639.96
ECF[1]	Jun. 20, 2003	Jun. 19, 2007	400.33	316.73
ECF[1]	Aug. 10, 1990	Sep. 13, 1993	345.00	330.00

[1] Extended Credit Facility (ECF), formerly PRGF.

Projected Payments to the Fund[2]

(In millions of SDRs (based on existing use of resources and present holdings of SDRs))

	2017	2018	2019	2020	2021
Principal	9.14	36.57	82.28	91.42	127.99
Charges/Interest	0.02	0.02	0.02	0.02	0.02
Total	9.16	36.59	82.30	91.44	128.01

[2] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Article IV Consultation

The previous Article IV consultation was concluded on November 17, 2015 (IMF Country Report No. 16/27).

Safeguards Assessment

- A safeguards assessment of Bangladesh Bank (BB) was concluded in July 2011. Since then, the BB has implemented a number of recommendations, including the approval for the incorporation of the Security Printing Corporation (Bangladesh) Limited, a subsidiary of BB, in the audit plan of BB's internal audit department; and the approval of Reserve Management Guidelines by the BB Board and monitoring of investment of foreign exchange reserves by a committee headed by a Deputy Governor. In the last two years, the authorities appointed local audit firms which are members of a global network of independent audit firms to audit BB's financial statements. They have provided unqualified audit reports explaining why management believes that the funds paid out through unauthorized transactions in February 2016 are recoverable. The BB's audit committee was reestablished in April 2017.

Anti-Money Laundering (AML) and Combating the Financing of Terrorism (CFT)

- Bangladesh has made progress in strengthening the anti-money laundering and counter-terrorism financing. The Asia/Pacific Group on Money Laundering (APG) completed its assessment of Bangladesh' anti-money laundering and counter-terrorist financing (AML/CFT) system. The assessment is a comprehensive review of the effectiveness of Bangladesh' AML/CFT system and its level of compliance with the FATF Recommendations. The report was formally adopted by at the APG Annual Meeting in September 2016. Bangladesh has made significant progress since the last Mutual Evaluation Report in 2009, reflecting political commitment and leadership on AML/CFT. The levels of technical compliance with the forty recommendations are generally high. However, levels of effectiveness across the eleven immediate outcomes are more mixed. The authorities are preparing an action plan to address the shortcomings.

Exchange Arrangement

- **Exchange regime.** The *de jure* exchange rate regime is a float. Effective February 7, 2013, the *de facto* regime was reclassified from other managed to a stabilized arrangement.
- **Exchange restriction.** Bangladesh is an Article VIII member and maintains one restriction subject to Fund approval under Article VIII, Section 2(a) on the convertibility and transferability of proceeds of current international transactions in nonresident taka accounts. In September 2013, a strategy paper laid out a roadmap toward gradual liberalization of exchange regulations. Since then, BB has eased several foreign exchange regulations and reporting routines. These include easing of restrictions on certain debits for current transactions purposes from the nonresident taka accounts, though a prior approval is required. In September 2015, amendments to the 1947 Foreign Exchange Regulations Act were approved in parliament, also easing existing regulations.

Resident Representative

The resident representative office was established in 1972. Ms. Stella Kaendera is the current Resident Representative since July 2014.

Bangladesh Technical Assistance, Oct 2015 - Mar 2017		
Department	**Topic**	**Timing**
FAD	Tax Administration	October - 2015
	Public Financial Management	November - 2015
	Tax Administration	February - 2016
	TADAT assessment	February - 2017
MCM	Reserves Management	August - 2016
	Strengthening Capacity for Internal Audit	September - 2016
STA	International Investment Position Statistics	October - 2015
	National Accounts Statistics & Property Price Index	March - 2016
	Monetary and Financial Statistics	April - 2016
	National Accounts	June - 2016
	Government Finance Statistics	August - 2016
	National Accounts	November - 2016
	National Accounts	March - 2017
	SARTTAC: National Accounts	March - 2017

IMF-WORLD BANK COLLABORATION

(April 2017)

1. The IMF and World Bank Group (both International Development Association (IDA) and International Finance Corporation (IFC) teams) work together to promote policies and critical reforms that are essential for maintaining macroeconomic and financial stability and for sustained high growth and poverty reduction in Bangladesh.

- Until recently, the IMF's priorities for macroeconomic policies and structural reforms were anchored by the Extended Credit Facility (ECF) arrangement, approved in April 2012 and completed in October 2015. With support from this arrangement, the authorities restored macroeconomic stability and undertook reforms in the areas of domestic revenue mobilization, notably enacting a new Value Added Tax Act in 2012; tax revenue administration; fiscal expenditure allocation, including the reduction in regressive energy subsidies and strengthening of social safety nets; public financial management, including strengthening the external debt management; banking supervision and regulation, including amending the Banking Companies Act in 2013; addressing weaknesses in the state-owned commercial banks; improving central bank operations; and liberalizing foreign exchange regulations. The priorities for macroeconomic policies and reforms going forward are identified in the main text of this report.

- The Bank's strategy is reflected in the Country Partnership Framework (CPF) for FY16-20, endorsed by the Bank Board in April, 2016. The CPF, which is aligned with the Government's Seventh Five Year Plan, is anchored in the Bangladesh Systematic Country Diagnostic (SCD), which was completed in 2015. The SCD identified five transformational investments needed for Bangladesh to create more and better jobs and to accelerate poverty reduction. These are in the areas of energy; inland connectivity and logistics; regional and global integration; urbanization; and adaptive delta management. In addition, the SCD identified three foundational priorities which represent important prerequisites for growth and where policy attention must be sustained: macroeconomic stability; human development; and institutions and business environment.

2. The teams note that collaboration between the IMF and the World Bank Group is strong, both at headquarters and in the field (through the IMF Resident Representative's Office and the World Bank's Country Office). For instance:

- There are frequent formal and informal exchanges of information on each other's activities and on assessments of developments, the outlook, and key policy issues.

- The teams invite each other to participate in critical internal discussions, share key documents, and seek comments on them.

- Staffs are also invited to relevant Board meetings.

- The teams regularly discuss the division of labor between the two institutions, and collaborate on the Debt Sustainability Analysis (DSA).
- WBOD and IMF are now also in the same building in Dhaka, facilitating yet deeper collaboration.

3. The teams agree that the two institutions should remain focused on the following reform areas, and based on the following division of labor:

Tax policy and administration. Bangladesh has one of the lowest tax-to-GDP ratios in the world. To boost growth, higher public investment in critical infrastructure is needed and for that purpose it is necessary to improve revenue generation. Under the ECF arrangement, the authorities enacted a new Value Added Tax (VAT) Act, 2012, which is now being implemented for a launch in July 2017. The new VAT is currently the authorities' main tool to boost tax collections over the medium term. Efforts to boost the capacity of the National Board of Revenue are ongoing.

Division of labor: The new VAT law and the VAT implementation plan continue to receive technical assistance (TA) from the IMF. A resident advisor was in place until late 2014 to help with VAT implementation. IDA is providing financial and TA support for several aspects of implementation, including designing organizational reforms, new business processes, and taxpayers' outreach which are urgent priorities under the VAT Improvement Program (VIP). Both institutions are currently providing TA to the implementation process. In early 2017, a joint Bank-Fund mission carried out the Tax Administration Diagnostic Assessment Tool (TADAT). The team is now currently working with the National Board of Revenue (NBR) to finalize the results of the assessment. Prior to the TADAT mission, a joint Bank-Fund team also provided training to tax administration officials across South Asia. The training was hosted by the NBR and was attended by tax administrators from Nepal, Sri Lanka, Bhutan and Bangladesh.

Public financial management (PFM). Sound PFM is important for maintaining fiscal discipline and improving the quality of public expenditure. The Government of Bangladesh (GoB) has undertaken series of public financial reform programs since the 1990s onwards. Since 2007, the WB-administered a Multi Donor funded Strengthening Public Expenditure Management Program (SPEMP) for supporting GoB PFM Vision and Medium Term Rolling Action Plan 2007-12. Through three discrete projects, SPMEP supported improving core PFM issues in the executive branch of government, as well as strengthening public expenditure oversight functions in Parliament (PAC) and Auditor General. In FY 2016, the GoB approved a new PFM strategy 2016-2021. The PFM reform strategy draws on Bank supported four policy notes (legal and regulatory framework; Integrated Budget and Accounting System (iBAS++); strengthening policy-budget link and integration of non-development and development budgets; and analysis of State-Owned Enterprises (SOE) financial reporting and oversight) and IMF Fiscal Affairs Department Technical Assistance Report 2015 on Strengthening the Budget Formulation Process, and other IMF analyses.

Division of labor: IDA has provided assistance through its administration of the Strengthening Public Expenditure Management Program (SPEMP). The MDTF was recently extended for five-years which will allow the WBG and the SPEMP Donors to support the PFM Strategy implementation as a key element of a broader engagement with the Government in this area. Concurrently, IDA is also taking the lead on public procurement reform and capacity building, and assisting the Government over the last one decade through two consecutive credits (Public Procurement Reform Project- PPRP; PPRPII), with the recent introduction of electronic government procurement that is rapidly expanding. Another project, Digitizing Implementation Monitoring and Public Procurement Project (DIMAPPP), is now at the advance stage of preparation (negotiations). The IMF is providing support through several TA missions on cash flow forecasting and management, on budget and accounting classification, and on the budget formulation process.

Debt management. There had been significant progress on strengthening debt management practices under the ECF arrangement, but more needs to be done.

Division of labor: The IMF and IDA will continue working jointly in this area, including on the DSA, with the IMF coordinating views on main macroeconomic assumptions and outlook and supporting structural reforms on debt management through Article-IV consultations, and IDA providing technical support on debt management capacity through the Public Expenditure and Revenue Analysis (PERA) work, Analytical Support Activity on PFM reforms as well as a Debt Management Performance Assessment (DeMPA).

Monetary and exchange rate policies. The IMF takes the lead in this area. IDA is playing a complementary role through operations to strengthen payments systems at Bangladesh Bank (BB).

Financial sector reforms. A sound and viable financial sector will remain critical for creating an improved environment for private sector investment. The IMF had provided TA on banking supervision, including through a resident advisor until late 2014, and on strengthening the state-owned commercial banks (SOCBs). The IMF will continue to support banking sector reforms through the Article-IV consultations. IDA will provide support to improve the regulatory and oversight capacity of BB. The case for improving governance, non-performing loans situation, and operational efficiency in the banking sector, especially in the SOCBs, continue to be relevant as well.

Energy sector reform. Over the last three years, spending on subsidies, particularly on energy, has declined as a share of GDP, initially through domestic price adjustments and more recently with help from a decline in the international oil prices. Reducing financial and operational inefficiencies in state-owned enterprises in the energy sector is also critical. Although there is a strong political will to corporatize the remaining distribution and generation assets to improve transparency, productivity and accountability, there has been strong resistance from the worker's union. Bangladesh ranks poorly among the low-income countries in terms of availability of electricity. While the fuel diversity is a necessity with the shortage in availability of natural gas which is primary fuel, reliance on expensive liquid fuel for power generation needs to be reduced which eventually would reduce the subsidy burden on the government. Proper incentives are needed for step up private investment in the energy sector. Institutionalization of transparent and competitive procurement processes will send the right signal to the market and help attract qualified sponsors. Division of labor: IDA will lead on policy dialogue and investment in this area, with the IMF focused on policies to address fiscal implications.

Social protection. Under the ECF arrangement social spending as a share of GDP was protected. However, further improvement is needed, particularly through better targeting, and consolidation of a large number of programs. Rationalization of regressive subsidies will also help provide additional room for enhanced spending on social safety programs.

Division of labor: IDA is taking the lead in this area through support to the development of the National Household Database to be used for objective and transparent beneficiary selection and strengthening administrative platforms at the central and local levels for improved management and better coordination of SSNs.

Trade and investment climate reform. To boost productivity and investment, it is vital to create a level playing field for all sectors and reduce the cost of doing business.

Division of labor: The Trade & Competitiveness (T&C) Global Practice, a joint IDA-IFC Unit, is targeting trade and investment reforms through a holistic approach. As part of integrated solution, IDA is providing investment financing (including pipeline) while IFC provides complementary advisory services in areas of business environment reforms, special economic zones, and trade and sectoral competitiveness for export diversification. T&C will address institutional and policy reforms (including those addressed in the Diagnostic Trade Integration Study and Doing Business analytics) to boost trade and sectoral competitiveness. The IMF provided support in reviewing the foreign exchange regulations.

Statistical policy. Improvements in statistics are critical to formulating sound policies and monitoring their outcomes. Both IDA and the IMF have sustained engagement in this area and will ramp it up further in the future as needed.

Division of labor: IDA is working on poverty, social, development statistics, and statistical infrastructure including IT needs and the IMF on macroeconomic and financial statistics. IDA is currently in the preparation phase of a new investment loan to enhance the capacity of the Bangladesh Bureau of Statistics (BBS).

Other structural policies. The World Bank keeps the IMF informed about its work on governance and anti-corruption, local government and decentralization, and private sector development. Upstream sharing allows the IMF to comment on such work before it is finalized.

4. The teams agree to continue to keep each other informed of their respective activities, coordinate financial and technical support, and share key documents.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

(April 2017)

Lending and Technical Assistance Operations

1. Bangladesh had cumulative public sector borrowing from the Asian Development Bank (ADB) of US$18.0 billion (256 loans) as of December 31, 2016, and technical assistance (TA) grants of US$252.4 million (422 projects). The country has been one of the largest borrowers of concessional resources. The loans and TA have supported all key sectors, including energy and transport, social infrastructure, and agriculture and natural resources.

2. In 2016, the ADB approved a total amount of US$1.1 billion in loans. This included loans for (i) Skills for Employment Investment Program (tranche 2) (US$100 million concessional ordinary capital resources loans (COL)); (ii) Natural Gas Infrastructure and Efficiency Improvement Project (US$167 million of which US$67 million is from COL); (iii) Railway Sector Investment Program-tranche 4 (US$50 million); (iv) SASEC Chittagong-Cox's Bazar Railway Project Phase 1- tranche 1 (US$300 million of which US$90 million is from COL); (v) Second Small and Medium-Sized Enterprise Development Project (US$200 million); (vi) Dhaka Water Supply Network Improvement Project (US$275 million); (vii) Coastal Towns Environmental Infrastructure Project-additional financing (US$6 million); (viii) Rural Infrastructure Maintenance Program- PDA (US$2 million COL); and (ix) City Region Development Investment Program- PDA (US$5 million COL).

3. The ADB has also supported 13 private sector projects worth US$422.3 million as of December 31, 2016. A US$20 million loan to Eastern Bank was approved in 2016 to finance the construction or expansion of textile and garment factories that will meet the high structural, fire, and electrical supply safety standards required by the 2013 Accord on Fire and Building Safety in Bangladesh and the 2013 Alliance for Bangladesh Worker Safety.

Country Partnership Strategy

4. The Country Partnership Strategy (CPS) 2016-2020, approved on September 28, 2016, focuses on the following priority investments for projects and programs: (i) easing infrastructure constraints in key sectors such as energy, transport and urban development; (ii) improving human capital through better education and skills development; (iii) promoting economic corridor development; (iv) improving rural livelihoods; and (v) providing climate and disaster resilient infrastructure and services. The CPS is closely aligned with the government's Seventh Five-Year Plan (FY2016-FY2020) priorities and aims to contribute to faster, inclusive and environmentally sustainable economic growth. Under the CPS, ADB aims for lending totaling US$8 billion for the period of 2016-2020, including nonsovereign lending. ADB's market-based financing from its ordinary capital resources would be used for major revenue-generating infrastructure projects. An average of US$4.3 million per annum and above in TA resources was included. In addition, TA loans

[1] Bangladesh joined the Asian Development Bank in 1973

and project design advances under the lending programs will support project and program preparation and advance their readiness.

5. The CPS prioritizes the drivers of change—higher private sector participation, addressing institutional capacity constraints and improving governance, deepening regional cooperation and integration and promoting gender equality. The CPS will combine financial support with knowledge. The CPS is operationalized through the Country Operations Business Plans (COBPs). The COBP, 2017–2019 was approved in October 2016.

6. Over a five-year cumulative period from 2012–2016, Bangladesh leveraged US$3.5 billion of cofinancing. By the end of 2016, cumulative direct value-added official cofinancing for Bangladesh amounted to US$7.5 billion for 58 investment projects and US$84.9 million for 101 technical assistance projects. In 2016, seven projects received cofinancing: (i) from the World Bank, Chevron USA, and the Government of Switzerland for Skills for Employment Investment Program- tranche 1 (US$80 million) and tranche 2 (US$4.5 million); (ii) from the Asian Infrastructure Investment Bank for Natural Gas Infrastructure and Efficiency Improvement Project (US$60 million); (iii) from Danish International Development Agency, Agence Française de Développement, and European Investment Bank for Dhaka Water Supply Network Improvement (US$372 million); (iv) from Japan International Cooperation Agency, and KEXIM Bank for Railway Sector Investment Program- tranche 4 (US$138.72 million); and (v) from KEXIM Bank for South Asia Subregional Economic Cooperation Railway Connectivity: Akhaura-Laksam Double Track (US$192 million) .

Economic and Sector Work Program

7. Each year, the ADB publishes its Asian Development Outlook and Asian Development Outlook Update, in which it assesses macroeconomic performance. The ADB's Bangladesh Resident Mission (BRM) also prepares a bimonthly Economic Indicators Update. In addition, BRM commissions studies on economic and thematic areas, relevant to the country's development issues.

STATISTICAL ISSUES

(April 2017)

Assessment of Data Adequacy for Surveillance

General. Data provision has some shortcomings, but is broadly adequate for surveillance. The most affected areas are national accounts, fiscal, and external sector statistics.

National Accounts. Bangladesh's annual GDP time series has a base year of 2005/06 based on a comprehensive benchmark compiled and published by the Bangladesh Bureau of Statistics (BBS) in 2013. There is a material statistical discrepancy in subsequent time periods as minimal source data is available – estimates are predominately derived from a biennial census of manufacturing establishments or extrapolations from the 2005/06 benchmark. A revision of the entire GDP time series based on the new 2015-16 benchmark is expected to be published in financial year 2019-20. Final annual GDP estimates are now published four, rather than ten, months after the reference period. The BBS has been provided with technical assistance to use value-added tax (VAT) data from the National Board of Revenue (NBR) to compile contemporary estimates and construct a contemporary statistical business register to increase the scope and coverage of economic statistics, and monthly VAT data from NBR is expected to be available from July 2017. Quarterly GDP is currently not compiled, but a technical assistance has been provided to develop a plan for quarterly flash GDP indicators based on available monthly and quarterly data, including the VAT data. The BBS is also implementing recommendations provided by the resident advisor to: (a) improve compilation procedures used to construct GDP; and (b) enhance institutional arrangements and address concerns raised by users.

Price Statistics. A new CPI series with base year 2005/06 was introduced in July 2012 and improved coverage. However, data users such as Bangladesh Bank have raised concern about the reliability of the CPI data. The CPI series is currently undergoing further improvements, including incorporating the recent household survey and Classification of Individual Consumption According to Purpose (COICOP). The IMF provided technical assistance TA in these areas. The producer price index has an outdated base year (1988/89) and requires urgent attention.

Government Finance Statistics. The Ministry of Finance (MoF) is currently revising the Budget and Accounting Classification System (BACS) to follow the latest international standard (GFSM 2014) and integrate the accounting and reporting systems for the budgetary central government. The new BACS is expected to be incorporated into the FY18 Budget. Bangladesh currently reports budgetary central government flow data for the GFS yearbook. No stock data is reported. The coverage of extrabudgetary and local government units outside central government is inadequate and is an area for future attention. The Bangladesh Bank (BB) provides data to the World Bank-IMF Quarterly Public Sector Debt Statistics database. No data are published on the assets and liabilities of the general government.

Monetary and Financial Statistics. BB compiles monetary data using the standardized report forms (SRFs) framework. The SRFs are reported electronically to the IMF on a regular basis. As a result, a consistent time series based on SRF data is available from December 2001. A survey of Other Financial Corporations (OFCs) is not yet available.

Financial Soundness Indicators. Bangladesh has started reporting 10 core and 9 encouraged Financial Soundness Indicators (FSIs) since August 2014.

External Sector Statistics. A quarterly BPM6 compliant time series covering the period 2005 to 2015 inclusive has been published by BB and reflects improved coverage of indicators, as well as of periodicity, and dissemination of balance of payments, international investment position, and external debt statistics. Reporting of data to the IMF's Coordinated Portfolio Investment Survey was also a major achievement. These were possible with TA support from the Japan Subaccount Project on the Improvement of ESS in the Asia and Pacific region. Despite the important progress made, steps remain to be taken by the BB to further improve the quality of ESS and ensure the continuous timely compilation and dissemination of Bangladesh's ESS.

Data Standards and Quality

Bangladesh has participated in the General Data Dissemination System (GDDS) since March 2001. The Data Module of the ROSC was published in December 2005. Metadata for the Enhanced General Data Dissemination System (e-GDDS) had not been updated since 2002.

Bangladesh: Table of Common Indicators Required for Surveillance

(As of May 1, 2017)

	Date of latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	4/24/17	4/24/17	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	4/24/17	4/24/17	D	D	D
Reserve/Base Money	4/24/17	4/24/17	D	D	D
Broad Money	Feb. 2017	April 2017	M	M	M
Central Bank Balance Sheet	Feb. 2017	April 2017	M	M	M
Consolidated Balance Sheet of the Banking System	Feb. 2017	April 2017	M	M	M
Interest Rates[3]	4/24/17	4/24/17	W	W	D
Consumer Price Index	Feb. 2017	March 2017	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]—General Government[5]	n/a	n/a	n/a	n/a	n/a
Revenue, Expenditure, Balance and Composition of Financing[4] —Central Government	Dec. 2016	April 2017	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Jun. 2016	Nov. 2016	Q/M	Q/M	Q/M
External Current Account Balance	Feb. 2017	April 2017	M	M	M
Exports and Imports of Goods and Services	Feb. 2017	April 2017	M	M	M
GDP/GNP	FY2016	Jun. 2016	A	A	A
Gross External Debt	FY2016	Nov. 2016	A	A	A
International Investment Position[7]	2016Q4	April 2017	Q	Q	A

[1] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); not available (NA).
[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[3] Both market-based and officially determined, including discount rates, money market rates, and rates on treasury bills, notes, and bonds.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments. Data for the general government are currently not being compiled due to capacity limitations.
[6] Currency and/or maturity composition may not be available for the most recent data.
[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

INTERNATIONAL MONETARY FUND

BANGLADESH

May 12, 2017

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

Approved By
Peter Allum (IMF) and John Panzer (IDA)

Prepared by
International Monetary Fund
International Development Association

This debt sustainability analysis (DSA) fully updates the January 2016 joint IMF/IDA DSA. Bangladesh's risk of external debt distress and overall debt distress is continued to be assessed as low. Cautious fiscal policy has kept the public debt outlook benign – total public debt is on a sustainable path. Boosting Bangladesh's low budget revenue is key to creating fiscal space for spending on power and transport infrastructure, two of the main bottlenecks to growth. The DSA assumes that the most promising new source of revenue – new value added tax (VAT) – comes into effect in full this coming fiscal year (FY18). The authorities have insisted that this new deadline will be met and that any demands from the business community to alter or water down the VAT's planned structure will be contained. [1]

[1] For the purposes of this DSA, the public sector comprises the central government and nonfinancial public enterprises. This analysis is based on the joint Fund-Bank debt sustainability framework for conducting debt sustainability analysis in low-income countries. Under IDA's Country Policy and Institutional Assessment (CPIA), Bangladesh is assessed to be a medium performer, with an average rating of 3.32 during 2013–15. This DSA uses the indicative thresholds for countries for this category.

A. Background

1. This DSA presents staffs' macroeconomic outlook and assumptions about the public sector's external and domestic borrowing paths. The DSA is based on the authorities' estimates of the stock of public external, domestic and private external debt as of end-FY16 and analyzes the likely trajectories of standard debt sustainability (solvency and liquidity) ratios through FY37.[2]

2. As of end-FY16, total public and publicly guaranteed (PPG) external debt amounted to US$26 billion (13 percent of GDP or 77 percent of exports of goods and services). The World Bank and the Asian Development Bank are—by far—the two largest creditors, with outstanding loans of US$12.1 and US$7.8 billion, respectively. The largest bilateral creditor is Japan, with outstanding loans of US$2.9 billion (text table).

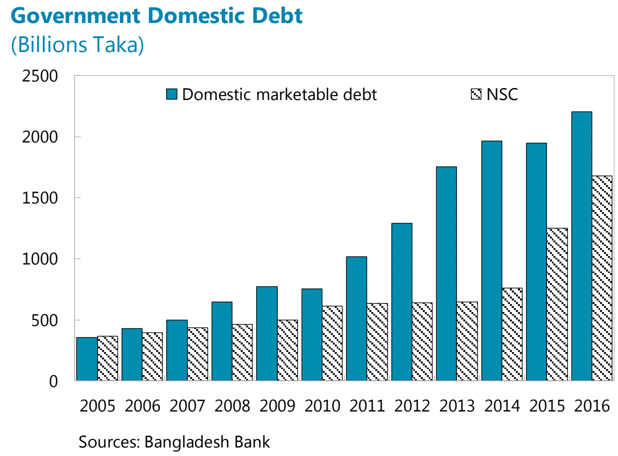
End-June 2016	USD millions	Percent
Total PPG External Debt	**26,203.72**	**100.0**
Multilateral	**20,915.7**	**79.8**
Asian Development Bank	7,823.55	29.9
Eurasian Economic Commission	14.67	0.1
World Bank (IDA)	12,108.16	46.2
Islamic Development Bank	473.08	1.8
IFAD	389.96	1.5
Nordic Development Fund	36.64	0.1
OPEC Fund	69.63	0.3
Bilateral	**5,288.0**	**20.2**
Belgium	1.34	0.0
China	1,017.70	3.9
Denmark	78.13	0.3
France	24.94	0.1
India	290.39	1.1
Japan	2,953.58	11.3
Kuwait	123.40	0.5
Norway	0.56	0.0
Russia	321.57	1.2
Saudi Arabia	63.81	0.2
South Korea	370.17	1.4
Spain	2.92	0.0
Sweden	1.44	0.0
Switzerland	1.82	0.0
United Arab Emirates	22.57	0.1
United States	13.69	0.1

Source: Bangladesh Authorities

3. Total public sector domestic debt as of end-FY16 amounted to 21.3 percent of GDP or 192 percent of central government revenues, including grants. Domestic debt comprises mostly commercial banks' holdings of treasury instruments and non-banks' holdings of national savings certificates (see box). It also includes net credit by Bangladesh Bank and the outstanding liabilities of state-owned enterprises to the banking system.

[2] Fiscal year is defined from July to June.

Box. National Savings Certificates (NSCs)



NSCs were introduced as a saving scheme for small savers when the banking system was less developed, and to provide a safety net for certain groups of population (pensioners, women etc.). NSCs have an administered interest rate usually higher than the market rates on bank deposits and government securities with similar maturity. There are about a dozen different instruments with maturities ranging between 3–5 years, available on demand. A single-lender ceiling is set to keep the scheme limited to small savers. The outstanding stock of NSCs is currently about forty percent of total domestic public debt, or ten percent of GDP. The issuance of NSCs has sharply accelerated in recent years and continues to grow mostly determined by public demand and not the budget borrowing plans of the government. The system suffers from various drawbacks such as impeding the much-needed capital market development. From a debt management point of view, given that the issuance is determined by household demand, the government is unable to develop and implement a robust borrowing and debt management strategy that would allow it to manage borrowing costs, maturities, and other aspects of its financing.

B. Underlying Assumptions

4. The main changes to the macroeconomic assumptions relative to the previous DSA are described below, primarily reflecting the impact of revisions to FY16 and FY17 projections:

Table. Macro Assumption Comparison FY16 – FY20

	FY16	FY17	FY18	FY19	FY20
Real GDP growth					
Current DSA	7.1	6.8	7.0	7.0	7.0
Previous DSA	6.3	6.8	7.0	7.0	7.0
Inflation (annual average)					
Current DSA	5.9	6.8	6.0	5.5	5.5
Previous DSA	6.5	7.0	6.7	6.4	6.1
Fiscal deficit (in percent of GDP)					
Current DSA	-3.4	-4.7	-4.4	-4.2	-4.1
Previous DSA	-4.4	-4.3	-4.1	-4.1	-4.0
Current account (in percent of GDP)					
Current DSA	1.7	-0.4	-1.0	-1.6	-2.0
Previous DSA	-1.3	-1.4	-1.6	-1.8	-2.0
Remittance growth					
Current DSA	-3.0	-17.0	3.5	3.5	4.5
Previous DSA	3.0	6.0	6.0	6.0	6.0

- **Real GDP growth.** Official statistics reported output growth rising to 7.1 percent in FY16 from 6½ percent in the preceding fiscal year, supported by robust domestic demand, particularly government consumption, private investment, and external demand. Over the medium-term, growth of 7 percent per year is achievable, but only with an increase in public and private investment and reforms that underpin capital market development and improve investment efficiency. Without these, growth is likely to fall off considerably.

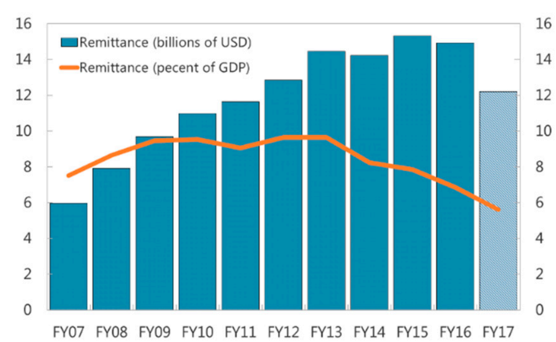
- **Inflation.** Headline CPI inflation (annual average) fell to 5½ percent by end-2016, below the 5.8 percent FY17 target, helped in part by favorable agricultural production and falling global commodity prices. Nonfood inflation has declined as well to 4½ percent in December 2016, compared to over 7 percent a year ago. Inflation is projected to increase somewhat in FY17 as global commodity prices pick up. However, with moderate money and credit growth, stable inflation expectations, and temperate private wage growth, inflation is projected to moderate in the medium term and remain close to Bangladesh Bank's target.

- **Fiscal deficit.** Preliminary data suggest that the FY16 fiscal deficit fell to around 3½ percent of GDP. In the first quarter of FY17 the budget recorded a small surplus, as for the same period a year earlier. The DSA assumes that the VAT – the most promising source of new revenue and a key structural reform under the recently completed ECF program— will be launched in July 2017.

- **Current account.** Exports held up as projected, but imports were revised down resulting in a $4½ billion improvement of the previously estimated trade deficit. This plus similar changes to the services and income accounts led to a significant upward revision to the FY16 current account surplus, from 0.5 percent of GDP to the current estimate of 1.7 percent. On the back of investment-led growth, the current account deficit is projected to widen to about 2 percent of GDP over the medium term, with international reserves remaining adequate.

- **Remittances.** The slowdown in remittances thus far in FY17 is projected to continue in the fiscal year. Remittances have been declining as a share of GDP over the past five years, and have begun falling in absolute terms. Inflows are forecast to drop further to just over $12 billion in 2017 and are assumed to pick up slightly over the medium term.

Remittance Inflows into Bangladesh



Sources: Bangladesh authorities, IMF Staff

C. External DSA

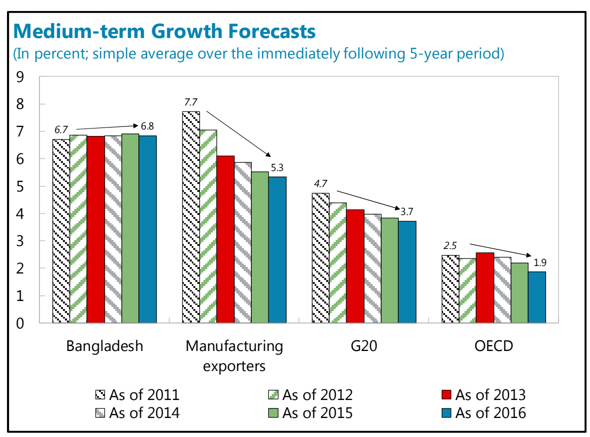
5. **All debt indicators remain well within the respective policy-dependent solvency thresholds under the baseline scenario.** The DSA baseline scenario does not include remittances given that the three year backward looking average (7.6 percent of GDP over FY14-FY16) drops below 10 percent which is the required threshold for including it in a remittance based analysis. Thus, the

remittance-adjusted thresholds for certain debt ratios are now higher.[3,4] The deterioration of the debt ratios from the exclusion of remittances does not increase the ratios by a large margin. Under the baseline scenario, the PV of PPG external debt to GDP ratio is projected to increase from 8.5 percent of GDP in FY17 to 10.2 percent in FY22, mostly reflecting externally-financed public investment. It is projected to rise slowly and reach close to 11 percent of GDP by FY37. Most PPG indicators also trend up initially, but remain well within the respective policy-dependent solvency thresholds under the baseline scenario (Figure 1 and Tables 2–3). The stress tests with the biggest impact on debt indicators are those involving a large depreciation, borrowing on less favorable terms and an exports shock.

6. Risks to the external front include a protracted slowdown in key export markets - particularly the EU and a further weakening of remittances. A combination of these could adversely affect the external sector with a negative impact on the balance of payments which in turn could deteriorate of the debt ratios.

- **Remittances continue to decline even though the number of Bangladeshi workers abroad have increased steadily in recent years.** Total remittances thus far in the fiscal year (Jul 16 – Mar 17) have dropped by over fifteen percent compared to the same period last year. GCC countries account for the largest number of migrant workers from Bangladesh and for the largest inflows of remittances into Bangladesh. Substantial deficit-reduction efforts, low oil prices and deepening conflicts that continue to weigh in on economic activity in the GCC and is expected to further affect employment and in turn remittances from these countries. Other factors including measurement gaps related to a shift away towards informal channels for transferring funds have been quoted as possible reasons.

- **Global growth is more subdued now than in the past.** The United States, Germany and the U.K. represent Bangladesh's three main export destinations. Thus, protracted risk of slowdown in the European Union could hurt exports. Additionally, per media reports, British garment importers have started putting price pressures on exports following the announcement of the Brexit. The Trans-Pacific Partnership, of which Bangladesh is not a member, is no



[3] Based on staff judgement, remittances were included in the baseline in the previous DSA. Remittances are included in the LIC DSA analysis when both criterion - larger than 10 percent of GDP and 20 percent of exports of goods and services measured on a backward-looking, three-year average basis - are met.

[4] Compared to the previous DSA, the threshold for the PV of debt to GDP is now 10 percent higher than with remittances, while the thresholds for PV of debt to exports and debt service to exports are 20 percent higher.

longer flagged as risk – however, there still remains a large uncertainty around the impact on global trade from the U.S trade policies.

D. Public DSA

7. **Bangladesh's moderate public debt and rapid growth gives scope for some cautious deficit spending as laid out in this year's budget target of 5 percent of GDP.** The budget has been and will continued to be financed mainly domestically with external financing relatively stable at around 1 percent of GDP. Currently, prudent fiscal policy has kept the public debt outlook benign. Per the DSA, the PV of public debt to GDP ratio is projected to increase from 31 per cent in FY17 to 33.8 per cent in FY22 and then stabilizing around that level over the long term as the impact of higher public investment on debt is mostly offset by an expected increase in tax revenue from the new VAT.[5] The ratio remains well within the benchmark value under the baseline and for all standard stress tests (Figure 2 and Tables 4-5). Debt indicators based on revenues trend downwards over the medium to long term also on the improvement in tax revenue from the upcoming VAT.

E. Conclusion

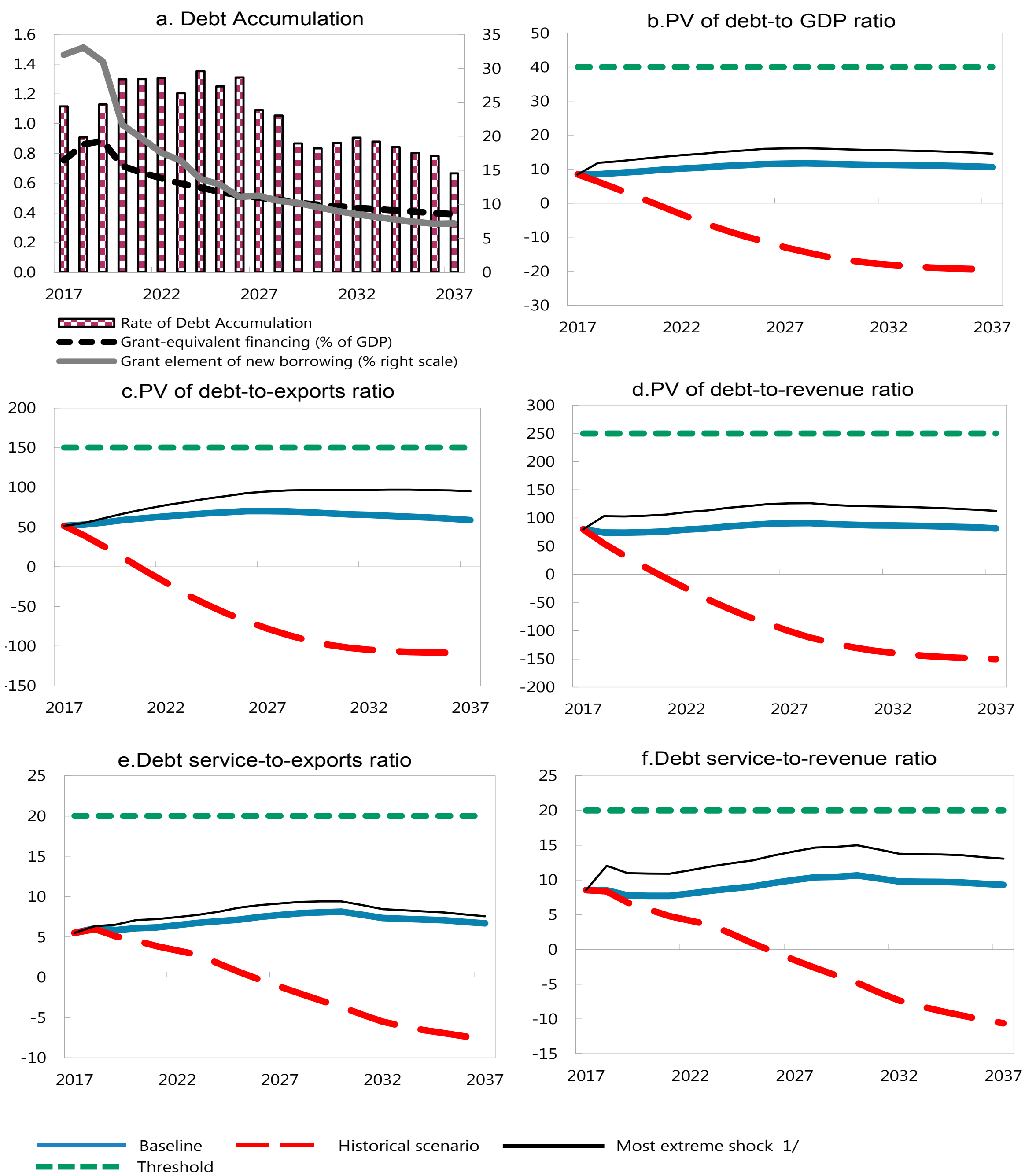
8. **The debt sustainability assessment remains unchanged and the risk of external debt distress and overall debt distress remains low.** Boosting Bangladesh's low budget revenue is key to preserving fiscal sustainability and sustaining growth. The favorable debt outlook is sensitive to the assumption of continued robust growth and revenue gains from the upcoming VAT launch. The failure to improve revenues would reduce the scope for boosting public investment, with adverse implications on growth and debt dynamics.

9. **The authorities agreed that Bangladesh continues to maintain a low risk of external debt distress along with a low risk of overall debt distress.** Moderate fiscal deficits, concessional external borrowing and prudent debt management policies have helped keep the outlook robust. The authorities acknowledged the problems arising from the rapid expansion of NSCs and that implementing the strategies in the MTDS (MTDS 2014) can get complex. They explained that they are working on proposals to improve monitoring to get a better understanding of who is benefiting from NSCs.

[5] The DSA in the 2015 Article IV discusses the consequences of failing to introduce the VAT. Please refer to Bangladesh: 2015 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Bangladesh, Country Report No. 16/27.

Figure 1. Bangladesh: Indicators of Public and Publicly Guaranteed External Debt, 2017–2037 1/

(In percent, unless otherwise mentioned)

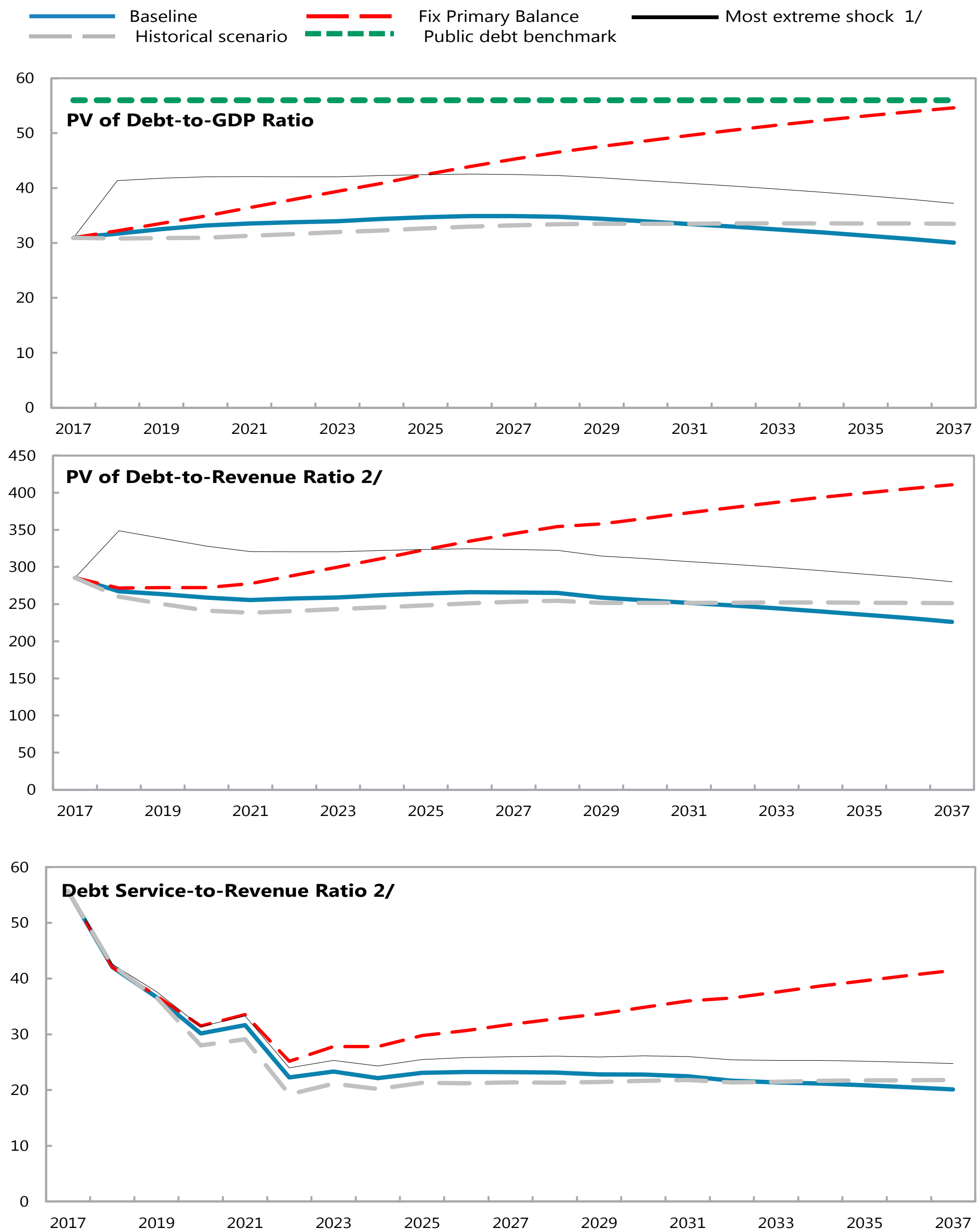


Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2027. In figure b. it corresponds to a One-time depreciation shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Bangladesh: Indicators of Public Debt, 2017–2037 1/

(In percent)



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2027.

2/ Revenues are defined inclusive of grants.

Table 2. Bangladesh: External Debt Sustainability Framework, Baseline Scenario, 2014–2037 1/

(In percent of GDP, unless otherwise indicated)

	Act 2014	Act 2015	Est 2016	Historical Average 6/	Standard Deviation 6/	Projections 2017	2018	2019	2020	2021	2022	2017-2022 Average	2027	2037	2023-2037 Average
External debt (nominal) 1/	**16.0**	**15.8**	**14.3**			**13.5**	**12.7**	**12.6**	**12.6**	**12.8**	**13.0**		**15.9**	**21.3**	
of which: public and publicly guaranteed (PPG)	15.0	13.4	13.4			13.5	13.5	13.8	14.1	14.4	14.6		15.2	12.8	
Change in external debt	-1.0	-0.2	-1.5			-0.8	-0.8	-0.1	0.0	0.2	0.2		0.6	0.3	
Identified net debt-creating flows	-3.9	-4.2	-4.3			-1.4	-0.8	-0.2	0.3	0.5	0.6		1.2	0.9	
Non-interest current account deficit	**-1.1**	**-1.9**	**-2.0**	**-1.2**	**1.3**	**0.4**	**1.0**	**1.5**	**1.9**	**2.1**	**2.2**		**2.3**	**2.2**	2.3
Deficit in balance of goods and services	6.3	5.2	4.2			4.8	5.1	5.4	5.6	5.6	5.6		5.7	5.9	
Exports	19.0	17.3	17.0			16.5	16.2	16.0	15.9	15.9	16.0		16.6	18.0	
Imports	25.3	22.5	21.1			21.3	21.3	21.4	21.5	21.6	21.6		22.3	23.9	
Net current transfers (negative = inflow)	-8.6	-8.1	-7.0	-9.1	1.0	-5.4	-5.1	-4.8	-4.6	-4.4	-4.2		-3.7	-2.9	-3.4
of which: official	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other current account flows (negative = net inflow)	1.3	1.1	0.9			0.9	0.9	0.9	0.9	0.8	0.8		0.3	-0.8	
Net FDI (negative = inflow)	**-0.9**	**-0.9**	**-0.9**	**-0.9**	**0.1**	**-0.9**	**-0.9**	**-0.9**	**-0.9**	**-0.9**	**-0.9**		**-0.9**	**-1.5**	-1.1
Endogenous debt dynamics 2/	**-2.0**	**-1.4**	**-1.4**			**-0.9**	**-0.8**	**-0.8**	**-0.7**	**-0.7**	**-0.7**		**-0.3**	**0.2**	
Contribution from nominal interest rate	0.3	0.4	0.3			0.0	0.0	0.1	0.1	0.1	0.2		0.6	1.5	
Contribution from real GDP growth	-0.9	-0.9	-1.0			-0.9	-0.9	-0.8	-0.8	-0.8	-0.8		-0.9	-1.3	
Contribution from price and exchange rate changes	-1.3	-0.9	-0.7			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**3.0**	**4.0**	**2.8**			**0.6**	**0.0**	**0.1**	**-0.3**	**-0.3**	**-0.4**		**-0.6**	**-0.7**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	9.0			8.4	7.7	7.7	7.8	8.1	8.5		12.3	19.1	
In percent of exports	...	...	53.4			51.2	48.0	48.1	49.3	51.1	53.3		74.2	105.8	
PV of PPG external debt	**...**	**...**	**8.1**			**8.5**	**8.6**	**8.9**	**9.3**	**9.8**	**10.2**		**11.6**	**10.6**	
In percent of exports	**...**	**...**	**47.9**			**51.4**	**53.0**	**55.8**	**58.9**	**61.3**	**63.6**		**69.9**	**58.6**	
In percent of government revenues	**...**	**...**	**78.9**			**79.8**	**74.1**	**74.0**	**74.7**	**76.2**	**79.3**		**90.6**	**81.4**	
Debt service-to-exports ratio (in percent)	**5.3**	**7.6**	**6.7**			**7.0**	**7.1**	**6.5**	**6.6**	**6.5**	**6.7**		**13.3**	**29.2**	
PPG debt service-to-exports ratio (in percent)	**3.7**	**3.9**	**3.4**			**5.5**	**6.1**	**5.9**	**6.1**	**6.2**	**6.5**		**7.7**	**6.7**	
PPG debt service-to-revenue ratio (in percent)	**6.8**	**7.1**	**5.6**			**8.5**	**8.5**	**7.8**	**7.7**	**7.7**	**8.1**		**10.0**	**9.3**	
Total gross financing need (Billions of U.S. dollars)	-0.1	-1.8	-0.4			1.9	1.6	1.0	1.3	1.2	1.7		12.6	68.9	
Non-interest current account deficit that stabilizes debt ratio	-0.1	-1.7	-0.5			1.2	1.7	1.6	1.9	1.9	2.0		1.8	2.0	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.1	6.6	7.1	6.2	0.6	6.8	7.0	7.0	7.0	7.0	7.0	7.0	6.5	6.5	6.5
GDP deflator in US dollar terms (change in percent)	8.7	5.9	4.4	5.2	3.2	1.9	2.4	2.1	2.1	2.0	2.0	2.1	2.0	2.0	2.0
Effective interest rate (percent) 5/	1.7	3.0	2.1	1.5	0.7	0.3	0.2	0.4	0.8	1.1	1.4	0.7	4.5	7.6	5.5
Growth of exports of G&S (US dollar terms, in percent)	11.9	2.7	9.4	12.4	8.9	5.6	7.6	8.0	8.6	9.5	9.5	8.1	9.5	9.5	9.5
Growth of imports of G&S (US dollar terms, in percent)	10.7	0.3	4.8	12.2	15.7	9.6	9.6	9.9	9.9	9.4	9.4	9.6	9.4	9.4	9.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	32.0	33.1	31.0	21.7	19.7	17.6	25.9	11.3	7.2	10.1
Government revenues (excluding grants, in percent of GDP)	10.4	9.6	10.3			10.6	11.5	12.0	12.5	12.8	12.8		12.8	13.0	12.9
Aid flows (in Billions of US dollars) 7/	3.2	3.0	3.1			3.7	4.6	5.2	5.5	5.7	6.1		8.7	18.8	
of which: Grants	0.8	0.6	0.2			0.5	0.8	0.9	0.9	1.0	1.1		1.7	3.8	
of which: Concessional loans	2.4	2.5	2.9			3.2	3.8	4.3	4.6	4.7	5.0		7.0	15.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			0.8	0.9	0.9	0.7	0.7	0.6		0.5	0.4	0.5
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			40.1	43.5	40.8	32.6	30.9	29.0		23.8	23.5	23.5
Memorandum items:															
Nominal GDP (Billions of US dollars)	172.9	195.0	218.1			237.2	260.1	284.2	310.4	338.8	369.8		562.0	1285.9	
Nominal dollar GDP growth	15.2	12.8	11.8			8.8	9.6	9.3	9.2	9.1	9.1	9.2	8.6	8.6	8.7
PV of PPG external debt (in Billions of US dollars)			17.3			19.7	21.9	24.8	28.5	32.5	37.0		64.2	134.0	
(PVt-PVt-1)/GDPt-1 (in percent)						1.1	0.9	1.1	1.3	1.3	1.3	1.2	1.1	0.7	1.0
Gross workers' remittances (Billions of US dollars)	14.2	15.2	14.7			12.2	12.6	13.1	13.7	14.3	15.0		19.8	35.5	
PV of PPG external debt (in percent of GDP + remittances)	...	...	7.6			8.0	8.2	8.5	8.9	9.4	9.8		11.2	10.3	
PV of PPG external debt (in percent of exports + remittances)	...	...	34.3			39.2	40.7	43.3	46.1	48.5	50.7		57.7	50.9	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	2.4			4.2	4.7	4.5	4.8	4.9	5.2		6.4	5.8	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 3. Bangladesh: Sensitivity Analysis for Key Indicators for Public and Publicly Guaranteed External Debt, 2017–2037

(In percent)

		Projections						
	2017	2018	2019	2020	2021	2022	**2027**	2037
PV of debt-to GDP ratio								
Baseline	8	9	9	9	10	10	**12**	11
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	8	6	4	2	-1	-3	**-13**	-20
A2. New public sector loans on less favorable terms in 2017-2037 2	8	9	10	11	12	12	**16**	17
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	8	9	9	9	10	10	**12**	11
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	8	9	10	11	11	12	**12**	11
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	8	8	9	9	10	10	**11**	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	8	6	3	4	5	5	**8**	10
B5. Combination of B1-B4 using one-half standard deviation shocks	8	5	2	3	3	4	**7**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	8	12	12	13	14	14	**16**	15
PV of debt-to-exports ratio								
Baseline	51	53	56	59	61	64	**70**	59
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	51	39	25	10	-5	-20	**-78**	-108
A2. New public sector loans on less favorable terms in 2017-2037 2	51	55	61	67	73	78	**95**	95
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	51	52	55	58	60	62	**69**	57
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	51	58	71	74	76	78	**81**	63
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	51	52	55	58	60	62	**69**	57
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	51	36	20	25	29	32	**49**	53
B5. Combination of B1-B4 using one-half standard deviation shocks	51	32	12	17	21	25	**45**	52
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	51	52	55	58	60	62	**69**	57
PV of debt-to-revenue ratio								
Baseline	80	74	74	75	76	79	**91**	81
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	80	55	33	13	-6	-25	**-101**	-150
A2. New public sector loans on less favorable terms in 2017-2037 2	80	77	81	86	90	97	**123**	132
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	80	74	74	75	77	80	**91**	81
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	80	78	87	87	87	90	**97**	81
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	80	73	73	74	75	78	**89**	80
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	80	50	27	31	35	40	**64**	74
B5. Combination of B1-B4 using one-half standard deviation shocks	80	44	16	22	26	31	**58**	72
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	80	103	103	104	106	110	**126**	112

Table 3. Bangladesh: Sensitivity Analysis for Key Indicators for Public and Publicly Guaranteed External Debt, 2017–2037 (Concluded)

(In percent)

				Debt service-to-exports ratio				
Baseline	5	6	6	6	6	6	**8**	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	5	6	5	5	4	3	**-1**	-8
A2. New public sector loans on less favorable terms in 2017-2037 2	5	6	5	6	6	6	**8**	10
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	5	6	6	6	6	6	**8**	7
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	5	6	7	7	7	7	**9**	8
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	5	6	6	6	6	6	**8**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	5	6	5	5	5	5	**5**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	5	6	5	4	4	5	**5**	5
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	5	6	6	6	6	6	**8**	7
				Debt service-to-revenue ratio				
Baseline	9	9	8	8	8	8	**10**	9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2017-2037 1/	9	8	7	6	5	4	**-2**	-11
A2. New public sector loans on less favorable terms in 2017-2037 2	9	9	7	7	7	8	**11**	14
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2018-2019	9	9	8	8	8	8	**10**	9
B2. Export value growth at historical average minus one standard deviation in 2018-2019 3/	9	9	8	8	8	9	**11**	10
B3. US dollar GDP deflator at historical average minus one standard deviation in 2018-2019	9	9	8	8	8	8	**10**	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2018-2019 4/	9	9	7	6	6	6	**7**	8
B5. Combination of B1-B4 using one-half standard deviation shocks	9	9	7	5	6	6	**6**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2018 5/	9	12	11	11	11	11	**14**	13
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	6	6	6	6	6	6	**6**	6

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly a
an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 4. Bangladesh: Public Sector Debt Sustainability Framework, Baseline Scenario, 2013–2036

(In percent of GDP, unless otherwise indicated)

	Act	Act	Est			Projections									
	2014	2015	2016	Average 5/	Standard Deviation 5/	2017	2018	2019	2020	2021	2022	2017-22 Average	2027	2037	2023-37 Average
Public sector debt 1/	35.3	34.5	34.7			36.0	36.6	37.4	37.9	38.1	38.2		38.4	32.3	
of which: foreign-currency denominated	15.0	13.4	13.4			13.5	13.5	13.8	14.1	14.4	14.6		15.2	12.8	
Change in public sector debt	-0.5	-0.7	0.2			1.3	0.6	0.8	0.5	0.2	0.1		-0.2	-0.8	
Identified debt-creating flows	-0.8	-0.1	-0.3			1.1	0.7	0.8	0.5	0.3	0.2		0.1	-0.5	
Primary deficit	1.0	1.8	1.5	1.3	0.5	2.9	2.4	2.3	2.2	1.6	1.5	2.2	1.1	0.6	1.0
Revenue and grants	10.9	9.9	10.4			10.8	11.9	12.3	12.8	13.1	13.1		13.1	13.3	
of which: grants	0.5	0.3	0.1			0.2	0.3	0.3	0.3	0.3	0.3		0.3	0.3	
Primary (noninterest) expenditure	11.9	11.7	11.9			13.8	14.2	14.7	15.0	14.8	14.6		14.3	13.9	
Automatic debt dynamics	-1.8	-1.8	-1.8			-2.0	-1.9	-1.9	-2.1	-1.8	-1.9		-1.6	-1.2	
Contribution from interest rate/growth differential	-1.2	-1.3	-1.7			-1.9	-1.9	-1.8	-2.0	-1.8	-1.8		-1.5	-1.2	
of which: contribution from average real interest rate	0.9	0.9	0.6			0.3	0.5	0.6	0.5	0.7	0.7		0.8	0.8	
of which: contribution from real GDP growth	-2.0	-2.2	-2.3			-2.2	-2.4	-2.4	-2.4	-2.5	-2.5		-2.4	-2.0	
Contribution from real exchange rate depreciation	-0.6	-0.6	-0.1			-0.1	0.0	0.0	-0.1	-0.1	-0.1		...	...	
Other identified debt-creating flows	0.0	0.0	0.1			0.1	0.3	0.3	0.4	0.5	0.5		0.6	0.2	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.1			0.1	0.3	0.3	0.4	0.5	0.5		0.6	0.2	
Residual, including asset changes	0.3	-0.7	0.4			0.2	-0.1	0.0	0.0	-0.1	-0.1		-0.3	-0.3	
Other Sustainability Indicators															
PV of public sector debt	...	...	29.4			30.9	31.7	32.5	33.2	33.5	33.8		34.9	30.1	
of which: foreign-currency denominated	...	...	8.1			8.5	8.6	8.9	9.3	9.8	10.2		11.6	10.6	
of which: external	...	...	8.1			8.5	8.6	8.9	9.3	9.8	10.2		11.6	10.6	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	4.5	4.9	4.4			9.3	7.7	7.1	6.3	6.0	4.7		4.3	3.3	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	283.0			285.5	267.3	263.5	258.7	255.6	257.4		265.9	226.1	
PV of public sector debt-to-revenue ratio (in percent)	...	...	285.9			291.6	274.4	270.2	265.0	261.6	263.5		272.0	231.2	
of which: external 3/	...	...	78.9			79.8	74.1	74.0	74.7	76.2	79.3		90.6	81.4	
Debt service-to-revenue and grants ratio (in percent) 4/	24.6	26.4	23.0			55.8	42.1	36.6	30.2	31.6	22.3		23.2	20.1	
Debt service-to-revenue ratio (in percent) 4/	25.7	27.2	23.3			56.9	43.2	37.6	30.9	32.4	22.8		23.8	20.6	
Primary deficit that stabilizes the debt-to-GDP ratio	1.5	2.5	1.3			1.6	1.7	1.5	1.7	1.4	1.4		1.3	1.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.1	6.6	7.1	6.2	0.6	6.8	7.0	7.0	7.0	7.0	7.0	7.0	6.5	6.5	6.5
Average nominal interest rate on forex debt (in percent)	0.9	1.5	0.8	1.0	0.2	1.1	1.4	1.8	2.2	2.4	2.7	1.9	3.3	4.7	3.5
Average real interest rate on domestic debt (in percent)	5.1	4.7	3.1	3.8	1.1	1.8	2.8	2.5	1.7	2.6	2.3	2.3	2.7	2.4	2.6
Real exchange rate depreciation (in percent, + indicates depreciation)	-3.9	-4.0	-0.8	-3.4	3.8	-0.9	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	5.7	5.9	6.6	7.0	0.8	7.0	6.2	5.7	6.2	5.7	5.6	6.0	5.4	5.2	5.3
Growth of real primary spending (deflated by GDP deflator, in percent)	0.2	4.5	8.7	1.4	2.9	23.9	10.7	10.2	9.4	5.4	6.1	11.0	5.0	5.6	6.1
Grant element of new external borrowing (in percent)	...	...	...	...	...	32.0	33.1	31.0	21.7	19.7	17.6	25.9	11.3	7.2	...

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 5. Bangladesh: Sensitivity Analysis for Key Indicators of Public Debt, 2017–2037

(In percent)

	Projections							
	2017	2018	2019	2020	2021	2022	2027	2037
PV of Debt-to-GDP Ratio								
Baseline	31	32	33	33	34	34	35	30
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	31	31	31	31	31	32	33	33
A2. Primary balance is unchanged from 2017	31	32	34	35	36	38	45	55
A3. Permanently lower GDP growth 1/	31	32	33	33	34	34	36	34
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	31	32	34	35	35	36	38	35
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	31	31	31	32	32	33	34	29
B3. Combination of B1-B2 using one half standard deviation shocks	31	31	32	32	33	34	36	33
B4. One-time 30 percent real depreciation in 2018	31	35	36	36	36	36	38	36
B5. 10 percent of GDP increase in other debt-creating flows in 2018	31	41	42	42	42	42	42	37
PV of Debt-to-Revenue Ratio 2/								
Baseline	286	267	263	259	256	257	266	226
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	286	260	250	241	238	241	253	251
A2. Primary balance is unchanged from 2017	286	272	272	272	278	289	345	411
A3. Permanently lower GDP growth 1/	286	268	264	260	258	261	275	252
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	286	272	274	271	270	274	292	267
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	286	262	254	250	248	250	259	221
B3. Combination of B1-B2 using one half standard deviation shocks	286	263	255	253	253	257	275	250
B4. One-time 30 percent real depreciation in 2018	286	296	289	281	277	278	291	268
B5. 10 percent of GDP increase in other debt-creating flows in 2018	286	349	339	328	321	321	324	280
Debt Service-to-Revenue Ratio 2/								
Baseline	56	42	37	30	32	22	23	20
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	56	42	37	28	29	19	21	22
A2. Primary balance is unchanged from 2017	56	42	37	32	34	25	32	41
A3. Permanently lower GDP growth 1/	56	42	37	30	32	23	24	23
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2018-2019	56	43	38	31	33	24	26	25
B2. Primary balance is at historical average minus one standard deviations in 2018-2019	56	42	36	29	30	21	22	19
B3. Combination of B1-B2 using one half standard deviation shocks	56	42	37	29	30	22	24	23
B4. One-time 30 percent real depreciation in 2018	56	44	40	34	36	27	31	31
B5. 10 percent of GDP increase in other debt-creating flows in 2018	56	42	42	51	41	32	33	30

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.