Bangladesh—Assessment Letter for the Asian Development Bank
August 11, 2009

This note provides the IMF staff's assessment of Bangladesh's macroeconomic conditions, prospects, and policies for various program and project loans to Bangladesh that will be considered by the Board of the Asian Development Bank in the coming months.

Bangladesh's economy has been resilient to the global financial crisis.

- *Growth and Inflation*. Real GDP growth slowed to 5.9 percent in FY09 (July 2008–June 2009), a modest deceleration from the pace recorded in recent years. Manufacturing output and exports (mainly textiles and garments) decelerated but have continued to record positive growth. Lower international food and fuel prices drove inflation down to 5.4 percent (y/y) in May 2009 with a further significant reduction expected in June reflecting base effects.

- *Fiscal Position*. Domestic revenue mobilization remains low compared to other countries in the region or at a similar development stage. But under-implementation of the development budget is estimated to have again kept the overall fiscal deficit in FY09 below the target in the revised budget (4.1 percent of GDP, excluding grants).

- *External Position*. The balance of payments strengthened considerably during FY09. Imports decelerated markedly after the onset of the global financial crisis owing to lower food and fuel prices, a good harvest, and lower demand for capital and intermediate goods, reflecting uncertainty about the economic outlook. At the same time, exports of textiles and garments held up well and remittances increased by 22 percent (to US$9.7 billion or almost 11 percent of GDP) during FY09, a delayed effect of a surge in overseas postings of Bangladeshi workers through mid-2008. The current account thus improved to a surplus of about 2 percent of GDP, possibly the highest level since Bangladesh's independence. Maintenance of the stable exchange rate to the U.S. dollar required Bangladesh Bank to buy large amounts of foreign exchange, particularly in recent months. As a result, gross international reserves are now at a record-high of US$7.7 billion and cover about 3.7 months of prospective imports of goods and services, a 15-year high.

- *Money, Credit, and Banking*. With the capital account still mostly closed, Bangladesh's financial sector has not been seriously affected by the global crisis. Earlier regulatory reforms and liberalization measures combined with robust economic growth have boosted private commercial banks' profitability and lowered non-performing loan ratios. The growth of credit to the private sector which reached 27 percent in September 2008 (y/y), eased since the onset of the global financial crisis.

Downside risks have eased in recent months and near-term economic prospects remain broadly favorable. Real GDP growth for FY10 is projected by the IMF at 5 percent, supported by a recovery of credit to the private sector, exports and remittances holding up, enhanced execution of the government's capital budget, and continued donor support to help advance structural reforms and address infrastructure bottlenecks. The weakness of imports may jeopardize the government's revenue target for FY10.

Bangladesh's medium-term prospects are good with a substantial upside which depends on the authorities' vigor to tackle structural reforms. Reforms to boost revenue and enhance the quality and speed of implementation of the development budget are needed to raise much-needed infrastructure investment and social spending. Another key priority is to strengthen prudential regulations for the banking sector and to continue reforms of the state-owned commercial banks and other state-owned enterprises. A Financial Sector Assessment Program (FSAP) Update mission by a team of experts from the IMF and the World Bank visited Bangladesh in July and recommended reform measures that could be implemented in the near-and medium-term to strengthen the financial sector. The country's external debt is deemed sustainable as long as borrowing continues to be made in a restrained manner and primarily on concessional terms.

IMF Relations. The PRGF arrangement expired in June 2007. In response to the natural disasters of late 2007, Emergency Natural Disaster Assistance of SDR 133.3 million was approved by the IMF's Executive Board in April 2008. The most recent Article IV consultation was concluded in September 2008 and the mission for the 2009 Article IV consultation is planned for the Fall.