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Bangladesh: Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria—Staff Report; Staff Statement; and Press Release on the Executive Board Discussion

In the context of the fourth review under the three-year arrangement under the Poverty Reduction and Growth Facility and request for a waiver of performance criteria with Bangladesh, the following documents have been released and are included in this package:

- the staff report for the Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria prepared by a staff team of the IMF, following discussions that ended on November 24, 2005, 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 January 19, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of February 3, 2006 updating information on recent developments.

- a Press Release summarizing the views of the Executive Board as expressed during its February 3, 2006 discussion of the staff report that completed the review and request.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Bangladesh*
Memorandum of Economic and Financial Policies by the authorities of Bangladesh*
Technical Memorandum of Understanding*
Poverty Reduction Strategy paper—Joint Staff Advisory Note

*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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BANGLADESH

Fourth Review Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Performance Criteria

Prepared by the Asia and Pacific Department

Approved by Steven Dunaway and Anthony Boote

January 19, 2006

- Discussions on the fourth review under the Poverty Reduction and Growth Facility (PRGF) arrangement were held in Dhaka during November 14-24, 2005. The staff team comprised Messrs. Rumbaugh (Head), Jang, Berezin (all APD), Akitoby (FAD), Moers (PDR), and Ismail (MFD technical expert). The mission was assisted by Mr. Dunn, the Resident Representative, and worked closely with the World Bank resident mission. Mr. Bannerji (OED) participated in the discussions.

- The mission met with Minister for Finance and Planning M. Saifur Rahman, Finance Secretary Siddiqur Rahman Choudhury, Bangladesh Bank Governor Salehuddin Ahmed, and other senior government officials.

- A three-year PRGF arrangement for SDR 347 million (65 percent of quota) was approved on June 20, 2003. With the completion of the second review in July 2004 the Board approved an augmentation of access under the PRGF arrangement of SDR 53 million (10 percent of quota) in accordance with the Trade Integration Mechanism. The third review was completed in June 2005, and the PRGF arrangement was extended to December 31, 2006.

- At the conclusion of the 2005 Article IV consultation and the third PRGF review, Directors commended the authorities' efforts in maintaining macroeconomic stability and in advancing the structural reform agenda, in spite of a difficult political environment and external shocks. Directors encouraged the authorities to continue to advance structural reforms in tax administration, banking, and the energy sector, as well as to improve overall governance.

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Executive Summary

The Bangladesh authorities have generally achieved macroeconomic objectives under the PRGF-supported program and made progress towards achieving many of the MDGs, despite delays in implementing structural reforms. Prudent macroeconomic policies have largely been maintained despite a difficult political environment and external shocks in the form of higher oil prices and the phase out of MFA quotas on garment exports.

Several quantitative and structural performance criteria have been missed for the fourth PRGF review. The nonobservance of these performance criteria largely reflects delays in securing the disbursement of external program assistance and difficulties in achieving the necessary internal consensus for advancing key structural reforms. In view of the remedial measures implemented by the authorities, including the implementation of priority structural measures and steps to bring the financial program back in line with PRGF objectives, staff supports the requests for waiver of performance criteria.

Since early 2005, the external position has come under some pressure, owing to the surge in oil prices, strong import growth, and accommodative monetary policy. In response, the authorities have tightened monetary policy by raising interest rates and increasing reserve requirements. While initially attempting to slow the depreciation of the exchange rate by selling foreign exchange, subsequently the central bank has allowed the exchange rate to move more freely in response to market forces. A further tightening of monetary policy would counter inflationary pressures and help stabilize the exchange rate.

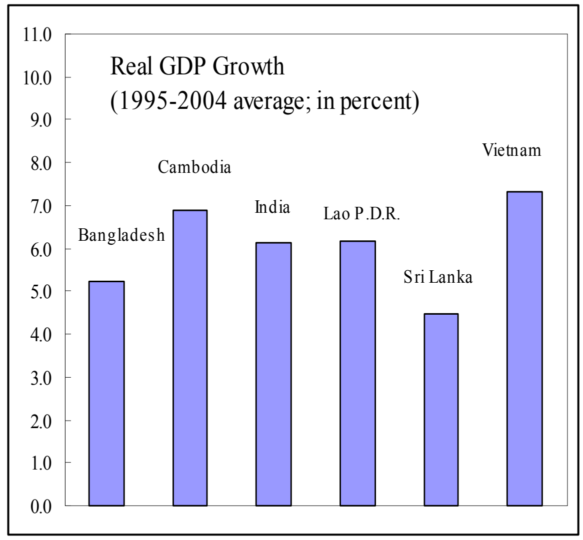
The overall fiscal position has remained within budget and program targets despite shortfalls in revenue. The government intends to push forward with tax administration reforms and strengthen collection efforts. The overall deficit for FY06 (July/June) is expected to be 4 percent of GDP with domestic financing limited to 2 percent of GDP, in line with program targets.

Delays in the bank restructuring program have been experienced. The divestment of Rupali Bank was interrupted by a court challenge, and the implementation of fundamental restructuring in the other nationalized commercial banks has been slower than expected. Recent measures have been taken to re-invigorate these reforms and more determined efforts will be needed in the near term to make the bank restructuring program successful.

The authorities have increased domestic fuel prices several times over the last year. These increases have reduced but not eliminated the quasi-fiscal losses being incurred in the energy sector.

I. BACKGROUND

1. **Owing to strong growth in the last decade, progress has been made toward meeting the Millennium Development Goals (MDGs).** Bangladesh has outperformed many low-income countries on a range of social indicators, and is well on the way to meeting MDGs related to education, gender parity, and infant and child mortality (Table 1). Overall growth performance has also been in line with other low-income countries in the region, but faster growth will be required if the MDG for poverty reduction is to be met by 2015. Growth continues to be adversely affected by inadequate investment in human capital, infrastructure bottlenecks, and poor governance.



2. **Despite a difficult political environment and external shocks, the authorities have generally maintained prudent macroeconomic policies.** During the first two years of the PRGF program, growth and inflation objectives were achieved. However, while structural policies have moved forward in all key areas, delays (often significant) were experienced in implementing reforms, especially in tax administration and bank restructuring. While some important progress has been made in improving the performance of the SOE sector and in trade reform under the World Bank Development Support Credit (DSC), more remains to be done in these areas, and only limited progress has been made in energy sector reform.

3. **Improving governance has been an important objective under the authorities' reform program.** Despite Bangladesh's continued low ranking on international perception-based governance indices, some notable improvements in the governance environment have been achieved. Many of these are related to improved macroeconomic management which has liberalized trade, opened more space for private sector activity, improved governance of the financial sector, and increased the allocation of resources devoted to pro-poor activities. However, Bangladesh continues to rank very low with respect to political stability, regulatory quality, and control of corruption.

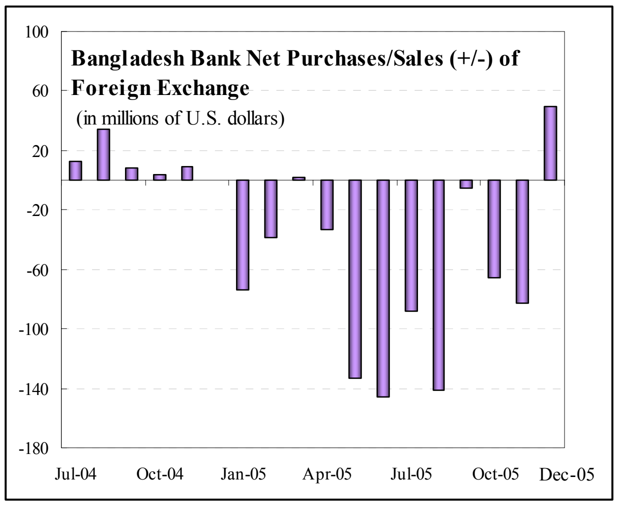
4. **With the next general elections due in January 2007, the political climate has become more tense and could affect the ability of the government to implement key reforms.** Political confrontation continues to create a difficult environment to build consensus for sensitive reforms such as restructuring and divesting state banks, strengthening tax collection and enforcement, and adjusting fuel prices. The investment climate has been adversely affected by frequent work stoppages and a series of bomb explosions that have taken place over the course of the last year. The risks posed by this environment on the implementation of critical reforms were emphasized by Directors in the last two Article IV consultations. The authorities view continued support from international financial institutions

as critical to sustained growth and poverty reduction, and have indicated their commitment to forge ahead with reforms.

II. Recent Developments and Performance Under the FY06 Program

5. **Economic developments in FY05 (July-June) were broadly in line with the program (Table 2).** Real GDP growth is estimated at 5½ percent, despite the impact of higher oil prices and devastating floods, and the economy has withstood well the initial impact of the elimination of Multi-Fiber Agreement (MFA) quotas (Box 1). Largely reflecting higher food prices, annual average inflation increased to 6½ percent, which was in line with program projections.

6. **The external position has been under some pressure since early 2005, owing to the surge in international oil prices, strong import growth, and accommodative monetary conditions.** However, garment exports have been much better than expected, and worker remittances have continued to be strong (Table 3). The external current account balance is estimated to have deteriorated to a deficit of about 1 percent of GDP in FY05 (less than envisaged in the program), from a small surplus in the previous year. Foreign exchange inflows were sufficient to enable Bangladesh Bank (BB) to exceed the end-June indicative target on net international reserves (NIR) while making extensive sales to the foreign exchange market to slow the depreciation of the taka. Monetary conditions became accommodative in early 2005, with treasury bill rates below the level of inflation. As a result, money and credit aggregates grew above program targets (Tables 4 and 5). This expansionary stance has also been a contributing factor to pressures in the foreign exchange market.



7. **The implementation of fiscal policy continued to be prudent in FY05, although revenue collections fell short of the program target.** The central government's overall deficit was contained to 3½ percent of GDP, about ¾ percentage point below the program target (Table 6). However, revenue was slightly below the program target, mainly reflecting weak collection of VAT and income tax in the large taxpayers units (LTUs). As in the past, the shortfall was offset by slow implementation of development expenditure. Thus, the end-June indicative targets on net bank credit to government and the government's domestic borrowing were met. However, this prudent fiscal stance of the central government masks quasi-fiscal liabilities being accumulated elsewhere in the public sector (as described below).

Box 1. The Impact of the Elimination of Textiles Quotas

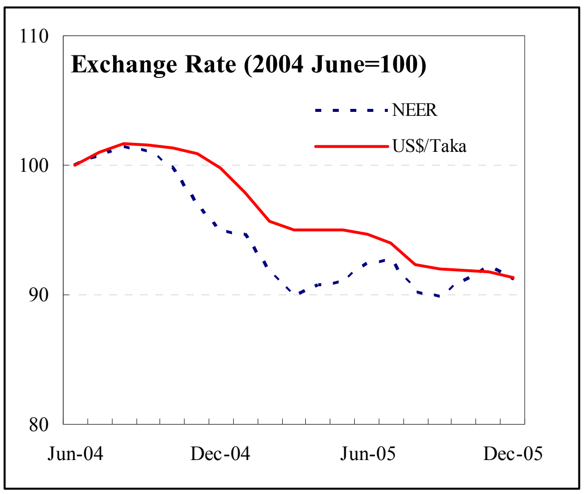
Bangladesh's exports of ready-made garments (RMG; 75 percent of total exports) have held up better than expected in the face of the elimination of quotas under the Multi-Fiber Agreement (MFA) at the start of 2005. Although RMG-export growth has decelerated from the high figures registered in July-December 2004, it has remained robust. There is also evidence of fresh investment in the sector.

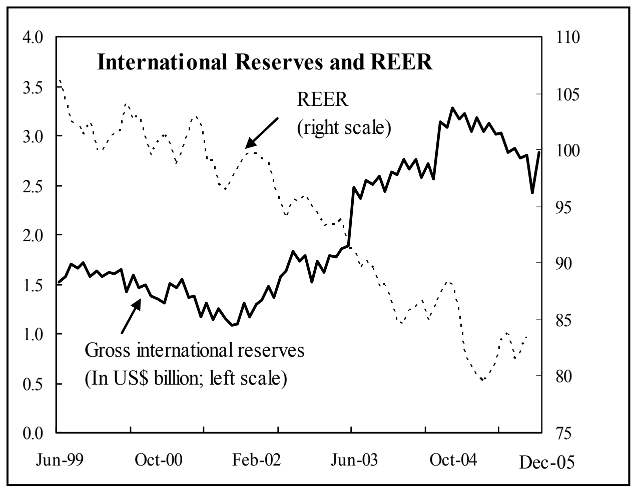
However, this masks different performance of the two main categories of RMG exports. Knitwear has continued to do well, but woven garments have taken a hit, intensifying the divergent behavior of the two categories that had been on display before. In fact, knitwear is about to take over from woven garments as the largest category of RMG exports. The strong growth of knitwear exports has been particularly pronounced to the United States (U.S.) (destination of 40 percent of Bangladesh's RMG exports). Knitwear exports to the U.S. have more than doubled since January, from a relatively low base. In the U.S. market, under the MFA, Bangladesh faced binding quotas, which have been lifted post-MFA, creating greater opportunities. On the contrary, in the European Union (EU) market, Bangladesh had already enjoyed quota-free (and duty-free) access since 2001, which major competitors (in particular China and India) have only received post-MFA. Prospects for knitwear exports to the U.S. are positive and should support continued RMG-export growth.

Bangladesh's RMG exports should also benefit from the recent invoking of WTO safeguards by the U.S. and EU on exports from China. This applies in particular to exports to the EU, as the categories covered under the EU-China agreement represent 87 percent of Bangladesh's RMG exports to the EU. The categories covered by the U.S. safeguards quotas represent 25 percent of Bangladesh's RMG exports to the U.S.

In the longer run, however, RMG-export prospects will depend on Bangladesh's own measures to improve its competitiveness. In this respect, some welcome measures have been taken recently. The number of regulatory stages involved in the import for and export of RMG have been halved, all trade-related quantitative restrictions on imports have been removed (including on important RMG inputs), and restrictions on FDI in the RMG sector outside the export processing zones (EPZs) have been eliminated. Furthermore, with the assistance of the AsDB, the capacity of the Chittagong port is being upgraded, and the authorities are seeking duty-free access for RMG exports in major markets. More remains to be done, in particular to address deep-seated governance and infrastructure problems.

8. **Developments in FY06 thus far reflect some tightening in economic policies to address high credit growth and increasing inflation.** Growth momentum appears to remain strong, but inflation has picked up in recent months. In the first four months of FY06, the CPI has risen to above 7 percent (y/y), led by rising food prices. The overall implementation of fiscal policy has remained prudent, and BB has taken steps in recent months to absorb excess bank reserves by pushing up interest rates in the auctions of government securities by about 3 percentage points since late February (MEFP, para. 6). As a result, private sector credit growth has begun moderating, but still remains high. This, together with the impact of higher oil prices on the balance of payments (Box 2), continues to put pressure on the international reserve position. The central bank's net international reserves declined from \$2.0 billion at end-June to \$1.6 billion as of mid-December, as oil payments to external creditors came due, but then increased to over \$1.9 billion as of end-December reflecting the resumption of program aid and net purchases of foreign exchange from the interbank market by BB. The taka has depreciated against the U.S. dollar by about 9 percent since early 2005.



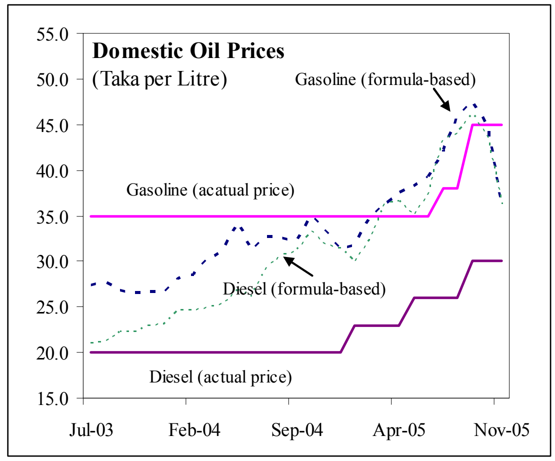


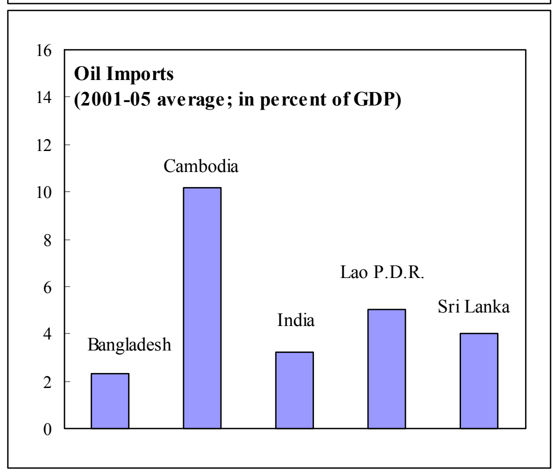
9. **Owing largely to delays in the disbursement of program assistance, several quantitative performance criteria for September 2005 were not observed (MEFP para. 5 and Table 2).** The targets for net international reserves, net domestic assets of the central bank, and net bank credit and total domestic financing of the government were all missed. Moreover, the end-September indicative target on revenue was missed by a small margin, although revenue collection in the first quarter of FY06 improved, recording growth of 15 percent from a year earlier. Since then, issues related to the World Bank's \$200 million DSC had been resolved and the disbursement was approved on December 1.[1] Slight delays

[1] Issues that delayed the review of the DSC were primarily related to adjustments in energy prices, establishing an anti-corruption commission, and preparing a government procurement law.

Box 2. Impact of Global Oil Price Increases

Over the last two years, Bangladesh has passed through about 60–75 percent of world oil price increases to domestic petroleum product prices (depending on the product), leading to the creation of quasi-fiscal liabilities. Impacts on growth and inflation have been subdued thus far, while the balance of payments has been under some pressure in recent months despite higher-than-expected remittances and garment exports.



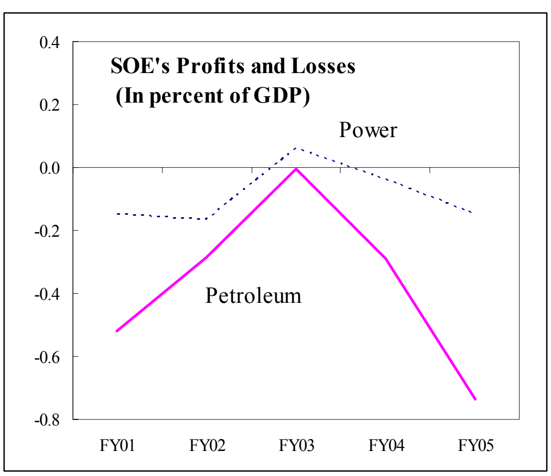


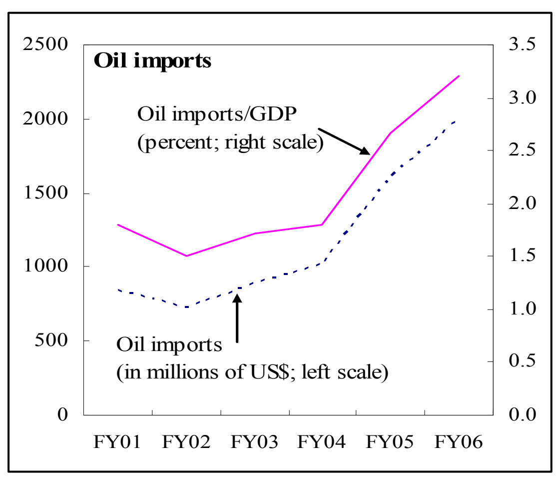
- Domestic petroleum product prices continue to lag behind international levels and levels in neighboring countries. The retail gasoline price is $0.68 per liter in Bangladesh, compared with $0.98 in India.

- The partial pass-through of rising oil prices, the relatively low weight of oil-dependent items in the consumption basket, and the availability of domestic sources of energy such as natural gas (whose price is also administered) have mitigated the impact on inflation. Bangladesh produces about 480 billion cu. ft. of natural gas per year (the energy equivalent of $4.8 billion of oil at current prices), which is sold at a price of $1.5 per 1,000 cu. ft., compared with $3.7 in India and about $6 in the U.S.

- The oil import bill is expected to increase to US$2 billion this year, almost doubling in the last two years. This has been partly offset by larger-than-expected earnings from garment exports and remittances. In addition, the authorities are negotiating for commercial trade credits to supplement the existing credit line from the Islamic Development Bank.

- Energy sector SOEs have been used to shield consumers from the full brunt of the global oil price increases. (BPC's losses now arise mostly from sales of diesel and kerosene.) The financial position of the energy sector SOEs has deteriorated significantly and they have been financed by loans from state banks. While power utilities have made some progress in improving operating efficiency and reducing arrears, much more remains to be done.





were also experienced with respect to meeting both of the structural performance criteria, reflecting problems in reaching internal consensus and capacity constraints (MEFP, Table 3). In the attached letter dated January 9, 2006, the government of Bangladesh requests completion of the fourth review under the PRGF arrangement and waivers for the nonobservance of performance criteria (Attachment I).

10. **Slow progress in tax administration reform has contributed to the failure to generate targeted revenue gains so far.** The institutional structures have been set up, including the LTUs for income tax and VAT and the Central Intelligence Cell, but inadequate resources, particularly in the VAT LTU, are hampering revenue collections (MEFP, para. 8). Moreover, audit and collection enforcement continue to be weak.

11. **The bank restructuring program continued to move slowly.** A court injunction delayed the process of divesting Rupali Bank for nearly five months. Since the injunction was lifted by the High Court on November 28, the authorities have restarted the divestment process. The financial conditions of the NCBs have improved, and the banks also undertook efforts to reduce excess staff and close unviable branches, which helped curtail operating losses. Nevertheless, meaningful steps in restructuring the banks have thus far been slower than expected. Responses to key recommendations of the consulting teams regarding human resource management, procurement, and lending to state-owned enterprises have been subject to considerable delays in the Ministry of Finance or not implemented at all.

Key Financial Indicators for Local Banks

(In percent)

	1998	2001	2004
Net nonperforming loans to total loans			
NCBs	26.8	25.2	17.6
Private banks	16.3	4.5	2.7
Capital to risk-weighted assets			
NCBs	5.2	4.2	4.1
Private banks	9.2	9.9	10.3

Source: Bangladesh Bank

12. **Significant headway has been made on trade reform, although overall rates of protection remain relatively high.** In FY05, the structure of customs duties was simplified to three rates, with the top rate reduced by 5 percentage points to 25 percent. Moreover, all remaining quantitative restrictions on imports, except those on grounds of religion, health, security, and the environment, were removed. Finally, administrative procedures for imports and exports were simplified, and restrictions on FDI in the garment sector outside the EPZs were abolished.

13. **While the financial performance of many SOEs has improved, progress has been slow in reforming those in the energy sector, and they remain a source of quasi-fiscal losses.** According to provisional data, the losses of manufacturing sector SOEs declined by 10 percent in FY05 (to 0.1 percent of GDP) and by almost 50 percent over the last three years. The recent increases in global oil prices, however, were only partially passed through to domestic prices, resulting in financial losses to Bangladesh Petroleum Corporation (BPC) amounting to ¾ percent of GDP in FY05. Moreover, substantial domestic arrears within the

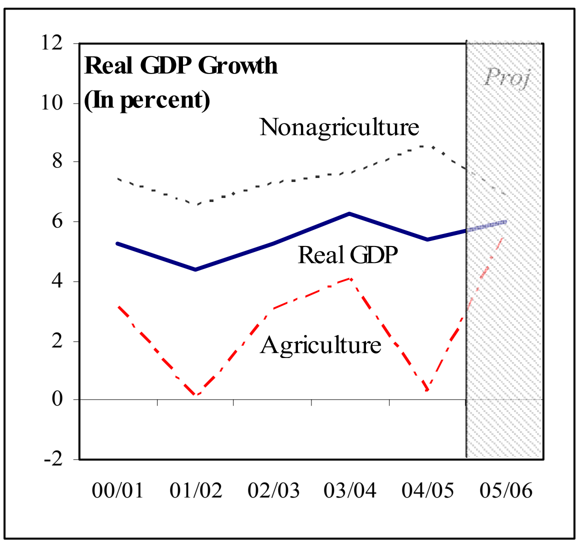
energy sector remain to be cleared despite significant improvement over the last year and a half.

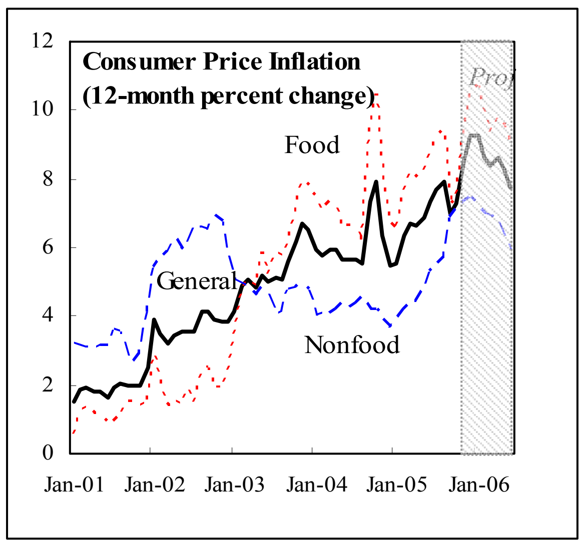
III. Report on the Discussions

14. **The discussions centered on policy adjustments needed to keep macroeconomic performance and structural reforms on track,** particularly: (i) monetary and exchange rate policies to bring the financial program back in line with program targets, (ii) progress on tax administration reform, (iii) implementation of bank restructuring programs, and (iv) further adjustments in prices of petroleum products and natural gas.

A. Macroeconomic Outlook and Poverty Reduction Strategy

15. **The macroeconomic framework targets real growth of 6 percent and inflation of 7½ percent in FY06.** Despite the drag arising from high oil prices, the program's target growth rate of 6 percent is expected to be achieved, helped by a recovery in agriculture and better-than-expected garment exports. However, given rising oil prices and some inflationary pressures in the economy, the average rate of inflation in FY06 is now projected to increase to about 7½ percent, compared with the previous target of 6 percent. Taking into account evidence of new investment in the garment sector, the recent U.S. and EU safeguard measures on China's garment exports, and the latest WEO projections of oil prices, both exports and imports are now expected to grow much faster than previously envisaged, with the current account deficit projected at about 2 percent of GDP, broadly the same as earlier estimates.





16. **This outlook is subject to downside risks, especially on the external front, stemming from high international oil prices and the unfolding impact of the elimination of MFA quotas.** On the domestic front, political uncertainty in the run up to the next general elections, and the potential for disruption, including terrorism threats, also pose risks. These risks could lead to slower growth, higher inflation, and a weaker external position.

17. **The main goals of the PRGF program remain to accelerate growth and reduce poverty, in line with the government's poverty reduction strategy (PRS).** Building on the I-PRSP, the government recently finalized and published a full PRS titled *Unlocking the Potential—the National Strategy for Accelerated Poverty Reduction* (NSAPR), which was discussed with development partners in November (MEFP, paras. 1 and 11).[2] The NSAPR is built on the policy triangle of pro-poor growth, human development and governance, and the authorities remain committed to accelerated implementation of key reforms to improve the environment for private sector activity and achieve the MDGs.

B. Fiscal Policy and Tax Administration

18. **The medium-term fiscal strategy is to protect fiscal sustainability while supporting growth and poverty reduction.** To this end, the authorities are committed to making sustained efforts in both tax policy and administration to achieve the program target of raising revenue by ½ percent of GDP each year. Moreover, the overall central government deficit over the medium term is targeted to be below 4 percent of GDP, consistent with the medium-term objective to contain public debt to under 60 percent of GDP, inclusive of the potential cost of SOE and NCB reforms (the key risk factor for fiscal sustainability).

19. **The FY06 fiscal deficit target of 4 percent of GDP, slightly lower than originally programmed, is consistent with the medium-term fiscal strategy.** Domestic financing will be contained at 2 percent of GDP, as originally programmed, and external support will remain primarily on concessional terms. The total revenue target will remain at 11 percent of GDP as originally programmed, with a contingency plan of cuts in spending in the event of a revenue shortfall. Total current spending is projected to be higher than programmed, on account of higher interest payments, as well as higher transfers related to social safety net spending. Capital and development expenditures are projected to be lower than budgeted, but this is more in line with actual implementation capacity, and would still represent a substantial increase over FY05.

20. **Achieving the FY06 budget revenue target will require stepped-up efforts to reform tax administration and to broaden the revenue base (MEFP, paras. 15–17).** Until a single LTU can be established, particular attention should be given to the near-term effectiveness of the separate LTUs for income tax and VAT. To this end, regarding the VAT LTU, the organization chart (organogram) was approved by the Ministry of Establishment in December 2005 (prior action for the fourth review), and the government will ensure that adequate budgetary resources are provided for its operation. LTU operations will be further improved by introducing risk-based audit procedures, developing computerized support for LTU operations, and introducing uniform tax identification numbers for VAT and income tax by end-April 2006 (structural benchmark for the fifth review). To strengthen audit

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[2] World Bank and IMF staff views on the NSAPR are reported in the Joint Staff Advisory Note (www.imf.org).

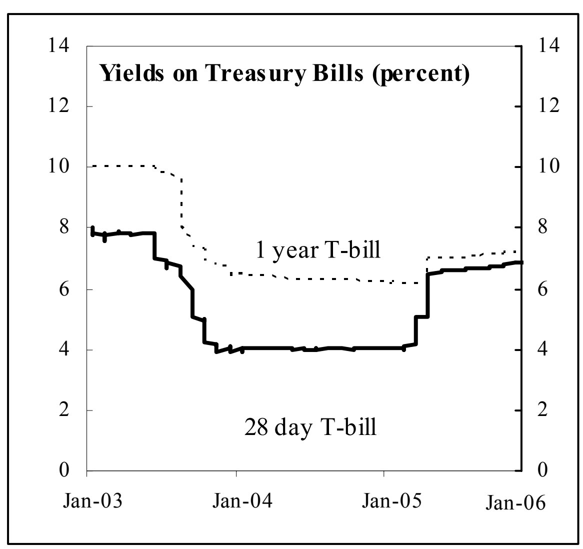
procedures, in January 2006 the authorities established an audit unit and appointed an advisor to head this unit (structural performance criterion for the fourth review for end-November, MEFP, para. 16). With regard to revenue policy, a thorough review of tax exemptions and incentives and their associated revenue losses will be undertaken by end-April 2006 (a structural performance criterion for the fifth review), with a view to broadening the tax base in the context of the FY07 budget.

21. **In the discussions, staff welcomed the improvement in revenue collections, but cautioned that more efforts will be needed to meet budget and program targets.** Given the risks of relying exclusively on tax administration measures to achieve the revenue target, the staff suggested that additional measures to supplement short-term performance could be considered until tax administration efforts bear more fruit. These could include increased excise taxation on cigarettes and telecommunication services, or adjustments in domestic natural gas prices to increase royalty transfers to the budget. The authorities welcomed these suggestions but were not in a position to commit to the timing of any tax increases. However, they remain committed to achieving the FY06 revenue targets and have agreed to have the revenue target under the program converted to a performance criteria for future reviews.

22. **The authorities are committed to further strengthening expenditure management and fiscal transparency.** To improve the composition of expenditure, the authorities continue to reorder priorities to favor pro-growth and pro-poor spending (MEFP, para. 18). Based on the government-wide accounting system, pro-poor expenditure tracking systems are being put in place in three key ministries along with new procedures for project implementation. The medium-term budget framework will be rolled out to six more line ministries in the FY07 budget, bringing the total to 10 ministries. In consultation with relevant development partners, the government has initiated a public expenditure review, expected to be completed in FY07.

C. Monetary and Exchange Rate Policies

23. **The authorities reiterated their commitment to take corrective actions to put the monetary program back on the path envisaged in the program.** While BB has been moving in the right direction in recent months to tighten the monetary stance, money and credit growth have exceeded program targets through November. The authorities indicated a preference for a continuation of a gradual pace of adjustment. Staff urged the authorities to tighten monetary policy further in the near term to ensure that the program's inflation and external reserve targets will be observed, and send a clear signal of BB's commitment to contain inflationary pressures. Interest rates have continued to



increase gradually, and currency in circulation has been brought back down from its seasonal peak in October.

24. **The staff agreed to modify the monetary program for the remainder of FY06 consistent with the program's overall macroeconomic objectives.** To reflect the increase in the reserve requirement as of October 1, 2005, the reserve money path and BB's NDA have been adjusted to reflect increased bank reserves, while still supporting the intended policy tightening (MEFP, para. 21). Moreover, the rate of broad money growth has been increased marginally to reflect a greater than envisioned shift of private sector savings away from National Savings Certificates into bank deposits, implying a reduction in M2 velocity (MEFP, para. 33).

25. **The authorities remain committed to the flexible exchange rate regime, and will confine interventions to countering disorderly conditions and building reserves to a more comfortable level (MEFP, para. 23).** They agreed that it was appropriate for the exchange rate to absorb some of the shock of adjusting to higher oil prices. To strengthen the functioning of the foreign exchange market and protect the international reserve position, BB has directed state-owned banks to make more efforts to clear their positions in the interbank market rather than relying on the central bank for their foreign exchange needs. The authorities assured staff that no bank is given preferential treatment by the central bank in the foreign exchange market. Since the third PRGF review, the taka/dollar rate has depreciated gradually and rates offered by the NCBs and private dealers have converged. Nevertheless, with receipt of more than $250 million in program assistance from the World Bank and AsDB in December, supplemented by net purchases by the central bank, net international reserves surpassed the level projected under the monetary program for end-December, although still falling short on a flow basis from the start of the fiscal year by $21 million (reflecting the overperformance of NIR at end-June 2005). In view of the considerable pressures in the foreign exchange market associated with oil financing, the authorities would not rule out the need for central bank sales into the market at times, but this would be designed to smooth exchange rate adjustment and not to resist fundamental changes.

26. **The authorities intend to further liberalize the exchange system by removing the only remaining exchange restriction under Fund jurisdiction by June 2006 subject to a favorable balance of payments position.** This restriction pertains to the convertibility and transferability of funds from nonresident taka accounts (MEFP, para. 24). To have regulatory safeguards in place to prevent illegal transactions, the authorities have prepared a new Money Laundering and Financing Terrorism Prevention Act (2005) and have requested technical assistance to strengthen their efforts.

D. NCB Reform

27. **The successful divestment of Rupali Bank will help improve market sentiment and facilitate the implementation of the entire bank restructuring program.** Since November, the authorities have taken steps to revive the divestment of Rupali Bank, including re-advertising the invitation for expressions of interest (MEFP, para. 27 and

Annex). The tender documents are expected to be distributed to short-listed firms by March 2006, with a preferred bidder expected to be announced by end-June 2006 (a structural benchmark for the fifth review).

28. **The staff urged the authorities to step up efforts to implement the bank restructuring program for the other NCBs to contain the risks associated with the NCBs' poor financial performance and management.** In the meantime, continued close monitoring of all NCBs' performance under MOUs will be important to restrain new lending and improve credit risk management. To expedite the restructuring of Agrani Bank, the government has revised the terms of reference of the consulting team on January 19 to provide it with increased authority to implement operational restructuring and to serve as the financial advisor for the eventual sale of the bank (a structural performance criterion for the fourth review for December 15). To strengthen oversight of NCB managements, the board of directors of Sonali Bank includes two members with banking and financial expertise (a structural benchmark for the fourth review), and the government will also reconstitute the boards of Agrani and Janata Banks. Furthermore, to enable the banks to function as independent corporate entities and place them under BB's regulatory purview, the authorities initiated the corporatization of Agrani and Janata Banks in December.

29. **A key problem that has impeded the successful restructuring of the NCBs is the lack of autonomy that bank managements and boards have over key operational decisions.** The authorities have acknowledged this issue and have granted the banks greater autonomy to take decisions on operational matters without prior consent from the Ministry of Finance (MEFP, para. 29). The Working Group on NCB reform, which is now being supported by an international banking expert, will work closely with the NCBs to ensure that the recommendations of the consulting teams are considered in a timely fashion. Bank managements and boards will be held accountable against performance benchmarks that are being designed in consultation with the World Bank.

E. Trade and SOE Reforms

30. **In the face of the elimination of MFA quotas, the authorities agreed on the importance of adopting further measures to facilitate trade.** The authorities plan to further reduce the number of regulatory stages involved in the clearance of imports and exports, and are seeking duty-free access for RMG exports to major markets (MEFP, para. 26). Moreover, the government intends to reduce and streamline supplementary duties in the context of the World Bank's DSC IV to further reduce the current high overall rate of protection.

31. **The energy sector SOEs continue to be a source of fiscal risk (MEFP, para. 10).** Bangladesh has passed through about 60–75 percent of the increase in world oil prices over the last two years (depending on the product), resulting in continuing losses at the BPC. The authorities noted, however, that given the recent decline in international oil prices from a peak in September and the fuel price adjustments already made, the monthly financial losses of BPC have declined. Assuming that world oil prices remain at current levels, and even if

there are no further adjustments in domestic prices, BPC losses in FY05/06 are projected to decline marginally to 0.6 percent of GDP from about 0.7 percent of GDP in FY04/05.

32. **The staff emphasized the importance of reducing BPC's losses through further price adjustments and also called for further increases in domestic gas prices.** The authorities indicated that they remain committed to taking further price adjustments this fiscal year to reduce and eventually eliminate BPC's losses.[3] They noted, however, that in light of the price increases already taken, and inflationary pressures, further adjustments would need to be made gradually, taking into account social considerations (MEFP, para. 20). The authorities will prepare a report quantifying quasi-fiscal costs arising from prices below international levels in the energy and power sector, including the implicit subsidies and revenue foregone by underpricing of natural gas, and identifying measures to mitigate the impact of price adjustments on vulnerable groups (a structural performance criterion for the fifth review).

F. Other Issues

33. **Improving governance remains a key challenge and a high priority, particularly to improve the investment climate.** The authorities have taken steps to develop an anti-corruption strategy with the assistance of donors (MEFP, para. 31). However, further efforts, including steadfast political commitment, are needed to tackle governance problems. The Anti-Corruption Commission, established in November 2004, will also need to be made fully operational. The staff noted that continued implementation of reforms of the NCBs, tax administration, and the trade system will contribute to improving governance and the investment climate.

34. **The authorities have made progress in implementing the recommendations of the safeguards assessment report (MEFP, para. 30).** There were no qualifications attached to the audit of BB's financial statements for FY05, and the accounting and internal audit departments have been strengthened with the assistance of the Fund and World Bank. BB is also taking steps to further improve its internal audit and control systems.

35. **External debt monitoring and management capacity need to be considerably strengthened.** The external debt unit in the Ministry of Finance is understaffed, and software for maintaining and analyzing the debt database is only partly operational. Progress with debt

[3] The price of petrol is now near the level implied by the pricing formula, but prices of diesel and kerosene would require adjustments of about 25 percent. A 30 percent adjustment in domestic gas prices would be required to adhere to the agreed formula, but more substantial increases would be required to reach international levels. Current petroleum and gas prices are also well below those in neighboring India as indicated in Box 2.

reconciliation efforts and analysis of loan-by-loan data is ongoing but has been constrained by delays in reconciling creditor statements with some donors.[4]

IV. Program Monitoring

36. **The program will continue to be monitored through quantitative and structural performance criteria and benchmarks.** Given the delays in meeting structural conditionality, staff took the position that approval of the organogram for the VAT LTU, establishing an audit unit and appointing an advisor for the unit, and revising the terms of reference for Agrani Bank consultants to include the role of financial advisor for its divestment would be prior actions for the completion of the fourth review. These measures have all been implemented. For the fifth PRGF review, quantitative performance criteria for end-March 2006 are proposed, and understandings on indicative targets for end-June, end-September, and end-December 2006 have been reached (MEFP, Table 2). Structural conditionality for the fifth review focuses on fiscal, NCB, and energy sector reforms (MEFP, Table 3). The monitoring of structural policies will continue to be closely coordinated with the World Bank.

37. **The government is requesting modification of the quantitative performance criteria on central government financing, as well as of the indicative targets on revenue.** The authorities view the performance criterion on total domestic financing as sufficient and suggest that the separate ceiling on bank financing be dropped as a performance criterion for the fifth and subsequent reviews (MEFP, para. 33). This request is consistent with their efforts to reduce the government's dependence on sales of National Savings Certificates, which currently account for two thirds of domestic debt, in favor of market-based treasury securities. Moreover, to stress their commitment to meet revenue targets under the PRGF arrangement, the authorities are proposing to convert the quarterly indicative targets for NBR revenue to a performance criterion from March 2006.

V. Staff Appraisal

38. **Bangladesh has achieved strong economic performance in recent years through prudent macroeconomic management and structural reforms.** The economy has continued to expand, and inflation has been kept in check. Nonetheless, Bangladesh remains a country with a high degree of poverty, serious capacity constraints, and heavy reliance on donor inflows. The authorities will need to maintain sound policies and steadily pursue key

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[4] A preliminary assessment in the HIPC Status Report (August 19, 2005) put Bangladesh's NPV/export ratio for FY04 at near the relevant HIPC threshold of 150 percent, whereas the last Article IV staff report (IMF Country Report 05/241) found it to be significantly lower. This is in part due to technical differences between the two exercises, such as different discount rates in the respective required templates, and different definition and period of exports.

structural reforms and capacity building for many years in order to improve the lives of all Bangladeshis. Owing largely to delays in the disbursement of external program assistance and delays in implementing structural reforms, several quantitative and structural performance criteria for the fourth review were not observed. These slippages have now been redressed.

39. **Disruptions associated with the run-up to the January 2007 elections and domestic security concerns could continue to affect the implementation of reforms.** In this connection, the staff welcomes the authorities' renewed commitment to prudent macroeconomic policies and to implement structural policies under the PRGF-supported program. Improving governance remains a key challenge and a high priority in Bangladesh, particularly to improve the investment climate. Accelerated implementation of reforms of the NCBs, tax administration, and the trade system will help achieve underlying program objectives as well as contribute to improved governance.

40. **The staff welcomes the finalization of the NSAPR and the authorities' efforts to better link NSAPR goals to the budget process and the medium-term budget framework.** In view of the authorities' limited technical capacity, continued donor assistance will be required for successful implementation of the NSAPR. To achieve the high growth targeted in the NSAPR, a steadfast implementation of reform policies will be needed.

41. **The authorities' commitment to protect fiscal sustainability while supporting growth and poverty reduction is welcome, but will depend crucially on better revenue mobilization.** Determined efforts to improve revenue collections are vital for funding development expenditure and social spending aimed at poverty reduction without jeopardizing fiscal sustainability. While revenue performance has improved, it has still fallen short of the indicative targets set under the program. The government, therefore, needs to step up its efforts to address the chronic revenue shortages, including by accelerating reforms in revenue administration and reducing tax exemptions and incentives in the context of the FY07 budget. Given the need to strengthen NBR capacity, further technical assistance from DFID, the World Bank, and the Fund will also be critical.

42. **The staff views the proposed monetary program as consistent with the authorities' inflation and international reserves objectives.** The upward adjustment in the reserve money path has been necessitated by recent changes in reserve requirements. The staff encourages BB to use open market operations more actively to tighten the monetary stance further and to raise interest rates on treasury securities. Such a move will send a clear signal of the central bank's commitment to contain inflation. The staff supports BB's efforts to improve the functioning of the interbank and treasury securities markets with MFD technical assistance.

43. **There is an ongoing need to further improve the functioning of the flexible exchange rate regime.** The authorities are encouraged to confine their interventions in the exchange market to countering disorderly conditions and building reserves to a more comfortable level. Moreover, the exchange rate should be allowed to absorb more of the

shock of adjusting to high oil prices, as necessary to safeguard the balance of payments position.

44. **Moving forward with the divestment of Rupali Bank is important to help improve market sentiment and facilitate the implementation of the entire bank restructuring program.** The poor financial condition of the NCBs underlines the urgency for decisive actions in this area. The authorities need to steadfastly consider the recommendations of the consultants on bank-by-bank resolution strategies, and give more autonomy to bank management and boards over key operational decisions. In the meantime, close monitoring of all NCBs' performance under MOUs will be required to restrain new lending and improve credit risk management.

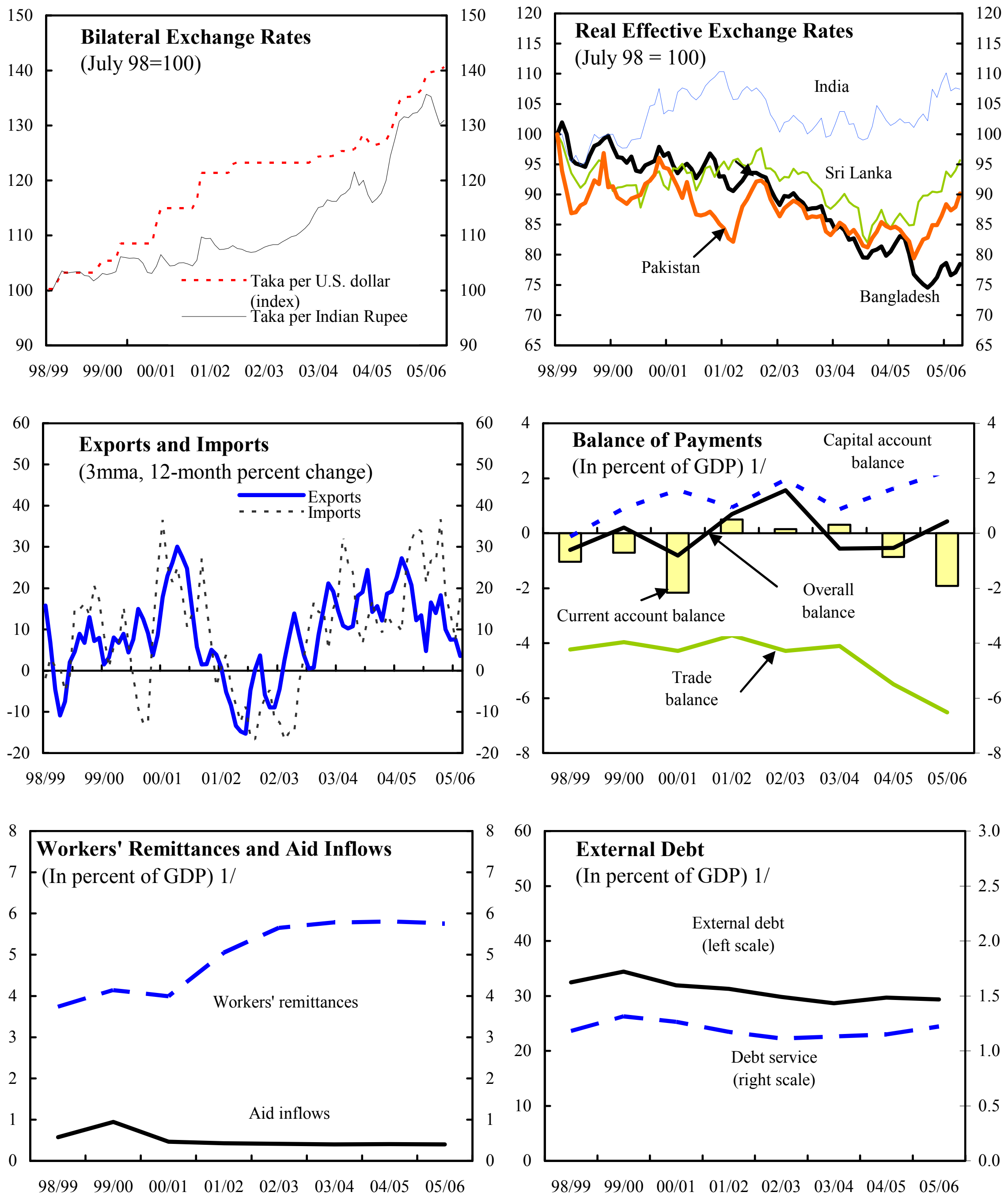
45. **The staff welcomes the authorities' commitment to make further oil price adjustments in order to reduce the fiscal burden posed by the energy sector SOEs.** The increases in global oil prices were only partially passed through to domestic prices, resulting in significant financial losses to BPC that are not sustainable and that could undermine other fiscal objectives. The staff also supports the authorities' plan to undertake a study quantifying quasi-fiscal costs arising from prevailing prices in the energy and power sector, and identifying measures to mitigate the impact of price adjustments on vulnerable groups.

46. **Further trade reform will contribute to growth momentum, particularly following the phasing out of MFA quotas.** The reduction and rationalization of trade taxes in FY05 will enhance competitiveness and reduce anti-export bias, and the authorities' plan to move forward in this area will help bolster confidence in the export sector. Reforms in revenue policy and administration will need to take into account any adverse implications on government revenue of further trade reform.

47. **The staff supports the authorities' request for modifying the quantitative performance criteria on central government financing, as well as targets on revenue.** Given the authorities' prudent fiscal policies in recent years, the performance criterion on total domestic financing would be sufficient, and the separate ceiling on bank financing is not necessary. This request is also consistent with their efforts to reduce the government's dependence on sales of National Savings Certificates in favor of market-based treasury securities. Moreover, the staff welcomes the authorities' commitment to meet revenue targets under the PRGF arrangement by converting the quarterly indicative target for NBR revenue to a performance criterion from March 2006.

48. **Bangladesh's overall performance under the program has been satisfactory, and the attached letter of intent and MEFP set out an ambitious agenda.** Despite a difficult political environment, the authorities have reiterated their commitment to persevere with the reform agenda. Given the corrective actions taken, the staff recommends approval of the authorities' request for waivers for the nonobservance of quantitative and structural performance criteria and completion of the fourth review.

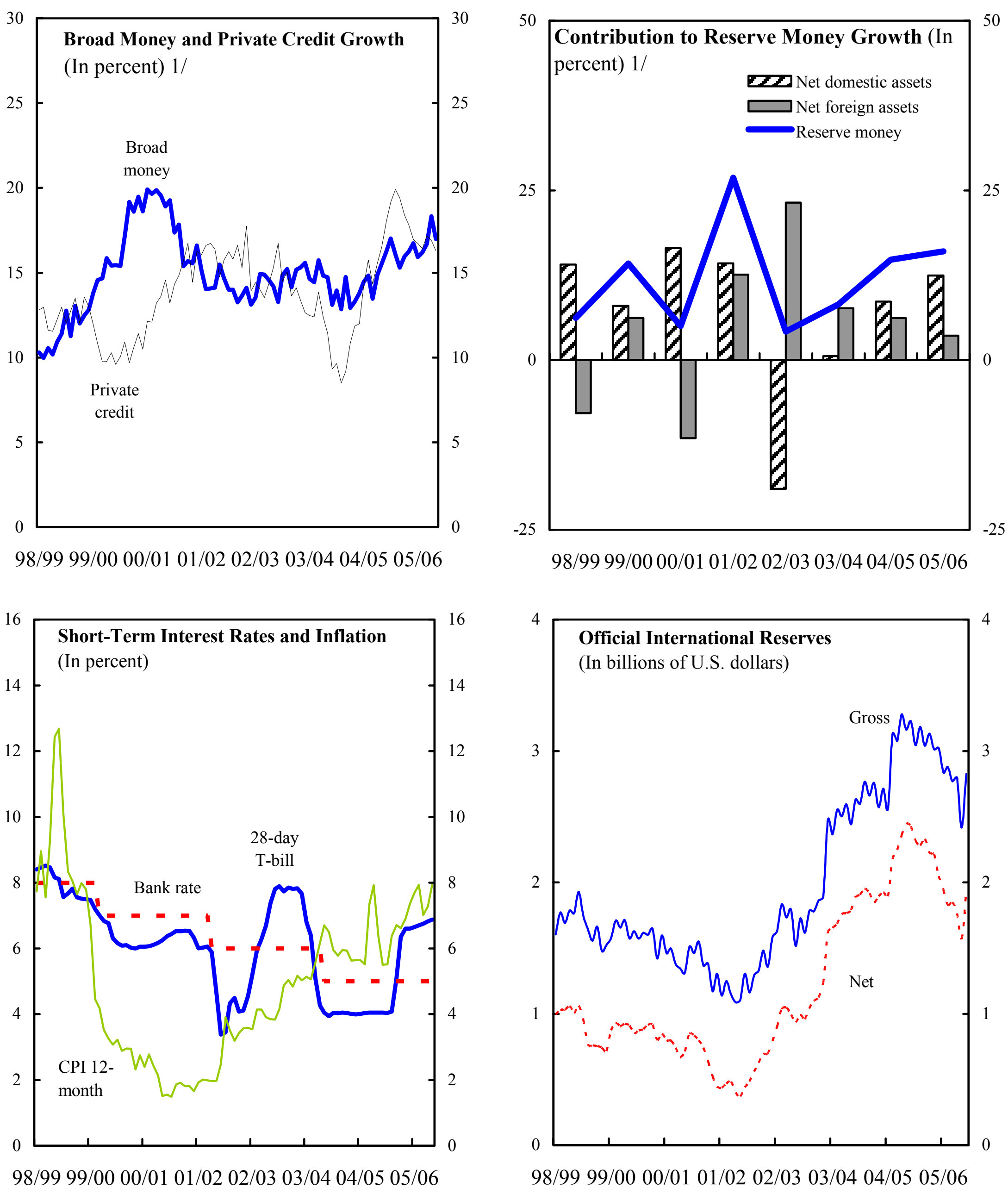
Figure 1. Bangladesh: External Sector Indicators, FY1999–2006



Sources: Data provided by the Bangladesh authorities; IMF, Information Notice System, *International Financial Statistics*; and Fund staff estimates and projections.

1/ Projections for 2005/06.

Figure 2. Bangladesh: Monetary Sector Indicators, FY1999–2006



Sources: Data provided by the Bangladesh authorities; IMF, Information Notice System, *International Financial Statistics* ; and Fund staff projections.

1/ Projections for 2005/06.

Table 1. Bangladesh: Millennium Development Goals, 1990-2004

	1990	1994	1997	2000	2004
Eradicate extreme poverty and hunger	(2015 target = halve 1990 $1 a day poverty and malnutrition rates)				
Population below US$1 a day (percent) 1/	35.9	28.6	26.7	36.0	...
Poverty gap at US$1 a day (percent) 1/	8.8	6.0	5.1	8.1	...
Share of income or consumption held by poorest 20 percent (percent)	…	...	...	9.0	...
Prevalence of child malnutrition (percent of children under 5)	65.8	…	56.3	47.7	...
Population below minimum level of dietary energy consumption (percent)	…	35.0	38.0	30.0	…
Achieve universal primary education	(2015 target = net enrollment to 100)				
Net primary enrollment ratio (percent of relevant age group)	71.2	…	93.6	87.7	84.0
Percentage of cohort reaching grade 5 (percent)	…	...	54.7	65.5	...
Youth literacy rate (percent of ages 15-24)	42.0	44.5	46.5	48.4	49.7
Promote gender equality	(2015 target = education rate to 100)				
Ratio of girls to boys in primary and secondary education (percent)	77.1	76.1	96.5	102.3	106.8
Ratio of young literate females to males (percent of ages 15-24)	65.5	67.3	68.7	70.0	71.1
Share of women employed in the nonagricultural sector (percent)	17.6	20.5	22.2	22.9	24.2
Proportion of seats held by women in national parliament (percent)	10.0	…	9.0	9.0	2.0
Reduce child mortality	(2015 target = reduce 1990 under 5 mortality by two thirds)				
Under 5 mortality rate (per 1,000)	144.0	116.0	...	82.0	69.0
Infant mortality rate (per 1,000 live births)	96.0	75.0	...	54.0	46.0
Immunization, measles (percent of children under 12 months)	65.0	78.0	72.0	76.0	77.0
Improve maternal health	(2015 target = reduce 1990 maternal mortality by three fourths)				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	...	380.0	...
Births attended by skilled health staff (percent of total)	...	9.5	8.0	12.1	14.0
Combat HIV/AIDS, malaria, and other diseases	(2015 target = halt and begin to reverse AIDS, etc.)				
Prevalence of HIV, female (percent of ages 15-24)	...	...	...	…	...
Contraceptive prevalence rate (percent of women ages 15-49)	39.9	44.9	49.2	53.8	...
Number of children orphaned by HIV/AIDS	…	...	...	…	...
Incidence of tuberculosis (per 100,000 people)	246.1	246.0	246.0	245.9	245.9
Tuberculosis cases detected under DOTS (percent)	…	6.7	18.1	23.5	33.0
Ensure environmental sustainability	(2015 target = various 2/)				
Forest area (percent of total land area)	9.0	…	...	10.2	...
Nationally protected areas (percent of total land area)	…	...	0.8	0.8	0.8
GDP per unit of energy use (PPP $ per kg oil equivalent)	10.1	10.3	10.4	10.9	10.5
CO2 emissions (metric tons per capita)	0.1	0.2	0.2	0.2	...
Access to an improved water source (percent of population)	71.0	94.0	...	97.0	75.0
Access to improved sanitation (percent of population)	23.0	41.0	...	48.0	48.0
Develop a global partnership for development	(2015 target = various 3/)				
Youth unemployment rate (percent of total labor force ages 15-24)	2.5	…	7.0	10.7	...
Fixed line and mobile telephones (per 1,000 people)	2.0	2.2	3.2	5.8	15.6
Personal computers (per 1,000 people)	…	...	0.2	1.5	7.8
General indicators					
Population (millions)	110.0	118.0	124.4	131.1	140.5
Gross national income (in billions of U.S. dollars)	31.0	36.6	43.5	49.8	61.2
GNI per capita (in U.S. dollars)	280.0	310.0	350.0	380.0	440.0
Adult literacy rate (percent of people ages 15 and over)	34.2	36.5	38.3	40.0	41.1
Total fertility rate (births per woman)	4.1	...	3.3	...	2.9
Life expectancy at birth (years)	54.8	...	59.8	...	62.4
Aid per capita (current US$)	19.0	14.8	8.1	8.9	10.1
Investment (percent of GDP)	17.1	18.4	20.7	23.0	23.4

Sources: World Bank; and Fund staff estimates.

Note: In some cases the data are for earlier or later years than those stated.
1/ Data may not be comparable across time periods due to methodological differences in survey design.
2/ Integrate the principles of sustainable development into country policies and programs and reverse the loss of environment resources. Halve the proportion of people without sustainable access to safe drinking water by 2015.
3/ Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system. Address the special needs of land locked countries and small island developing states.

Table 2. Bangladesh: Key Economic Indicators, FY2003─09 1/

			Prog.	Act.	Rev. Prog.	Projections		
	2002/03	2003/04	2004/05		2005/06	2006/07	2007/08	2008/09
National income and prices (percent change)								
Real GDP	5.3	6.3	5.2	5.4	6.0	6.0	6.5	6.5
GDP deflator	4.5	4.2	6.0	5.0	6.0	6.0	5.0	4.5
CPI inflation (annual average) 2/	4.4	5.8	6.5	6.5	7.5	6.0	5.0	4.5
Central government operations (percent of GDP)								
Total revenue	10.3	10.2	10.5	10.6	11.0	11.5	11.7	11.9
Tax	8.3	8.2	8.6	8.5	9.0	9.5	9.7	9.9
Nontax	2.0	1.9	1.9	2.0	2.0	2.0	2.0	2.0
Total expenditure	13.7	13.1	14.7	14.1	15.1	15.4	15.5	15.6
Current expenditure	8.1	7.8	8.6	8.5	8.7	8.7	8.6	8.6
Of which : Interest payments	1.9	1.6	1.7	1.7	1.8	1.7	1.7	1.7
Annual Development Program	5.4	5.0	5.3	5.0	5.4	5.7	6.0	6.0
Other expenditures 3/	0.2	0.3	0.8	0.6	1.0	1.0	0.9	1.0
Overall balance (excluding grants)	-3.4	-2.9	-4.2	-3.5	-4.0	-3.9	-3.8	-3.7
Primary balance	-1.5	-1.3	-2.4	-1.9	-2.3	-2.2	-2.2	-2.1
Financing (net)	3.4	2.9	4.2	3.5	4.0	3.9	3.8	3.7
Domestic	1.2	1.8	2.0	1.7	2.0	1.9	1.8	1.7
External	2.1	1.1	2.2	1.8	2.0	2.0	2.0	2.0
Total central government debt (percent of GDP)	51.1	48.7	47.9	48.4	48.5	47.4	46.1	44.9
Money and credit (end of year; percent change)								
Net domestic assets	12.2	13.4	14.8	17.1	15.0	13.5	13.5	13.1
Credit to private sector	12.6	12.0	14.7	17.0	13.9	13.1	12.8	12.8
Broad money (M2)	15.6	13.8	14.2	16.7	14.3	13.4	13.0	13.0
Balance of payments (in billions of U.S. dollars) 4/								
Exports, f.o.b.	6.5	7.5	7.8	8.6	9.6	10.5	11.5	12.6
(Annual percent change)	9.5	15.8	4.1	14.0	11.7	9.8	9.4	9.3
Imports, f.o.b.	8.7	9.8	11.6	11.9	13.7	14.9	16.1	17.5
(Annual percent change)	13.1	13.0	18.0	20.6	15.0	9.1	8.3	8.2
Current account	0.1	0.2	-1.1	-0.5	-1.2	-1.2	-1.3	-1.3
(Percent of GDP)	0.1	0.3	-1.8	-0.9	-1.9	-1.8	-1.7	-1.6
Gross official reserves (in billions of U.S. dollars)	2.5	2.7	2.9	3.0	3.3	3.5	3.8	4.1
In months of imports of goods and nonfactor services	2.9	2.8	2.4	2.6	2.5	2.5	2.5	2.5
Memorandum item:								
Nominal GDP (in billions of taka)	3,006	3,330	3,731	3,685	4,142	4,653	5,202	5,790

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1.
2/ CPI has recently been rebased using FY96 weights.
3/ Consists of other capital, net lending, and food accounts (including check float and discrepancy).
4/ Balance of payments is presented on the basis of BPM5.

Table 3. Bangladesh: Balance of Payments, FY03–09 1/

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

	2002/03	2003/04	2004/05 Country Rep. No. 05/241	2004/05 Est.	2005/06 Country Rep. No. 05/241	2005/06 Rev. Prog.	2006/07 Proj.	2007/08 Proj.	2008/09 Proj.
Trade balance	-2,215	-2,319	-3,783	-3,297	-4,346	-4,070	-4,372	-4,622	-4,876
Exports (f.o.b)	6,492	7,521	7,827	8,573	7,983	9,580	10,520	11,507	12,575
Of which : RMG sector	4,912	5,686	5,857	6,418	5,798	7,060	7,695	8,388	9,118
Imports (f.o.b)	-8,707	-9,840	-11,610	-11,870	-12,328	-13,651	-14,893	-16,129	-17,451
Of which : Crude petroleum and petroleum products	-887	-1,022	-1,496	-1,602	-1,768	-2,000	-2,094	-2,166	-2,257
Services	-691	-874	-1,141	-870	-1,313	-1,182	-1,285	-1,437	-1,488
Income	-458	-374	-354	-641	-346	-713	-757	-870	-923
Transfers	3,440	3,743	4,200	4,290	4,633	4,770	5,224	5,638	5,976
Official current transfers 2/	82	61	52	52	70	55	56	57	59
Private transfers	3,358	3,682	4,148	4,238	4,563	4,715	5,168	5,581	5,916
Of which: Workers' remittances	3,062	3,372	3,824	3,851	4,206	4,352	4,787	5,170	5,481
Current account balance	76	176	-1,077	-518	-1,372	-1,196	-1,190	-1,291	-1,312
Capital and financial account balance	1,009	492	1,153	972	645	1,407	742	1,029	1,128
Capital account	428	319	309	258	366	349	406	474	488
Financial account	581	173	845	714	279	1,058	337	555	640
Foreign direct investment	376	385	410	540	429	600	629	659	716
Portfolio investment	2	6	0	0	0	0	0	0	0
Net aid flows 3/	634	242	931	751	228	842	252	473	589
Aid disbursements	1,070	734	1,373	1,188	686	1,285	730	988	1,125
Debt amortization	-436	-492	-442	-437	-458	-444	-478	-515	-536
Other long-term loans (net)	-20	-41	-45	-46	0	0	0	0	0
Other short-term loans (net)	142	13	150	241	0	200	0	0	0
Other assets (net)	-125	-125	-200	-155	-149	-134	-109	-133	-125
Trade credits (net)	-499	-321	-375	-417	-208	-350	-385	-394	-489
Commercial banks (net)	71	14	-26	-200	-21	-100	-50	-50	-50
Errors and omissions	-274	-357	0	-322	0	-200	0	0	0
Overall balance	811	311	76	132	-727	11	-448	-262	-184
Financing items	-811	-311	-76	-132	0	-11	-200	-260	-275
Bangladesh Bank 4/	-811	-311	-76	-132	0	-11	-200	-260	-275
Financing gap	0	0	0	0	727	0	648	522	460
Exceptional Financing (identified)	...	...	...	...	727	...	605	455	450
World Bank	...	...	...	...	492	...	395	355	350
ADB	...	...	...	...	200	...	185	100	100
Other	...	...	...	...	35	...	25	0	0
Residual financing gap	...	...	...	...	0	...	43	67	10
Memorandum items:									
Current account balance (percent of GDP)	0.1	0.3	-1.8	-0.9	-2.2	-1.9	-1.8	-1.7	-1.6
Export growth rate (percent)	9.5	15.8	4.1	14.0	2.0	11.7	9.8	9.4	9.3
Import growth rate (percent)	13.1	13.0	18.0	20.6	6.2	15.0	9.1	8.3	8.2
Gross official reserves (in millions of US dollars) 5/	2,471	2,714	2,876	3,024	3,185	3,250	3,543	3,837	4,131
(In months of imports of goods and services)	2.9	2.8	2.4	2.6	2.3	2.5	2.5	2.5	2.5
Net international reserves (in millions of US dollars)	1,604	1,915	1,993	2,047	1,993	2,058	2,258	2,518	2,793
Medium and long-term external public debt (in millions of US dollars)	16,953	17,196	17,802	18,057	18,757	18,898	19,798	20,793	21,841
(In percent of GDP)	32.8	30.4	29.3	30.1	29.8	30.3	29.3	28.1	27.0
Debt-service ratio 6/	5.6	4.3	5.0	4.6	4.9	4.2	4.0	3.9	3.8
Nominal GDP (in millions of US dollars)	51,719	56,585	60,805	59,951	62,867	62,412	67,620	74,119	80,876

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1. Following an STA technical assistance mission in August 2002, presentation of the data has been modified to comply with the fifth edition of the Balance of Payments Manual.
2/ Excludes official capital grants.
3/ Loans only.
4/ Includes Asian Clearing Union balances.
5/ Gross foreign reserves of Bangladesh Bank, including resident foreign currency deposits.
6/ In percent of current earnings defined as the sum of exports of goods, nonfactor services, and private transfers.

Table 4. Bangladesh: Central Bank Balance Sheet, June 2004–Dec 2006

	Jun-04		Sep-04		Dec-04		Mar-05		Jun-05		Sep-05		Dec-05	Mar-06	Jun-06	Sep-06	Dec-06
	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog. 4/	Actual	Revised Program for FY06			Program for FY07	
	(End of period; in billions of taka)																
Net international reserves 1/	110	116	123	134	135	147	134	148	128	130	134	121	122	126	140	150	153
Net international reserves 2/	110	115	122	134	134	136	132	132	113	122	...	...	...	...	...	...	...
Net international reserves 3/	...	...	...	...	...	...	...	...	125	135	130	123	121	124	135	143	145
Net domestic assets 1/	122	123	114	109	118	103	122	113	138	144	138	159	179	182	178	176	186
Net domestic assets 2/	122	124	115	109	119	114	125	129	153	152	...	...	...	...	...	...	...
Net domestic assets 3/	...	...	...	...	...	...	...	...	140	139	142	157	180	184	183	183	195
Net credit to central government	53	110	75	76	83	82	86	96	116	146	113	141	161	169	170	171	184
Credit to other nonfinancial public sector	1	1	1	1	1	0	1	0	1	0	1	0	1	1	1	0	0
Credit to deposit money banks	53	55	54	54	56	56	57	58	60	57	61	58	61	61	61	62	62
Other items, net 1/	15	-43	-16	-21	-23	-35	-22	-41	-39	-61	-37	-40	-43	-46	-49	-50	-51
Reserve money	232	239	237	243	253	250	256	261	266	274	272	280	300	308	318	326	339
Currency	167	173	170	179	186	186	188	192	194	203	200	208	218	223	229	235	245
Reserves	66	66	67	64	67	64	68	69	72	70	72	72	82	85	89	91	94
	(Change since start of fiscal year; in billions of taka)																
Net international reserves 1/	17	22	7	18	19	32	18	32	12	15	6	-9	-9	-4	10	10	13
Net international reserves 2/	...	...	12	19	19	21	17	17	-1	8	...	...	...	...	...	...	...
Net international reserves 3/	...	...	...	...	...	...	...	...	...	...	4	-13	-15	-11	0	8	9
Net domestic assets 1/	1	2	-9	-14	-5	-20	-1	-10	15	21	0	15	35	38	34	-2	8
Net domestic assets 2/	...	...	-9	-15	-5	-10	1	5	29	28	...	...	...	...	...	...	...
Net domestic assets 3/	...	...	...	...	...	...	...	...	...	...	2	19	41	46	44	0	12
Net credit to central government	-10	13	-35	-34	-27	-28	-24	-14	7	37	-3	-5	15	22	23	1	14
Credit to other nonfinancial public sector	0	0	0	0	0	-1	0	-1	0	-1	0	0	1	1	1	-1	-1
Credit to deposit money banks	5	6	-1	-1	2	1	2	3	5	3	1	0	4	4	4	1	1
Other items, net	6	-16	27	21	20	7	21	2	4	-18	2	20	17	14	11	-1	-2
Reserve money	18	24	-2	5	14	11	17	22	27	35	6	6	26	34	44	8	21
Currency	13	19	-3	6	13	13	15	19	21	30	6	5	15	20	26	6	16
Reserves	5	5	1	-2	1	-2	2	3	6	5	1	1	12	14	19	2	5
Memorandum items:																	
Reserve money (year-on-year percent change)	8.4	11.3	11.7	14.6	14.2	13.1	13.2	15.0	11.4	14.8	11.9	15.1	19.7	18.1	16.0	16.3	12.9
Net international reserves (in millions of U.S. dollars) 1/	1,825	1,915	2,025	2,257	2,248	2,412	2,200	2,304	1,993	2,047	2,063	1,851	1,827	1,877	2,058	2,178	2,203
Flow since start of fiscal year (in millions of U.S. dollars) 1/	221	311	200	341	331	497	283	389	78	131	70	-196	-220	-170	11	120	145
Net international reserves (in millions of U.S. dollars) 2/	1,871	1,944	2,071	2,275	2,277	2,302	2,229	2,232	1,919	2,072	...	...	...	...	...	...	...
Flow since start of fiscal year (in millions of U.S. dollars) 2/	...	...	200	331	331	358	285	288	-25	128	...	...	...	...	...	...	...
Net international reserves (in millions of U.S. dollars) 3/	...	...	...	...	...	...	...	2,304	1,974	2,131	2,044	1,932	1,900	1,950	2,131	2,251	2,276
Flow since start of fiscal year (in millions of U.S. dollars) 3/	...	...	...	...	...	...	...	...	...	...	70	-199	-231	-181	0	120	145
Required domestic cash reserves (in billions of taka)	48	49	49	50	50	53	53	53	62	64	64	64	75	77	81	83	86
Excess domestic cash reserves (in billions of taka)	14	17	18	14	17	11	15	16	10	6	9	8	7	8	8	8	9

Sources: Data provided by the Bangladeshi authorities; and Fund staff estimates and projections.

1/ Calculated from monetary data using end of period exchange rates.
2/ Calculated using program exchange rates (rates for FY05 as of end-March 2004).
3/ Calculated using program exchange rates (rates for FY06 as of end-March 2005).
4/ The September 2005 program target for NIR, as shown, is not adjusted for the delay in the World Bank education sector loan ($100 million), which is now expected in Q4 of FY2006.

Table 5. Bangladesh: Monetary Program, June 2004–Dec 2006

	Jun-04		Sep-04		Dec-04		Mar-05		Jun-05		Sep-05		Dec-05	Mar-06	Jun-06	Sep-06	Dec-06
	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Actual	Revised Program for FY06			Program for FY07	
	(End of period; in billions of taka)																
Net foreign assets	158	163	172	187	183	192	184	194	179	186	187	180	181	188	203	214	218
Bangladesh Bank	110	116	123	134	135	147	134	148	128	130	134	121	122	126	140	150	153
Commercial banks	48	47	49	53	48	45	50	46	51	55	53	59	60	61	63	64	65
Net domestic assets	1,118	1,134	1,139	1,147	1,219	1,213	1,255	1,216	1,302	1,328	1,337	1,377	1,435	1,461	1,528	1,566	1,620
Domestic credit	1,152	1,219	1,221	1,234	1,300	1,313	1,341	1,337	1,402	1,432	1,439	1,495	1,562	1,600	1,675	1,721	1,783
Net credit to central government	204	204	199	189	214	209	222	201	240	239	236	246	261	279	302	312	330
Credit to other nonfinancial public sector	59	69	59	68	73	68	76	71	76	86	78	104	109	111	112	113	114
Credit to private sector	889	946	963	977	1,011	1,037	1,043	1,065	1,086	1,107	1,125	1,145	1,192	1,211	1,261	1,296	1,339
Other items, net 1/	-34	-85	-84	-87	-81	-100	-86	-121	-100	-104	-103	-119	-127	-139	-147	-155	-163
Broad money (M2)	1,276	1,297	1,311	1,334	1,402	1,406	1,439	1,410	1,481	1,514	1,524	1,557	1,617	1,649	1,730	1,780	1,839
	(Change since start of fiscal year; in billions of taka)																
Net foreign assets	18	23	9	24	20	30	21	32	16	23	8	-6	-4	2	17	11	16
Bangladesh Bank	17	70	7	18	19	32	18	32	12	15	6	-9	-9	-4	10	10	13
Commercial banks	1	-2	2	6	1	-2	3	-1	4	8	2	3	4	6	7	1	3
Net domestic assets	118	134	5	13	85	79	121	82	168	194	35	48	107	133	199	38	93
Domestic credit	118	123	2	15	80	94	122	118	183	213	37	63	130	168	242	46	109
Net credit to central government	31	13	-5	-15	10	5	18	-3	36	35	-4	8	22	40	63	10	28
Credit to other nonfinancial public sector	4	13	-10	0	5	-1	7	2	7	18	2	17	22	24	25	1	2
Credit to private sector	83	97	17	31	65	91	97	119	140	160	39	38	85	104	154	35	79
Other items, net	0	11	1	-2	4	-15	-1	-36	-15	-19	-3	-15	-23	-35	-43	-8	-16
Broad money (M2)	136	157	14	37	105	109	142	113	184	217	43	43	103	135	216	49	108
	(Year-on-year percent change)																
Net foreign assets	13.0	16.3	15.4	25.2	17.4	23.2	17.7	24.1	10.0	14.2	0.2	-3.4	-5.8	-3.5	9.2	18.7	20.4
Net domestic assets	11.8	13.4	11.0	11.8	15.7	15.2	17.6	14.0	14.8	17.1	16.5	20.0	18.3	20.2	15.0	13.8	12.9
Domestic credit	11.4	11.9	8.2	14.6	14.5	19.8	17.3	14.2	15.0	17.5	16.6	21.1	18.9	19.7	16.9	15.1	14.2
Net credit to central government	17.7	7.8	15.3	9.6	17.5	24.6	24.2	20.6	17.7	17.2	24.8	30.4	25.1	38.9	26.5	26.7	26.6
Credit to other nonfinancial public sector	6.9	23.8	9.0	25.2	19.7	10.8	19.7	13.7	10.6	25.8	14.6	51.8	60.9	56.8	29.4	8.7	4.6
Credit to private sector	10.3	12.0	12.7	14.3	13.5	18.0	15.8	19.4	14.8	17.0	15.2	17.2	15.0	13.7	13.9	13.2	12.3
Other items, net	-0.5	-32.3	-18.3	42.8	-32.5	68.5	2.0	16.0	18.1	22.7	17.7	36.1	26.6	15.3	41.5	30.8	28.9
Broad money (M2)	11.9	13.8	11.5	13.5	16.0	16.3	17.7	15.3	14.2	16.7	14.2	16.7	15.0	16.9	14.3	14.3	13.7
	(In billions of taka, unless otherwise noted)																
Memorandum items:																	
Broad money multiplier	5.49	5.43	5.53	5.48	5.54	5.62	5.61	5.40	5.57	5.53	5.60	5.56	5.38	5.35	5.44	5.46	5.42
Broad money velocity	2.62	2.57	2.61	2.56	2.52	2.49	2.52	2.55	2.52	2.43	2.52	2.65	2.44	2.45	2.40	2.38	2.35
Net domestic financing of central govt. (since beginning of FY)	76	60	4	-6	33	16	53	19	76	64	8	13	32	55	83	16	40
Bank	31	13	-5	-15	10	5	18	-3	36	35	-4	8	22	40	63	10	28
Nonbanks	45	46	9	9	23	11	35	22	40	29	12	5	10	15	20	6	12

Sources: Data provided by the Bangladeshi authorities; and Fund staff estimates and projections.

Table 6. Bangladesh: Central Government Operations, FY03–09 1/

	2002/03	2003/04	2004/05 Prog.	2004/05 Est.	2005/06 Prog. Country Rep. No. 05/241	2005/06 Budget Approved	2005/06 Rev. prog. Nov. 2005	2006/07 Proj.	2007/08 Proj.	2008/09 Proj.
					(In billions of taka)					
Total revenue	309.7	339.0	392.0	389.2	457.2	457.2	457.2	536.5	606.5	689.8
Tax revenue	248.2	274.3	319.5	314.1	373.1	373.1	373.1	443.8	504.3	573.9
NBR taxes	237.6	261.9	305.0	299.9	356.5	356.5	356.5	424.7	481.2	547.2
VAT, supplementary duties, excises	124.8	141.0	163.6	161.6	192.3	192.4	192.4	228.3	257.0	293.3
Customs duties	66.9	70.9	80.0	79.1	91.0	91.0	91.0	109.5	125.1	140.2
Taxes on income and profits	43.7	47.1	58.5	56.7	69.5	69.6	69.6	83.0	95.1	109.1
Other NBR taxes	2.2	2.9	2.9	2.6	3.5	3.5	3.5	3.9	4.1	4.6
Non-NBR taxes	10.7	12.4	14.5	14.2	16.6	16.6	16.6	19.1	23.1	26.7
Nontax revenue	61.5	64.7	72.5	75.1	84.1	84.1	84.1	92.6	102.2	115.9
Total expenditure	411.4	435.7	548.3	525.0	633.5	643.8	623.9	716.8	806.2	904.4
Current expenditure	244.5	258.6	320.3	312.5	351.4	361.8	361.8	407.1	446.5	500.5
Pay and allowances	71.2	76.6	90.6	84.2	106.6	98.8	98.8	114.8	119.8	133.3
Goods and services	42.5	45.1	57.8	56.4	64.1	57.6	57.6	77.8	92.3	109.9
Interest payments	56.6	54.5	65.0	61.8	67.2	70.5	73.5	77.9	87.3	95.8
Subsidies and transfers	70.2	78.9	101.7	103.2	101.4	117.1	117.1	116.4	124.9	136.9
Block allocations	4.0	3.6	5.1	6.9	12.1	17.8	14.8	20.3	22.2	24.5
Food account surplus(-)/deficit(+)	-2.7	3.5	1.7	0.6	3.5	1.7	1.7	1.5	1.5	1.5
Annual Development Program (ADP)	163.0	167.9	198.0	185.8	238.9	245.0	225.0	267.0	313.0	348.0
Non-ADP capital and net lending	6.6	16.0	25.6	24.2	32.2	27.9	27.9	31.2	35.2	42.2
Extraordinary expenditures	12.3	7.8	2.7	1.9	7.5	7.5	7.5	10.0	10.0	12.2
Check float plus discrepancy	-12.2	-18.2	0.0	-5.7	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (excluding grants)	-101.7	-96.6	-156.3	-130.1	-176.3	-186.6	-166.7	-180.4	-199.7	-214.6
Primary balance (excluding grants)	-45.1	-42.1	-91.3	-68.3	-109.1	-116.1	-93.2	-102.5	-112.4	-118.8
Net financing	101.7	96.6	156.3	130.1	176.3	186.6	166.7	180.4	199.7	214.6
External	64.2	36.8	80.3	66.3	93.0	103.2	83.7	92.1	104.1	115.4
Domestic	37.5	59.8	76.0	63.8	83.3	83.4	83.0	88.3	95.6	99.2
Bank	-10.7	13.4	36.0	35.0	36.3	36.4	63.0	64.0	63.7	66.1
Nonbank	48.2	46.4	40.0	28.8	47.0	47.0	20.0	24.0	31.9	33.1
					(In percent of GDP)					
Total revenue	10.3	10.2	10.5	10.6	11.0	11.0	11.0	11.5	11.7	11.9
Tax revenue	8.3	8.2	8.6	8.5	8.9	8.9	9.0	9.5	9.7	9.9
NBR taxes	7.9	7.9	8.2	8.1	8.5	8.5	8.6	9.1	9.3	9.5
Non-NBR taxes	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5
Nontax revenue	2.0	1.9	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Total expenditure	13.7	13.1	14.7	14.1	15.2	15.5	15.1	15.4	15.5	15.6
Current expenditure	8.1	7.8	8.6	8.5	8.4	8.7	8.7	8.7	8.6	8.6
Pay and allowances	2.4	2.3	2.4	2.3	2.6	2.4	2.4	2.5	2.3	2.3
Goods and services	1.4	1.4	1.6	1.5	1.5	1.4	1.4	1.7	1.8	1.9
Interest	1.9	1.6	1.7	1.7	1.6	1.7	1.8	1.7	1.7	1.7
Subsidies and transfers	2.3	2.4	2.7	2.8	2.4	2.8	2.8	2.5	2.4	2.4
Block allocations	0.1	0.1	0.1	0.2	0.3	0.4	0.4	0.4	0.4	0.4
Annual Development Program	5.4	5.0	5.3	5.0	5.7	5.9	5.4	5.7	6.0	6.0
Non-ADP capital and net lending	0.2	0.5	0.7	0.7	0.8	0.7	0.7	0.7	0.7	0.7
Other expenditures	0.3	0.3	0.1	0.1	0.3	0.2	0.2	0.2	0.2	0.2
Check float plus discrepancy	-0.4	-0.5	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (excluding grants)	-3.4	-2.9	-4.2	-3.5	-4.2	-4.5	-4.0	-3.9	-3.8	-3.7
Primary balance (excluding grants)	-1.5	-1.3	-2.4	-1.9	-2.6	-2.8	-2.3	-2.2	-2.2	-2.1
Net financing	3.4	2.9	4.2	3.5	4.2	4.5	4.0	3.9	3.8	3.7
External financing (net)	2.1	1.1	2.2	1.8	2.2	2.5	2.0	2.0	2.0	2.0
Domestic financing	1.2	1.8	2.0	1.7	2.0	2.0	2.0	1.9	1.8	1.7
Banks	-0.4	0.4	1.0	0.9	0.9	0.9	1.5	1.4	1.2	1.1
Nonbank	1.6	1.4	1.1	0.8	1.1	1.1	0.5	0.5	0.6	0.6
					(In percent of GDP)					
Memorandum item:										
Nominal GDP (in billions of taka)	3,006	3,330	3,731	3,685	4,171	4,171	4,142	4,653	5,202	5,790
Overall balance, including grants	-2.3	-2.4	-3.6	-3.0	-3.5	-3.7	-3.4	-3.2	-3.1	-3.0
Poverty reducing Spending	5.5	6.1	7.8	6.7	8.4	8.4	8.4	8.8	9.3	9.8
Government wage bill and pensions	3.8	3.7	3.8	3.8	3.8	3.8	3.8	3.8	3.7	3.6
Total central government debt	51.1	48.7	47.9	48.4	48.3	...	48.5	47.4	46.1	44.9

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates.

1/ Fiscal year ends June 30.

Table 7. Bangladesh: Proposed Schedule of Disbursements Under the PRGF Arrangement and Augmentation of PRGF Access in Accordance with the Trade Integration Mechanism (TIM)

Original Amount	Augumentation	Total	Available Date	Conditions for Disbursement
SDR 49.5 million (9.3 percent of quota)		SDR 49.5 million (9.3 percent of quota)	June 25, 2003	Observance of the end-March 2003 quantitative benchmark, implementation of prior actions, and Board approval of arrangement.
SDR 49.5 million (9.3 percent of quota)		SDR 49.5 million (9.3 percent of quota)	December 15, 2003	Observance of the end-September 2003 performance criteria and structural performance criteria for end-September and end-November 2003 and completion of the first review.
SDR 49.5 million (9.3 percent of quota)		SDR 49.5 million (9.3 percent of quota)	July 28, 2004	Observance of the end-March 2004 performance criteria and structural performance criteria for end-December 2003 and end-April 2004 and completion of the second review.
SDR 49.5 million (9.3 percent of quota)	SDR 17.78 million (3.33 percent of quota)	SDR 67.28 million (12.63 percent of quota)	June 29, 2005	Observance of the end-September 2004 performance criteria and structural performance criteria for end-September and end-November 2004, implementation of prior actions, and completion of the third review.
SDR 49.5 million (9.3 percent of quota)	SDR 17.78 million (3.33 percent of quota)	SDR 67.28 million (12.63 percent of quota)	February 15, 2006	Observance of the end-September 2005 performance criteria and completion of the fourth review.
SDR 49.5 million (9.3 percent of quota)	SDR 17.78 million (3.33 percent of quota)	SDR 67.28 million (12.63 percent of quota)	mid-June, 2006	Observance of the end-March 2006 performance criteria and completion of the fifth review.
SDR 50.0 million (9.4 percent of quota)		SDR 50.0 million (9.4 percent of quota)	mid-December, 2006	Observance of the end-September 2006 performance criteria and completion of the sixth review.
Total SDR 347.0 million (65 percent of quota)	SDR 53.33 million (10 percent of quota)	SDR 400.33 million (75 percent of quota)		

BANGLADESH: FUND RELATIONS
(As of November 30, 2005)

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

II. **General Resources Account:**	SDR million	Percent Quota
Quota	533.30	100.00
Fund holding of currency	533.08	99.96
Reserve position in Fund	0.23	0.04

III. **SDR Department:**	SDR million	Percent Allocation
Net cumulative allocation	47.12	100.00
Holdings	0.18	0.38

IV. **Outstanding Purchases and Loans:**	SDR million	Percent Quota
PRGF arrangements	215.78	40.46

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	6/20/03	12/31/06	400.33	215.78
ESAF	8/10/90	9/13/93	345.00	330.00
SAF	2/06/87	2/05/90	201.25	201.25

VI. **Projected Payments to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	2005	2006	2007	2008	2009
Principal	0.00	0.00	0.00	4.95	14.85
Charges/interest	0.53	2.49	2.49	2.49	2.44
Total	0.53	2.49	2.49	7.44	17.29

VII. Safeguards Assessment

Under the Fund's safeguards assessment policy, the Bangladesh Bank is subject to a safeguards assessment with respect to an augmentation of access under the PRGF Arrangement approved on July 28, 2004. The assessment was completed on January 24, 2005 and concluded that safeguards in place at the BB require further improvement. Weaknesses were identified in the legal, financial reporting, internal audit and internal control areas, and the safeguards assessment recommended measures to address them.

VIII. Exchange Arrangement

Exchange regime. The exchange regime is characterized as a managed float with no preannounced path for the exchange rate. Until May 31, 2003, the taka was fixed to the U.S. dollar, but was periodically adjusted. It was devalued on three occasions during 2000–02, when the trading band for BB's transactions was correspondingly widened or raised. From January 2002 until May 30, 2003, the official band for the taka remained unchanged at Tk 57.4–58.4 per U.S. dollar. Authorized dealer (AD) banks set their own buying and selling rates for the U.S. dollar and other currencies generally within the band until October 2002. From November 2002, however, AD banks have set rates outside the band. Effective May 31, 2003, BB no longer announced a trading band for its foreign exchange transactions.

At the June 2003 Article IV consultation, the Executive Board approved maintenance by Bangladesh of margin requirement for the opening of letters of credit for the import of goods until November 30, 2003, and also approved the maintenance of restrictions of advance payments for imports and the convertibility and transferability of proceeds of current international transactions in nonresident taka accounts until the conclusion of the second review under the PRGF arrangement or June 30, 2004, whichever is sooner. The restriction pertaining to advance payments for imports was fully lifted as of end-December, 2004. At the last Article IV consultation (June 2005), the Executive Board did not approve the maintenance of the restriction on the convertibility and transferability of proceeds from nonresident taka accounts but noted the authorities' intent to remove this restriction by end-June 2006.

IX. Article IV Consultation

The next Article IV consultation will be held subject to the provisions of the decision on consultation cycles approved on July 15, 2002. The last Article IV consultation was held in March-April 2005, and was concluded on June 7, 2005 (IMF Country Report No. 05/241).

X. Technical Assistance During 2004–05

2004

January–February:	STA mission provided recommendations in the area of Government Finance Statistics.
February–May:	An MFD expert assisted the Fund mission in monitoring and expanding memoranda of understanding for the nationalized commercial banks.
February–Oct:	A peripatetic advisor assisted BB with improving accounting standards in accordance with IAS.
March–April:	STA mission provided recommendations to improve balance of payment statistics, particularly in the areas of foreign direct investment, private sector external debt, and related income items.
April–Oct:	An MFD expert provided periodic assistance in the area of foreign exchange operations.

2005

February–March:	STA mission conducted the data ROSC.
March–Aug:	A peripatetic advisor assisted BB with improving accounting standards in accordance with IAS.
May:	An MFD expert provided periodic assistance in the area of foreign exchange operations.
February–Sept:	An MFD expert provided assistance in the area of bank restructuring.
March–Aug:	A peripatetic MFD advisor provided assistance in improving BB risk-based internal auditing standards.
March–Oct:	An MFD expert provided assistance in the area of bond market development.
November:	An MFD expert provided assistance in the area of bank restructuring.

XI. Resident Representative

The resident representative office was established in 1972. The current Resident Representative, Mr. Jonathan Dunn, took up the post in August 2004.

BANGLADESH: RELATIONS WITH THE WORLD BANK[1]

The World Bank has an expanding assistance program in Bangladesh including investment and policy-based lending, analytical and advisory services, and lending and non-lending technical assistance. The Bank also maintains policy dialogue on a broad range of macroeconomic and sector issues. This Annex, however, focuses on Bank activities that are complementary to those of the Fund.

World Bank-Bangladesh Relations and Policy Dialogue

Since taking office in 2001, the Government has made progress on critical areas such as budgetary management, state-owned enterprises (SOEs), central and commercial banking, energy, telecommunications, public procurement, separation of public accounts and audit, and other areas of economic governance. The Bank has regularly interacted with the Government and provided inputs for the design and sequencing of reforms, as requested by the authorities.

The Poverty Reduction Strategy Paper (PRSP) was completed in October 2005, building on a broad-based participatory process, and the interim PRSP prepared in 2003. A Joint Staff Advisory Note on the PRSP is being prepared by the Bank and the Fund, and will be discussed by the Bank's Board in early January 2006.

As part of its nonlending services, the Bank has completed key reports. These include, inter alia, the *Public Expenditure Review* and the *Poverty Assessment* – prepared jointly with the Asian Development Bank - which provided inputs for the I-PRSP. In addition, an *Investment Climate Assessment* (jointly with the Bangladesh Enterprise Institute) and a report on *Private Provision of Infrastructure* in Bangladesh have been completed. More recently, the Bank completed the *Development Policy Review*, a review of trade policies in South Asia, and the *Bangladesh Development Forum Economic Update*. Other key by Bank reports included the *Observance of Standards and Codes* (ROSC), *Promoting the Rural Non-Farm Sector in Bangladesh*. The World Bank study *Attaining the Millennium Development Goals in Bangladesh: How Likely and What Will it Take?* was launched recently and a dialogue was held with economists, academics and key policy makers.

In response to the Government's and development partners' requests, and in recognition of the increasing trend in contracting NGOs for service delivery, the Bank completed a study of the NGO sector, focusing on the implementation of NGO activities, Government-NGO relations, NGO impact on development outcomes, and their long-term financial sustainability. The study on *Strategy for Growth and Employment*, planned for delivery in FY06, will assess the longer-term growth challenges facing Bangladesh.

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[1]Prepared by World Bank staff.

Restructuring SOEs. The Bank has engaged in an extensive dialogue with the authorities on SOE-related issues. A report entitled *Bangladesh: Review of Public Enterprise Performance and Strategy* was discussed widely. In response to a request from the authorities, the Bank provided technical assistance to the Privatization Commission and assisted it in the preparation of the government's new Privatization Policy, which has since been endorsed by Cabinet. Dialogue relating to SOEs in the energy sector has been particularly intensive and the Bank has provided detailed recommendations to the authorities in areas relating to pricing policy and the regulatory regime for energy and other utilities. As part of a wide reform program of rolling back state ownership and control within the economy, the *Enterprise Growth and Bank Modernization Project*, approved in June 2004, is supporting restructuring of financial and non-financial SOEs.

Restructuring the Financial System. The Bank has been actively engaging the authorities in a dialogue on financial sector reform. Together with the Fund, the Bank co-managed the Financial Sector Assessment Program report that was prepared in October 2002. With IDA financing, the Government is implementing a program to strengthen the Bangladesh Bank. The mentioned *Enterprise Growth and Bank Modernization Project* is supporting restructuring and eventual divestment of the nationalized commercial banks.

Trade Liberalization. In response to requests from the authorities, the Bank has provided regular analytical support to the Government. The Bank-supported *Export Diversification Project* included a component designed to build capacity within the Tariff Commission for tariff analysis and WTO-related negotiations. In addition, the Bank has regularly provided trade-related policy notes as inputs into the annual budget preparation process. A report was also completed last year on trade policy regimes in South Asia and another trade study relating to Bangladesh and India is ongoing. The recently-completed *Bangladesh Growth and Export Competitiveness Study* examined key macro- and microeconomic factors affecting Bangladesh's competitiveness and provided specific recommendations on priority policy and institutional actions. Further, the upcoming Bank study on the *Challenges and Opportunities in a Post-MFA World: Strategic Options for Sustained Export Growth* will analyze the key issues facing the Bangladesh RMG sector as it faces a changing world scenario without quotas.

Infrastructure Development. Infrastructure development is needed in the country for economic growth in general, and private sector development in particular. In this context, the Bank is helping to prepare a power sector strategy, and is supporting a Power Sector Development TA which includes a project preparation facility.

Strengthening Governance. The Bank has engaged the government in an active dialogue aimed at improving the investment climate by strengthening accountability and transparency. The Bank has prepared several analytical reports on the subject, including an Institutional and Governance Review, a Country Financial Accountability Assessment, a Country Procurement Assessment, and user surveys on the quality of service delivery. In addition, the

Bank is providing technical assistance to the government for improving its procurement systems.

The Bank is currently preparing a series of policy notes on selected aspects of public administration and governance, including policy advice to the Ministry of Finance, National Pay Commission and the Ministry of Establishment in relation to civil service reform issues, including compensation policy.

As part of the Bank's regular public expenditure work, a set of policy notes are also being initiated, which will form the basis for the Public Expenditure Review in FY2006. A programmatic approach is being taken to allow better co-operation with other donors. The unifying theme of the notes will be the role of public expenditure on growth and poverty reduction, aiming to provide inputs for the Government to use in their budget preparation process. As part of the *Economic Management Technical Assistance Program* (EMTAP), a TA project for the National Board of Revenue will assist in its capacity building, focusing on organizational restructuring, human resource management, development of ICT capacity, and strengthening customs, VAT and income tax administration, and training and research and statistics.

The World Bank's Country Assistance Strategy

A new Country Assistance Strategy (CAS) is being prepared jointly with ADB, DfID, and JBIC. The new CAS, which will be discussed by the Bank's Board in early March 2006, will help align Bank assistance with the country's PRSP.

The FY01 CAS had identified four main strategic thrusts to help Bangladesh's poverty reduction efforts: (i) build stronger institutions and governance across sectors; (ii) consolidate gains in human development; (iii) implement an integrated approach to rural development; and (iv) accelerate and broaden private sector-led growth. The FY03 CAS Progress Report, which was discussed by the Board in June 2003, confirmed these thrusts while initiating a shift in Bank assistance toward more programmatic policy-based lending to support I-PRSP goals, and re-engagement in sectors critical to the country's development such as power and water management. Accordingly, the Bank approved the first Development Support Credit ($300 million) in FY03, complementing a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) approved by the IMF Board in June 2003. The second DSC (US$200 million) was approved in July 2004, and the third DSC in December 2005.

The World Bank's Assistance Program

The Bank has been assisting Bangladesh since FY1973. As of November 2005, the World Bank Group has approved 201 IDA credits, 4 IDA grants and 1 IBRD loan for Bangladesh totaling US$11.7 billion in original commitments. The active portfolio included 26 projects, representing US$2.6 billion in net commitments and US$1.4 billion in undisbursed funds. During FY2004 and FY2005, new commitments totaled $526.5 million and $600 million and disbursements totaled $230 million and $590 million, respectively. The Bank is currently supporting projects in key sectors, including social and human development, rural development, energy and infrastructure, private sector development, finance, and environment. These operations emphasize policy and institutional reforms in line with the CAS and CASPR objectives.

In FY2004 the Bank approved three IDA credits totaling US$407.1 million and four IDA grants totaling US$119.4 million to support six projects. IDA credits are helping finance the Second Primary Education Development Project (US$150 million), which is part of a Sector Wide Approach (SWAp) supported by a donor consortium led by ADB; and the Enterprise Growth and Bank Modernization Project (US$250 million). The Power Sector Development TA Project is being financed by an IDA credit of US$7.1 million and an IDA grant of US$8.4 million, while the Bangladesh Water Supply Program ($40 million), the Reaching Out of School Children Project ($51 million), and the Economic Management TA Program ($20 million) are being supported with IDA grants.

In FY2005 the Bank approved 3 IDA credits for a total of US$600 million. These credits include two policy-based credits and an investment credit prepared within a sector-wide approach (SWAp) framework. The development policy-based lending includes the second Development Support Credit (US$200 million) and the Programmatic Education Sector Adjustment Credit (US$100 million). DSC II continued to support the main themes of the I-PRSP—attaining macroeconomic stability, improving governance, enhancing human development and ensuring social protection – and recognized the Government's efforts at implementing broad reforms in pursuit of the I-PRSP goals. The investment credit was the Health, Nutrition and Population Sector Program II ($300 million), which contributes to a sector-wide program supported by several development partners.

Projected commitments for FY2006 are about US$500 million.[2] About US$300 million of these commitments would support policy-based lending, including the Third Development Support Credit (US$200 million; approved in December 2006) and the second Programmatic Education Sector Adjustment Credit (US$100 million). Investment credits totaling about US$200 million would support projects promoting private sector participation in infrastructure and local governance improvement.

As of November 2005, IFC's held portfolio stood at $139.7 million in 9 projects. Of this, $108.8 million were under IFC's own account and $30.9 million for B-loan participants. Projects span a range of sectors including power, telecommunications, cement, and financial markets. During FY2004, IFC committed $5 million in a leasing company, ULC, US$40 million to an oil and gas company, Cairn Energy, to support its expenditure needs in Bangladesh and India; a $30 million second investment in GrameenPhone; and as a small

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[2]IDA Credit amounts are indicative.

equity investment of $1.6 million in a local commercial bank, BRAC Bank, focusing on SMEs. No commitments were undertaken in FY2005.

In FY2002, with the support of several donors, IFC started a regional SME technical assistance facility covering Bangladesh, Bhutan, Nepal, and north-east India. IFC has committed $5 million to the facility for the duration of the initiative. In December 2004, SEDF, FIAS and IFC hosted a roundtable on regulatory reform and economic zones in Dhaka. FIAS expects to release an investment incentives review for the Government shortly and is scheduled to begin work on a study on administrative barriers to investment as well as a review of economic zones policy and its implementation.

The Bank Group continues to be involved in providing technical and advisory assistance to the government in a number of areas, including banking, energy, privatization, taxation, tariff and trade policy, poverty monitoring and analysis, and financial management.

World Bank-Fund Collaboration

The Bank and the Fund have been working closely in Bangladesh, particularly in areas related to macroeconomic management, financial sector, reform of state-owned enterprises, tax policy and administration, public expenditure management, and issues relating to financial accountability. Bank staff routinely participate in Article IV missions and provide feedback, as requested, on the macroeconomic framework and other aspects of the Fund's macroeconomic dialogue with the authorities. The Bank co-managed the Financial Sector Assessment Program report and Fund staff were regularly consulted during the preparation of the Public Expenditure Review. The Bank has also collaborated with the Fund in several areas related to the Report on Observance of Standards and Codes (ROSC) and safeguards assessment.

Dialogue between the two institutions has intensified in recent years, especially in the context of the preparation of the country's poverty reduction strategy. In addition, Fund and Bank staffs collaborated closely in preparing the Joint Staff Assessment of the I-PRSP, and in completing the complementary Development Support Credits and PRGF.

BANGLADESH: RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

Lending and technical assistance operations

The Asian Development Bank (AsDB) has assisted Bangladesh since 1973. The cumulative commitment and disbursement to Bangladesh stood at $7.9 billion and $5.43 billion respectively on December 31, 2005. The cumulative outstanding loan as of November 30, 2005 was $4.51 billion. As of end 2004, public sector lending was dominated by four sectors: energy (34%), transport and communications (25%), social infrastructure (20%), and agriculture and natural resources (19%). Lending in the other sectors, including finance, governance, and multisector operations remains relatively small, although these sectors have been given more prominence in recent years. In addition, so far ADB supported 7 private sector projects, valued at $242 million, including the Meghnaghat Power Project, which is the first build-own-operate power project, and the GrameenPhone, which has substantially expanded access to mobile telecommunications in rural areas.

ADB's new Country Strategy and Program (CSP) for Bangladesh for 2006-2010 was approved by the ADB's Board on October 31, 2005. This new results-based CSP is part of a joint strategy prepared with the UK's Department for International Development, Government of Japan, and World Bank. Over its first three years, the CSP proposes loans totaling about $1.8 billion for 15 projects. This will be supported by a technical assistance grant program amounting to about $13.8 million. The CSP is aligned with the vision and priorities of recently approved Bangladesh's national poverty reduction strategy, which aims to achieve the MDGs, including halving the number of poor people in the country by 2015 and delivering substantial improvement in almost all aspects of human development. The four partners' joint strategy is built on: (i) improving the investment climate for private sector-led growth and employment; (ii) advancing the social development agenda to empower the poor so that all benefit from growth; and (iii) addressing key governance issues to enable growth and social development.

The lending level for 2005 amounted to $512.5 million for following projects: Second Urban Primary Health Care ($40.0 million), Agribusiness Development ($42.5 million), Southwest Area Integrated Water Resources Planning and Management ($20.0 million), Emergency Flood Damage Rehabilitation ($180.0 million), and Gas Transmission and Development ($230.0 million). In addition, during 2005, 13 technical assistance grants for project preparatory and advisory services amounting to $7.5 million were provided.

Economic and sector work program

The AsDB publishes its Asian Development Outlook and its update every year in which it assesses macroeconomic performance. Beginning in 2001, the AsDB has also prepared

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[1] Prepared by AsDB staff.

quarterly economic updates. In support of AsDB's Country Strategy and Program exercise, several new thematic assessments and sector studies have been completed. These include: thematic assessments for poverty, growth and poverty reduction, private sector development, governance, environment, and gender, and sector studies for transport, information and communications technology, water resource development, agriculture and rural development, fisheries, regional cooperation, finance, industry and trade sectors, Dhaka-Chittagong economic corridor development and public sector borrowing capacity study. At the request of the Government, a new study has been undertaken on the economic impact assessment of the proposed TATA investment in Bangladesh. A new bi-monthly Economic Indicators Update has been launched. A new publication – Bangladesh: Key Development Challenges has been prepared and will be published by early 2006. Several other economic and sector works completed in the last two years in connection with CSP preparation will be published by 2006.

Dhaka, Bangladesh
January 9, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C., U.S.A.

Dear Mr. de Rato:

1. On behalf of the Government of Bangladesh, I hereby transmit the attached Memorandum of Economic and Financial Policies (MEFP) that reviews recent economic developments and progress in implementing the program supported by the PRGF arrangement, and sets out the objectives and policies that the Government intends to pursue in 2006. These are in line with the priorities set forth in *the National Strategy for Accelerated Poverty Reduction* (NSAPR), which was approved by the National Economic Council and published in October 2005. Implementation of the NSAPR, which sets pro-poor growth, human development, and good governance as the pillars of the country's development agenda, will begin in FY05/06. In this regard, the Government remains committed to maintaining macroeconomic stability, implementing structural reforms, particularly in tax administration, nationalized commercial banks, and the energy sector, and improving governance. By implementing the measures set forth in the attached MEFP, the Government can make progress in meeting these objectives.

2. Owing to delays in the disbursement of external program assistance and in implementing structural reforms, several quantitative and structural performance criteria for the fourth review were not observed. The targets for net international reserves, net domestic assets of the central bank, and net bank credit and total domestic financing of the government were missed (MEFP, Table 2). We have taken corrective actions and the fiscal and monetary programs are being brought back in line with the objectives for FY05/06. Reflecting difficulties in reaching internal consensus and capacity constraints, slight delays were also experienced with respect to establishing an audit unit in the National Board of Revenue (NBR) and to revising the terms of reference for the PWC consultants to allow them to serve as financial advisors for the eventual divestment of Agrani Bank. The measures with respect to NBR have now been implemented, and the revised contract for the Agrani consultants is expected to be finalized by January 19, 2006. We have also revived the process of divesting Rupali Bank, which had been delayed by a court injunction. On this basis, and in view of the policies set out in the attached MEFP, the Government requests waivers for the nonobservance of these quantitative and structural performance criteria, completion of the fourth review, and disbursement of the fifth loan under the PRGF of SDR 67.28 million.

3. The Government believes that the policies set out in the attached MEFP are adequate to achieve the objectives of the program, but it will take any further measures that may

become appropriate for this purpose. The Government of Bangladesh will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

4. The Government of Bangladesh will continue to provide the Fund with such information as the Fund may request in connection with progress in implementing the economic and financial policies, and achieving the objectives of the program.

5. The Government of Bangladesh intends to make this letter and the attached MEFP available to the public, and authorizes their publication on the IMF website, together with the Fund staff report on the fourth review under the PRGF arrangement and the Joint Staff Advisory Note (JSAN) on the NSAPR, once the Executive Board completes the review.

Sincerely yours,

/s/

M. Saifur Rahman
Minister for Finance and Planning
Ministry of Finance and Ministry of Planning

Attachments

BANGLADESH

Memorandum of Economic and Financial Policies for 2006

January 9, 2006

I. INTRODUCTION

1. The government continues to implement the reform strategy adopted in June 2003 to move Bangladesh to a higher growth path and faster poverty reduction. This strategy is being supported by a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) and is further articulated in the National Strategy for Accelerated Poverty Reduction (NSAPR), which was approved by the National Economic Council and published in October, and was discussed with development partners during the PRS Implementation Forum held in Dhaka during November 15-17. This memorandum assesses recent economic performance, updates the medium-term policy framework, and lays out the objectives and policies that the government intends to pursue in the remainder of FY06 (ending June) and the first half of FY07, supplementing our Memorandum of Economic and Financial Policies (MEFP) dated May 26, 2005.

II. RECENT PERFORMANCE

2. Bangladesh's economy continues to expand. Despite the impact of higher oil prices and devastating floods, real GDP grew by 5½ percent in FY05, while industrial production increased by 10 percent. The economy benefited from a continued expansion in the construction, manufacturing, and service sectors. Annual average inflation increased to 6½ percent, as projected, on account of higher prices for food imports. Increases in international oil prices and strong import demand more than offset higher export growth and remittances leading to a deterioration in the current account balance in FY05 to a deficit of about 1 percent of GDP.

3. Macroeconomic management was broadly on course in FY05 and all indicative targets for end-June 2005 were met. The overall budget deficit was contained to 3½ percent of GDP, about ¾ percentage point below the program target. Total expenditure was 0.6 percent of GDP lower than programmed, on account of lower-than-projected recurrent and development spending. Tax revenue collections by the National Board of Revenue (NBR) were also short of both the original budget estimates (by 0.6 percent of GDP) and the revised budget (by 0.1 percent of GDP). While shortfalls in revenue collections reflected delays in the implementation of tax administrative reforms and weaknesses in collection enforcement, NBR revenue still increased by 14.5 percent, a marked improvement over the 10 percent growth rate achieved in FY04.

4. In the aftermath of extensive flooding, monetary conditions were accommodative during the first nine months of FY05. While this policy stance helped support growth in the

face of rising energy prices and uncertainty about the impact from the phase-out of the MFA quotas, it contributed to an increase in inflation, which stood at 6.9 percent (y/y) as of end-June. Moreover, the growth in money and credit aggregates, at 17 percent, was significantly above program targets.

5. Underlying financial performance remained broadly on track in the first quarter of FY06. However, largely owing to delays in the disbursement of $200 million under the World Bank's DSC and $100 million under a World Bank education sector loan, the end-September quantitative performance criteria on NIR, NDA of Bangladesh Bank, and domestic financing and net bank borrowing of the central government were missed. Financing of the government increased further in October and November. This is due to an acceleration in government spending related to advanced implementation of budgetary allocations to address food shortages in the northern regions, but steps have been taken to ensure that annual expenditure and overall financing do not exceed budgetary allocations (see paragraph 18). While NBR revenue performance was slightly below target in the first quarter, total NBR receipts for July to November increased by 14 percent relative to the previous year.

6. Since March 2005, Bangladesh Bank has gradually tightened monetary policy. BB raised the Cash Reserve Requirement (CRR) by half a percentage point in March and again in October (to 5 percent). Furthermore, the Statutory Liquidity Requirement was increased effective October 1 (from 16 to 18 percent). Rates on treasury securities have also risen, with the one-month and three-month treasury bill rates increasing by nearly 3 percentage points since late February, to 7 percent, although this is still below the rate of inflation. BB has also actively used the repo and reverse-repo facilities to enhance daily monetary operations. The tighter monetary stance has led to some reduction in annual private credit growth from 20 percent in February to 16.3 percent in November, but this is still high. Meanwhile, annual broad money growth has remained at 17 percent as of November, while the level of excess banking reserves has generally been maintained at low levels. A rebound in food production and the somewhat tighter monetary stance have helped prevent a further increase in inflation, despite the rising fuel prices, as CPI inflation increased only marginally from 7 to 8 percent (y/y) between March and November.

7. Notwithstanding the strong inflows from exports and worker remittances, pressures on the foreign exchange market began to emerge towards the end of FY05 and BB sold about $500 million to the market from March through early August. After limiting sales to the foreign exchange market for most of August and September, BB sold about $100 million during October and November, but has refrained from further sales since then. The taka/dollar exchange rate has depreciated by about 9 percent during 2005.

8. Some further progress has been made on the fiscal structural reform agenda, although tax administration efforts have yet to translate into substantial revenue gains. In the FY06 budget, we further strengthened the income tax LTU by defining a turnover threshold above which taxpayers will be included in the LTU. Sustained efforts are being made to identify tax evaders through information gathered by the Central Intelligence Cell (CIC), and by

implementing standard and transparent procedures, including notifying delinquent taxpayers and imposing penalties for late payments. Reflecting these efforts, 26,000 new individual taxpayers submitted tax returns under self assessment. As a result, income tax receipts increased by 16 percent in the first four months of the fiscal year compared with the previous year (from Tk 12.4 billion to Tk 14.4 billion). The LTU system was also expanded to cover domestic VAT, and joint audits for income tax and VAT LTUs are now being conducted to improve tax compliance. However, lack of resources has thus far constrained the effective operation of the VAT LTU.

9. With respect to NCB reform, management support teams are now in place in Agrani, Janata, and Sonali banks. The teams have submitted reports to the Working Group on NCB reform on how to improve the banks' operational performance and put their finances on a more solid footing. For Rupali Bank, we finalized the Preliminary Information Memorandum (PIM) and issued the public announcement for the request of expression of interest to the public on May 12. Twenty potential strategic investors expressed interest, but a court injunction, which was finally dismissed in November, temporarily delayed the Government from moving further with the divestment of the bank. The Memoranda of Understanding (MOUs) will be strengthened for all four NCBs and BB will continue to closely monitor the MOUs. While performance under the MOUs has been mixed, they have served to effectively limit any further deterioration in the operations of the banks. There have been delays in meeting some of the conditions such as foreign exchange and risk management guidelines, and cash recoveries from the largest defaulters. Limits on credit extension have been observed except for state-mandated extensions of credit, particularly to the Bangladesh Petroleum Corporation (BPC) for oil financing.

10. Energy sector SOEs continue to create contingent liabilities (amounting to almost one percent of GDP in FY05). The weak performance of the energy sector SOEs is due mainly to the BPC and the Dhaka Electricity Supply Authority (DESA). BPC incurred significant losses in the last two years due to sharp increases in world oil prices. To reduce the losses of energy sector SOEs and improve their financial viability over the medium term, the government has passed through about 60-75 percent of the increase in world oil prices over the last two years. Domestic retail prices for petrol and octane have increased by 27 and 29 percent, and those for kerosene and diesel by 76 and 50 percent, respectively (with the most recent adjustments being 15-18 percent in September). Although these adjustments still fall short of what is implied by the official pricing formula, they have helped to contain quasi-fiscal losses in an environment of rising global energy prices.

III. Macroeconomic Framework and Policies

11. We remain committed to the reform strategy of private sector-led growth and poverty reduction, as outlined in the NSAPR. Consultations were held at the regional and national levels and with the donor community. Attention was placed on: (i) prioritizing near-term policies in key sectors and programs and aligning them with the NSAPR; (ii) incorporating the costing of the proposed sectoral projects into the medium-term budgetary framework; and (iii) improving the monitoring and evaluation mechanism of social development.

12. We have updated the medium-term macroeconomic framework to incorporate the impact of external shocks. Bangladesh's economy remains resilient and could achieve a growth rate of 6 percent in FY06, which is expected to accelerate further to 6½-7 percent in FY07-09 if structural reforms create a more robust business climate. Despite rising prices for food and energy and a possible exchange rate adjustment in response to the oil price shock, the rate of inflation as of June 2006 (y/y) is projected to decrease to about 7 percent. The external current account deficit is projected to deteriorate to 1.9 percent of GDP, despite stronger than anticipated growth in exports and remittances, reflecting a further increase in the oil import bill.

13. Uncertainty remains about the magnitude of the impact from the phase-out of MFA quotas. Thus far, the impact has been more benign than anticipated, and exports of ready-made garments (RMG) and RMG-related imports have both risen at a faster pace than originally envisioned under the program. Moreover, there are indications of continued investment in the sector, especially in knitwear. Nevertheless, over the medium term, RMG export prospects will depend on measures to improve competitiveness. Funding and operational constraints for upgrading infrastructure, particularly for improvements in port operations, remain a major problem and governance problems will also need to be addressed.

A. Fiscal Policy

14. Our fiscal strategy is to protect fiscal sustainability while ensuring adequate support for human capital, physical infrastructure, and anti-poverty programs. To this end, we are making efforts to expand the tax base and improve revenue administration. We remain fully committed to pursuing a revenue effort of about ½ percent of GDP in FY06 and FY07. The overall deficit for FY06 was budgeted to increase to 4½ percent of GDP to allow for increased public spending on human capital and infrastructure. Taking into account less than full implementation of ADP spending, the deficit is now projected to be 4 percent of GDP. Domestic financing will continue to be capped at 2 percent of GDP and external support will remain primarily on concessional terms. With prudent debt management, and steps to eliminate the creation of contingent liabilities in the SOE sector, the ratios of external debt to GDP and the net present value of debt to exports should remain within comfortable zones over the medium term.

15. To improve revenue administration, efforts will continue to enhance the near-term effectiveness of the LTU system. The existing system of multiple taxpayer identification numbers will eventually be replaced with a single number. As a first step, unique tax identification numbers will be established in the LTU system (comprising both income tax and VAT) by end-April 2006. Regarding the VAT LTU, the Ministry of Establishments approved the organogram on December 21, 2005 (prior action for completing the 4th PRGF review), and we will ensure that permanent staffing and adequate resources are put in place.

16. A number of other initiatives will also be pursued in the period ahead related to revenue administration. We will continue to focus on the modernization of the NBR along functional lines. With assistance from the World Bank, a strategic reform plan is being

developed that will be supported by time-bound actions to be implemented over the next three years. The plan includes the introduction of a rigorous self-assessment system, a risk-based auditing system supported by third-party information, and the use of modern technology, particularly an integrated computer system for handling assessment, audit case selection, and collection. An improved board structure will be critical to enhancing NBR management. A circular was issued on January 4, 2006 to establish an audit unit that will operate independent from the tax and customs departments and report directly to the NBR Chairman. All auditors within NBR will be under the supervision of the head of this unit and/or the NBR chairman, and all audit activities will be under the purview of this unit. The head of this audit unit has also been selected (an audit advisor with the rank and status of a member reporting directly to the Chairman) (prior action for the 4th review given the November 30 deadline that was set as a structural performance criterion). The government will ensure that adequate funding is available for the audit unit. The audit advisor will prepare a six-month audit program of implementation that is expected to be approved by the NBR Chairman by end-February 2006. In addition, other key personnel will be appointed to facilitate work on tax administration reform, including a tax expert to advise on key aspects of the NBR modernization project, supported by an HR advisor, and an IT manager. For customs administration, an external audit of pre-shipment inspection (PSI) companies will be initiated by end-April 2006.

17. With respect to revenue policy, we intend to undertake a thorough review of tax exemptions and incentives and their associated revenue losses by end-April 2006, with a view to broadening the tax base (structural performance criterion for the fifth review). To supplement near term revenue performance until improved administration produces more significant results, prices of natural gas will be adjusted this fiscal year to provide for increased royalty/dividend payments to the budget. We plan to request a TA mission from the Fund's Fiscal Affairs Department in early 2006 to review our fiscal reform efforts and discuss modalities for possible further TA support.

18. On the expenditure side, we will ensure that pro-growth and pro-poor spending is given priority, and that public sector wages are contained. In light of delays in the disbursements of external program loans this fiscal year, low-priority spending has been reduced and a concerted effort has been taken to root out wasteful expenditures. Interest payments are now projected to exceed the budget estimate by about Tk 3 billion and other current expenditure will be reduced to ensure that total current expenditure does not exceed Tk 361 billion. Expenditure related to poverty reduction has increased from 6.1 percent of GDP in FY04 to 6.7 percent of GDP in FY05 and will increase further to 8.4 percent of GDP in FY06. We have stepped up our efforts to strengthen expenditure management by improving project selection and execution under the ADP. Expenditure tracking systems have been put in place in three key ministries along with new procedures for project implementation. We also plan to roll out the medium-term budget framework to six more line ministries in the FY07 budget bringing the total to 10 ministries. In consultation with relevant development partners, the government has initiated an expenditure review to improve public expenditure management and enhance fiscal transparency and accountability. This review is expected to be completed in FY07. Meanwhile, we have streamlined the

project approval process; implemented new procurement regulations; delegated more financial authority to the line ministries; and required line ministries to strengthen their own project monitoring capacity.

19. We are cognizant of the need to limit expenditures on wages and salaries of public servants while providing a compensation structure that is competitive with what is offered by the private sector. The overall increase in the government wage and pensions bill arising from the 2005 Pay Commission recommendations will be limited to TK 40 billion, and is being phased in over three years with the increase in FY06 limited to Tk 16 billion. The government will maintain its selective hiring freeze to reduce employment through attrition while eliminating unnecessary and redundant posts. To ensure medium-term fiscal sustainability, we are working with the World Bank on a plan for civil service reform in the context of the EMTAP that will include improving recruitment, performance evaluation and merit-based promotion, training and career planning, and development of a senior civil service.

20. Reform of the energy sector SOEs is key to improving their financial performance and reducing infrastructure bottlenecks to growth. We are monitoring oil market developments closely, in coordination with the World Bank in the context of the DSC. In view of the substantial surge in energy prices since the beginning of FY05, we recognize that further price adjustments are needed, especially for kerosene, diesel, and gas. However, in light of the price increases already taken, and continuing inflationary pressures, further adjustments will need to be made gradually while taking into account social considerations. Increases in domestic prices already implemented have reduced the monthly operating losses of BPC from levels experienced in FY05. In addition, we intend to make further price adjustments this fiscal year to further reduce and eventually eliminate these losses. To strengthen DESA, we intend to take measures to improve bill collections, curb system losses, and reduce illegal connections, while reducing DESA's arrears using a combination of loan restructuring and collections. We will also prepare a report quantifying quasi-fiscal costs arising from prices below international levels in the energy and power sector, including the implicit subsidies and revenue foregone by underpricing of natural gas, and identifying measures to mitigate the impact of price adjustments on vulnerable groups (structural performance criterion for the 5th review).

B. Monetary and External Sector Policies

21. A tightening of the monetary policy stance will be needed in the near-term to ensure stability in the money and foreign exchange markets and contain inflation. The growth rates of broad money and private credit are still above program targets and will need to be further reigned in. BB will continue to actively employ indirect monetary instruments for conducting monetary policy. Interest rates on treasury securities have already increased further in November and December and will continue to be raised as needed to meet monetary objectives. The decision to increase the cash reserve requirement has necessitated an increase in the reserve money path. However, while the revised monetary program will incorporate a higher growth rate of reserve money (16 percent compared to 10 percent in the previous

MEFP), the rate of growth of currency in circulation and the level of excess reserves will be maintained as originally envisioned.

22. With MFD technical assistance, further steps are being taken to improve the functioning of the interbank and treasury bill markets, including strengthening the primary dealer system, deepening the secondary market for treasury securities, and developing liquidity forecasting. BB intends to introduce volume-based auctions for bond issues in January and will eventually extend this to all government securities, and is also taking steps to strengthen the primary dealer system by working closely with dealers to define the rules and obligations that will govern their conduct. Instructions have been issued to all banks for making mark-to-market based revaluations of their government securities holdings. In addition, BB and the Securities and Exchange Commission (SEC) have agreed to allow government bonds to be traded in the stock exchange. BB, SEC and NBR have also developed an enabling regulatory framework for the issuance of corporate bonds and the securitization of receivables.

23. We are committed to the floating exchange rate regime, and will confine interventions to countering disorderly conditions and building reserves to a more comfortable level. We have taken steps to ensure that no bank is given preferential treatment in the foreign exchange market. The taka/dollar rates offered by the NCBs and private dealers have now converged. Interventions in the foreign exchange market by BB are now being conducted in a transparent manner by selling foreign exchange to the highest bidder, rather than conducting intervention solely through the NCBs. The government will rely on market-based mechanisms when the system comes under stress. In this regard, changes in a market-based exchange rate would be an expected part of adjusting to the adverse external environment without jeopardizing the program's NIR targets or prospects for export-led growth. In view of the considerable pressures in the foreign exchange market associated with oil financing needs, we expect the need for some further intervention at times, but this will be designed to smooth adjustment in the rate, not prevent it.

24. In line with our previous commitments, we intend to remove the only remaining restriction under Fund jurisdiction pertaining to the convertibility and transferability of funds from nonresident taka account by end-June 2006 if the balance of payments position is favorable. Attention will be paid to having regulatory safeguards in place to prevent illegal transactions and limit the scope for capital outflows.

25. BB has taken steps to improve regulatory oversight of the banking system. In addition to the core risk management guidelines that were introduced last year, guidelines have been developed covering information technology processes, consumer and small business lending, and Islamic banking. Provisioning standards have also been tightened through the creation of special mention accounts for loans that have become non-performing after 90 days. Five percent of the gross amount of the loan is now required as a general provision and interest on these loans can no longer be booked as profit. Additionally, a National Steering Committee led by BB has been formed to move forward with the implementation of Basel II banking standards. BB has also strengthened its capacity to supervise and regulate banks effectively

by performing comprehensive systems audits and taking action against banks that are in violation of regulatory and prudential norms. The NCBs continue to breach their net open position exposure limits while settling large oil import bills of the state-owned BPC. In response, BB has instructed the banks to strengthen their internal forecasting systems to better anticipate net shifts in demand for foreign exchange. In cases where outflows are not sufficient to match inflows, BB has instructed the NCBs to bid more aggressively for foreign exchange in the interbank market.

26. In the face of the phase-out of MFA quotas, we are adopting further measures to reduce anti-export bias and improve the investment climate. We will reduce further the number of regulatory stages involved in the clearance of imports and exports. At the same time, we are seeking duty-free access for RMG exports to the U.S. market. With respect to overall trade policy, we have eliminated all quantitative restrictions except those on grounds of health, national security, religion, and environmental protection. However, overall rates of protection remain high and the government plans to further reduce average tariffs (including any surcharges) by at least two percentage points in the context of the FY07 budget.

C. Reforming the Nationalized Commercial Banks

27. Given the unfortunate delays already experienced, the government has intensified efforts to ensure the successful divestment of Rupali Bank. All outstanding legal challenges to Rupali's divestment have been resolved and we have extended and signed GBRW's contract to ensure that they continue to provide their expertise throughout the divestment process. We have also obtained all the necessary waivers or approvals form relevant regulatory authorities to proceed with Rupali's divestment. Renewed expressions of interest have been sought and the preliminary information memorandum will be updated by end-January 2006. We expect that tender documents will be sent to short-listed firms by March 2006 and that a preferred bidder will be announced, in line with tender procedures and selection processes for technical and financial evaluations, by end-June 2006 (structural benchmark for the fifth review). The government has already worked out the details for recapitalizing Rupali. In addition, at the point of transaction, the government will remove from Rupali's books and assume full responsibility for the liabilities of existing pensioners and for the accrued rights of current employees, with cash payments made from the government's budget as these payments become due. The eventual majority shareholder will have management control over all aspects of the bank's operations, including on HR policies and pay scales.

28. With respect to the other three NCBs, we are committed to bringing Agrani to the point of divestment in the near term. To this end, we will redraft PWC's contract to give the existing consultants the authority to act as financial advisors for the eventual sale of the bank in line with the program's structural performance criterion (prior action for the 4th review given the December 15 deadline that was set as a structural performance criterion) and we initiated corporatization of the bank in December. We will also ensure that at least two members of the boards of directors for Sonali, Agrani, and Janata, with sufficient financial

and banking experience, as well as meeting BB's fit and proper criteria, have been put in place.

29. We recognize that NCB restructuring and divestment will be facilitated by granting bank managements and their support teams greater autonomy over day to day operations and strategic reforms, and by strengthening the role of the NCB Working Group. BB will regularly monitor the implementation of the reforms measures in the NCBs and will be consulted in an advisory capacity in the matters of privatization of banks. In the context of the Enterprise Growth and Bank Modernization Project (EGBM), we are creating a matrix of near-term actions, in consultation with the World Bank. This action plan supports our commitment to operationalize the NCB reform agenda as previously outlined in the MEFP for the Third Review, and an updated action plan is attached. Key actions focus on: (i) revising the terms of reference for the consulting teams to give them authority to implement recommendations in collaboration with the management of the banks; (ii) reconstituting the boards of directors of Agrani and Janata; (iii) reviewing the practices of management and the boards of directors, and advising as necessary, to ensure that they are cognizant of their authority to take decisions on operational policies without prior consent from the Ministry of Finance (as defined in the Bangladesh Banks (Nationalization) Order); (iv) holding NCB boards and management accountable against annual performance targets; and (v) corporatizing Janata and Sonali (in addition to Agrani).

D. Program Monitoring and Governance

30. Progress has been made in addressing the recommendations under the safeguards assessment. An audit of BB's financial statements for FY05, conducted by two local affiliates of international accounting firms, has been completed and the audited financial statements and the audit opinion have been published. The audit was unqualified, disclosures in the financial statements are being continuously expanded, and the accounting and internal audit departments are being strengthened, supported by technical assistance from the IMF and World Bank.

31. To improve the investment climate, concerted actions have been taken to develop an anti-corruption strategy and improve the law and order situation. A skeleton organizational chart (organogram) of the Anti-Corruption Commission (ACC), established in November 2004, has been approved to enable the ACC to recruit essential staff and start its work. The full organogram is being developed with the assistance of the AsDB. Additional technical assistance in support of the government's overall anti-corruption strategy is being provided by the World Bank and USAID. The government has also drafted a new Money Laundering and Terrorist Financing Prevention Act (2005).

32. With regard to program monitoring, quantitative performance criteria for end-March 2006 and indicative targets for June-December 2006 are being proposed. The fifth review will assess compliance with the end-March 2006 quantitative performance criteria and specified structural conditionality. Key structural benchmarks and structural performance criteria for the fifth review will continue to focus on fiscal, NCB, and energy sector reforms.

To stress our commitment to meeting revenue targets under the PRGF-supported program, we propose to convert the quarterly indicative revenue targets for NBR revenue to a performance criterion starting from March 2006. Technical assistance coordinated closely with the World Bank and DFID will remain essential to building capacity, especially in tax administration and NCB reform.

33. The composition of domestic financing from sales of National Savings Certificates is shifting towards the treasury market. In the near term, the bulk of domestic financing will be through treasury bill sales to commercial banks while we bolster the ability of nonbank institutions and investors to purchase treasury securities. In view of this, we have requested modification of the performance criterion on central government financing. Since government financing is through marketable securities and recourse to central bank credit is controlled by the ceiling on NDA of Bangladesh Bank, we view the PC on total domestic financing as sufficient for maintaining a credible commitment to reducing inflation and therefore request that the separate sub-ceiling on bank financing be dropped.

Attachments

MEFP Table 1.	Key Economic Indicators
MEFP Table 2.	Indicative Targets and Quantitative Performance Criteria Under the PRGF Arrangement
MEFP Table 3.	Structural Performance Criteria and Benchmarks Under the PRGF Arrangement
MEFP Annex	Near-term Reform Action Plan for NCBs

MEFP Table 1. Bangladesh: Key Economic Indicators, FY2003–09 1/

			Prog.	Act.	Rev. Prog.	Projections		
	2002/03	2003/04	2004/05		2005/06	2006/07	2007/08	2008/09
National income and prices (percent change)								
Real GDP	5.3	6.3	5.2	5.4	6.0	6.0	6.5	6.5
GDP deflator	4.5	4.2	6.0	5.0	6.0	6.0	5.0	4.5
CPI inflation (annual average) 2/	4.4	5.8	6.5	6.5	7.5	6.0	5.0	4.5
Central government operations (percent of GDP)								
Total revenue	10.3	10.2	10.5	10.6	11.0	11.5	11.7	11.9
Tax	8.3	8.2	8.6	8.5	9.0	9.5	9.7	9.9
Nontax	2.0	1.9	1.9	2.0	2.0	2.0	2.0	2.0
Total expenditure	13.7	13.1	14.7	14.1	15.1	15.4	15.5	15.6
Current expenditure	8.1	7.8	8.6	8.5	8.7	8.7	8.6	8.6
Of which : Interest payments	1.9	1.6	1.7	1.7	1.8	1.7	1.7	1.7
Annual Development Program	5.4	5.0	5.3	5.0	5.4	5.7	6.0	6.0
Other expenditures 3/	0.2	0.3	0.8	0.6	1.0	1.0	0.9	1.0
Overall balance (excluding grants)	-3.4	-2.9	-4.2	-3.5	-4.0	-3.9	-3.8	-3.7
Primary balance	-1.5	-1.3	-2.4	-1.9	-2.3	-2.2	-2.2	-2.1
Financing (net)	3.4	2.9	4.2	3.5	4.0	3.9	3.8	3.7
Domestic	1.2	1.8	2.0	1.7	2.0	1.9	1.8	1.7
External	2.1	1.1	2.2	1.8	2.0	2.0	2.0	2.0
Total central government debt (percent of GDP)	51.1	48.7	47.9	48.4	48.5	47.4	46.1	44.9
Money and credit (end of year; percent change)								
Net domestic assets	12.2	13.4	14.8	17.1	15.0	13.5	13.5	13.1
Credit to private sector	12.6	12.0	14.7	17.0	13.9	13.1	12.8	12.8
Broad money (M2)	15.6	13.8	14.2	16.7	14.3	13.4	13.0	13.0
Balance of payments (in billions of U.S. dollars) 4/								
Exports, f.o.b.	6.5	7.5	7.8	8.6	9.6	10.5	11.5	12.6
(Annual percent change)	9.5	15.8	4.1	14.0	11.7	9.8	9.4	9.3
Imports, f.o.b.	8.7	9.8	11.6	11.9	13.7	14.9	16.1	17.5
(Annual percent change)	13.1	13.0	18.0	20.6	15.0	9.1	8.3	8.2
Current account	0.1	0.2	-1.1	-0.5	-1.2	-1.2	-1.3	-1.3
(Percent of GDP)	0.1	0.3	-1.8	-0.9	-1.9	-1.8	-1.7	-1.6
Gross official reserves (in billions of U.S. dollars)	2.5	2.7	2.9	3.0	3.3	3.5	3.8	4.1
In months of imports of goods and nonfactor services	2.9	2.8	2.4	2.6	2.5	2.5	2.5	2.5
Memorandum item:								
Nominal GDP (in billions of taka)	3,006	3,330	3,731	3,685	4,142	4,653	5,202	5,790

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1.
2/ CPI has recently been rebased using FY96 weights.
3/ Consists of other capital, net lending, and food accounts (including check float and discrepancy).
4/ Balance of payments is presented on the basis of BPM5.

MEFP Table 2. Bangladesh: Indicative Targets and Quantitative Performance Criteria Under the PRGF Arrangement, June 2005-Dec 2006 1/

(Cumulative flows, end of period) 2/

	Jun-05		Sept-05		Dec-05		Mar-06	Jun-06	Sept-06	Dec-06
	Indicative Targets		Performance Criteria		Indicative Targets		Indicative Target/PC		Indicative Targets	
	Target	Prel.	Target	Prel.	Prog.	Prel.	PC	Target		
					(In billions of taka)					
Ceiling on net domestic assets of Bangladesh Bank 3/	29	28	2	19	11	42	46	44	0	12
Ceiling on net domestic financing of central government 3/	76	64	8	13	28	...	55	83	16	40
Ceiling on net central government bank borrowing 3/	36	35	-4	8	4	22	...	...	...	...
Taxes collected by National Bureau of Revenue 4/ 5/	...	...	73	70	154	...	244	356	87	184
					(In millions of U.S. dollars)					
Floor on cumulative increase of net international reserves of Bangladesh Bank 3/ 6/	-25	128	-30	-199	-65	-86	-181	0	120	145
Contracting or guaranteeing of short-term external debt by the central government 7/	0	0	0	0	0	0	0	0	0	0
Contracting or guaranteeing of nonconcessional medium- and long-term debt by the central government 3/	250	8	100	0	150	0	200	250	100	150
Of which: External debt with an initial maturity of over one year and up to five years 7/	0	0	0	0	0	0	0	0	0	0
Accumulation of external payments arrears 7/	0	0	0	0	0	0	0	0	0	0
Memorandum item:										
Projected World Bank loan disbursements (in millions of US dollars, cumulative flow)										
DSC	...	...	200	0	200	200	200	200	100	100
Education sector loan	...	...	100	0	100	0	0	100	...	...

1/ The aggregates are defined in the Technical Memorandum of Understanding dated January 9, 2006.
2/ Cumulative flow since start of financial year beginning July 1.
3/ Performance criteria assessed on a periodic basis under the program period.
4/ Indicative targets assessed on a quarterly basis under the program period for September 2005 and December 2005.
5/ To be assessed as a performance criterion from March 2006.
6/ Adjusted downward by $100 million for September 2005, December 2005, and March 2006, reflecting delay in disbursement of World Bank education sector loan as per addendum to TMU (IMF Country Report No. 05/241).
7/ Performance criteria assessed on a continuous basis under the program period.

MEFP Table 3. Bangladesh: Structural Performance Criteria and Benchmarks Under the PRGF Arrangement

	Measures	Timing	Status
	I. Performance Criteria and Benchmarks for the Fourth Review		
1.	Establishment in the NBR of an independent audit unit headed by an advisor of the rank and status of a member reporting directly to the Chairman 1/	November 30, 2005	Independent audit unit was established and the advisor selected on January 8, 2006.
2.	Reconstitution of Sonali Bank's Board of Directors to meet BB’s fit and proper test for board membership, and ensuring that at least two board members have relevant banking experience.	December 15, 2005	Observed.
3.	Signature of final contract for appointment of financial advisor for Agrani Bank. 1/	December 15, 2005	Revisions to the terms of reference of the consultants to include the role of financial advisor were completed on January 19, 2006.
	II. Performance Criteria and Benchmarks for the Fifth Review		
1.	Further improving LTU operations by introducing risk-based tax payer audit procedures, developing computerized support for LTU operations, and introducing a uniform taxpayer identification number.	April 30, 2006	
2.	Finalize a comprehensive report reviewing all tax exemptions and incentives and evaluating the associated revenue losses. 1/	April 30, 2006	
3.	Finalize a report quantifying all quasi-fiscal costs arising from prices below international levels in the energy and power sector, including the implicit subsidies and revenue foregone by underpricing of natural gas, and identifying measures to mitigate the impact of price adjustments on vulnerable groups. 1/	April 30, 2006	
4.	Announcement of preferred bidder for Rupali Bank in line with the agreed tender procedures and selection process for technical and financial evaluations.	June 30, 2006	

1/ Indicates structural performance criteria.

NEAR-TERM REFORM ACTION PLAN FOR NATIONALIZED COMMERCIAL BANKS

1. This Annex updates Annex I in the Memorandum of Economic and Financial Policies dated May 26, 2005 and highlights steps that will be taken during 2006. The government remains committed to the restructuring and eventual divestment of the NCBs and will take all necessary steps to ensure the timely implementation of the NCB reform program.

2. An International Bank Restructuring Expert has been appointed to assist the Working Group in monitoring the performance of the management teams in each of the three NCBs and to help operationalize the NCB reform strategies. To facilitate the effectiveness of the Bank Restructuring Expert, the government has strengthened the role of the Working Group and given bank managements and their support teams greater autonomy over day-to-day operations and strategic reforms. Bangladesh Bank will monitor the implementation of the restructuring measures by the NCBs on a regular basis and will report the implementation status of the restructuring measures taken by the banks to the Ministry of Finance every two weeks.

3. The government will grant NCB managements and boards full autonomy in decisions pertaining to the operational restructuring of the banks. In turn, bank managements and boards will be held accountable and their performance will be measured against quantitative and qualitative performance targets being designed in consultation with the World Bank.

4. As was done in finalizing the Preliminary Information Memorandum (PIM) and Expression of Interest (EOI) of Rupali Bank, Bangladesh Bank will be regularly consulted, in an advisory capacity, in all phases of privatization of the banks as well as be part of the committee evaluating the fitness and propriety of the prospective investors.

I. BANK-BY-BANK ACTION PLANS

A. Rupali Bank

5. The objective is to revive the privatization of Rupali Bank, which had been delayed by a court injunction. To this end, the following steps will be taken by end-February 2006:

- Removal of all the legal obstacles relating to the bank's privatization.
- Receipt of the necessary waivers or approvals from the Ministry of Finance, Bangladesh Bank, Securities and Exchange Commission, and local stock exchanges.
- Re-publication of the request for Expression of Interest (EOI) to the public.

- Updating of financial data in preliminary information memorandum (PIM) through December 31, 2005.

- Contracting an accounting firm to perform a closing audit based on international accounting standards for the period ending December 2005 as per the special audits conducted by HVC.

- Reconfirming in the PIM the government's commitment that successful strategic investors will be given full management control, including over HR policy.

- Reconfirming in the PIM the government's commitment to recapitalize Rupali Bank to zero capital level through the issuance of government bonds to offset the capital shortfall in the bank's statutory accounts and a loan from Rupali to the government to cover all other non-performing assets. The accrued pension obligations of Rupali will also be removed from the bank's balance sheet, and will become the responsibility of the government.

- Reconfirming in the PIM that under no circumstances will capital forbearance be granted to the newly privatized bank. As such, all shareholders will be expected to inject new equity to bring Rupali's capital up to CAR, which may require the issuance of new shares to cover the obligations of existing minority shareholders in the bank.

- Extending the existing MOU beyond December 2005, and strengthening the MOU in consultation with the World Bank. Performance under the MOU will continue to be monitored closely by Bangladesh Bank and the MOU will be maintained until Rupali's eventual divestment.

B. Agrani Bank

6. The objective is to bring Agrani Bank to the point of divestment in the near term. To prepare for this objective, the following steps are being taken:

- MOF has instructed Bangladesh Bank to corporatize the bank, and this process is underway.

- Revising the terms of reference of the consulting team (PWC) to provide them with authority to implement operational restructuring, in collaboration with the management of the bank, and contract with PWC to serve as the financial advisor during Agrani's divestment.

- Ensuring that at least two members of the boards of directors have sufficient financial and banking experience as well as meeting BB's fit and proper criteria.

- Reviewing the practices of management and the boards of directors, and advising as necessary, to ensure that they are cognizant of their authority to take decisions on operational policies and matters referred by the Working Group (including on branch closure, staff retrenchment, VRS, and pay scales) without prior consent from the Ministry of Finance (as defined in the Bangladesh Banks (Nationalization) Order).

- Extending the existing MOU beyond December 2005 . The MOU will also be strengthened in consultation with the World Bank. The MOU will continue to be monitored closely by Bangladesh Bank and will be maintained until Agrani's eventual divestment.

C. Janata Bank

7. The objective is to restructure Janata Bank and bring it to the point of divestment. To prepare for this objective, the following intermediate steps are being taken:

- MOF has instructed Bangladesh Bank to corporatize the bank, and this process is underway.

- Revising the terms of reference of the consulting team (IDI Ltd.) to provide them with the necessary authority to implement operational restructuring, in consultation with the World Bank.

- Ensuring that at least two members of the boards of directors have sufficient financial and banking experience as well as meeting BB's fit and proper criteria.

- Reviewing the practices of management and the boards of directors, and advising as necessary, to ensure that they are cognizant of their authority to take decisions on operational policies and matters referred by the Working Group (including on branch closure, staff retrenchment, VRS, and pay scales) without prior consent from the Ministry of Finance (as defined in the Bangladesh Banks (Nationalization) Order).

- Extending the existing MOU beyond December 2005 . The MOU will also be strengthened in consultation with the World Bank. The MOU will continue to be monitored closely by Bangladesh Bank and will be maintained until Agrani's eventual divestment.

D. Sonali Bank

8. The objective is to contain Sonali's future losses by restricting the bank's lending activities and restructuring its operations to the point where a minority shareholding can be divested. To prepare for this objective, the following intermediate steps are being taken:

- Ensuring that at least two members of the boards of directors have sufficient financial and banking experience as well as meeting BB's fit and proper criteria (to be completed by December 15, 2005 as a structural benchmark for the 4th review).

- Revising the terms of reference of the consulting team (IBTC) to provide them with the necessary authority to implement operational restructuring, in consultation with the World Bank.

- Reviewing the practices of management and the boards of directors, and advising as necessary, to ensure that they are cognizant of their authority to take decisions on operational policies and matters referred by the Working Group (including on branch closure, staff retrenchment, VRS, and pay scales) without prior consent from the Ministry of Finance (as defined in the Bangladesh Banks (Nationalization) Order).

- Extending the existing MOU beyond December 2005 . The MOU will also be strengthened in consultation with the World Bank. The MOU will continue to be monitored closely by Bangladesh Bank and will be maintained until Sonali's eventual divestment.

- Corporatizing the bank (this action to be completed by end-2006).

BANGLADESH—TECHNICAL MEMORANDUM OF UNDERSTANDING
January 9, 2006

This memorandum sets out (i) the definitions for the proposed quantitative performance criteria and benchmarks under the period January-December 2006; and (ii) related reporting requirements. The data are to be based mainly on balance sheets of BB and the banking system as compiled by BB Research Department for management.

Item 1: *Net domestic assets of Bangladesh Bank* (BB) are defined as reserve money minus net international reserves (NIR) of BB valued in taka using the program exchange rates specified in Table 1 below.

Reserve money consists of currency issued by BB (excluding its own holdings) plus government currency held outside the BB plus balances of deposit money banks (DMBs) with BB (excluding foreign exchange clearing accounts) plus balances of other financial institutions with BB.)

NIR is defined in item 4 below.

Item 2: *Net domestic financing of central government* is defined as the sum of the flow of net bank credit to central government and nonbank claims on central government during the specified period.

Net bank credit to central government is defined as the sum of: (i) BB holdings of government securities and treasury bills; (ii) BB Ways and Means advances to the government; (iii) BB credit to autonomous and semi-autonomous bodies; (iv) government currency liabilities; (v) DMBs holdings of government securities and treasury bills; (vi) DMBs credit to Food Ministry; (vii) DMBs credit to other ministries, autonomous and semi-autonomous bodies; (viii) any other loans, advances and bills discounted extended to central government by the banking system, minus all bank deposits, including lending and onlending accounts, of central government.

Nonbank claims on central government is defined as the sum of: (i) all national savings certificates and related instruments held by nonbank residents, as reported by the National Savings Directorate; (ii) all outstanding U.S. Dollar Premium and Investment Bonds; (iii) all treasury bills and bonds held by nonbank residents, as reported by BB; and (iv) all loans and advances extended by nonbank residents to central government, if any.

Item 3: *Net bank borrowing of central government* is defined as the change in bank credit to central government as defined above during the specified period. As of January 2006, this item will be dropped as a performance criterion under the PRGF program.

Item 4: *Net international reserves of BB* are defined as gross foreign assets of BB (less BB's blocked account with the Central Bank of Iraq) minus international reserve liabilities of BB.

Gross foreign assets of BB consist of its holdings of monetary gold, exchange balances held outside Bangladesh, foreign securities (valued in market prices), foreign bills purchased and discounted, net Fund position and SDR holdings, and the net forward position, if any, of BB. Excluded from gross foreign assets will be: (i) illiquid foreign assets including real property; and (ii) any other foreign assets over which the Bangladesh Bank does not have effective control or which it cannot readily sell, including blocked accounts, pledged, collateralized or other encumbered assets. Also excluded are participation in international financial institutions, holdings of nonconvertible currencies, holdings of precious metals other than monetary gold, and claims in foreign exchange arising from derivative transactions (such as futures, forwards, swaps and options).

International reserve liabilities of BB consist of all foreign currency denominated liabilities of the BB to residents and nonresidents with outstanding maturity up to and including one year, including: (i) Asian Clearing Union debit balances; (ii) all obligations in respect of swap and outright forward transactions; and (iii) any overdue obligations of the central government with respect to foreign debt service. Liabilities also include those arising from balance of payments support borrowing by the Bangladesh Bank, irrespective of maturity, including all liabilities to the Fund.

Item 5: *Contracting or guaranteeing of short-term external debt* is defined for debt with original maturity of up to one year owed or guaranteed by central government. The term debt is defined as set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000),[1] but excludes normal

[1]The definition is as follows: "9. (a) For the purpose of this guideline, the term debt will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.

(continued)

import-related credits, forward contracts, swaps, other future market contracts, and short-term liabilities of the banking system. The definition also includes debt instruments with put options that would be triggered within one year after the contracting date.

Item 6: *Contracting or guaranteeing of medium- and long-term nonconcessional external debt* is defined as contracting or guaranteeing nonconcessional external debt by central government with an original maturity of more than one year. *Nonconcessional debt* is defined as borrowing containing a grant element of less than 35 percent. This definition includes not only debt as defined in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274-(00/85), August 24, 2000), but also commitments contracted or guaranteed for which value has not been received. Excluded from this definition are credits extended by the Fund and Asian Development Bank, and U.S. Dollar Premium and Investment Bonds purchased by nonresidents. Debt falling within the limit shall be valued in U.S. dollars at the bilateral exchange rates prevailing at the time of the contract is entered into, or guarantee issued.

The *grant element* is to be calculated by using the currency-specific discount rates reported by the OECD as Commercial Interest Reference Rates (CIRR) as of the date of contracting or guaranteeing the debt; for maturities of less than 15 years, the grant element will be calculated based on six-month averages of the CIRR, and for maturities of 15 years or longer, the grant element will be calculated based on 10-year CIRR averages. Maturity will be determined based on the original contract.

Item 7: *External payments arrears* are the stock of overdue payments (interest and principal payments) on short-term debt in convertible currencies with an original maturity of up to and including one year (spot, money market, letters of credit, and others) and medium- and long-term debt contracted or guaranteed by the government (including BB). The limit excludes overdue payments that relate to debts which are subject to rescheduling, or that are in dispute and under discussion with creditors.

* * *

1. For the quarters ending in September 2005, and March and June 2006, any foreign asset, liability or cash flow denominated in a currency other than U.S. dollars shall be converted into U.S. dollars by applying the appropriate end of period exchange rate for March 31, 2005, as published in the Fund's *International Financial Statistics* (Table 1). For the quarters ending September and December 2006, the March 31, 2006 exchange rates will be used.

(b) Under the definition of debt set out in point 9 (a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt."

Table 1. Selected End-of-Period Exchange Rates, March 31, 2005

Taka per U.S. dollar	63.5220	Indian rupee per U.S. dollar	43.7550
SDR per U.S. dollar	1.5108	Pakistani rupee per U.S. dollar	59.1240
Australian dollar per U.S. dollar	1.2955	Swedish kroner per U.S. dollar	7.0526
British pound per U.S. dollar	0.5312	Japanese yen per U.S. dollar	107.3500
Canadian dollar per U.S. dollar	1.2096	Gold price in U.S. dollars per troy ounce (London PM fixed)	433.9000
Euro per U.S. dollar	0.7714		

Source: Fund's *International Financial Statistics.*

2. For the purposes of program monitoring, the following information, including any revisions to historical data, will be provided by BB and Ministry of Finance, or PRGF Monitoring Unit, unless specified otherwise, to the Asia and Pacific Department of the Fund, through the office of the Resident Representative in Dhaka, as set out in Table 2.

3. In accordance with the recommendations of the Safeguards Assessment, the data on the international reserves and balance sheet of BB should be reconciled with the final accounts of BB for each period. Annual data will also be reconciled with the final audited accounts when they become available.

4. The macroeconomic scenario under the program envisions the disbursement of $US100 million under the World Bank's education section loan in the fourth quarter of FY06 and $US100 million under the World Bank's DSC IV in the first quarter of FY07. If the amount or timing of these disbursements differ from that envisioned under the program, the quantitative performance criteria under the PRGF program for NIR and NDA of Bangladesh Bank, and central government net domestic financing will be adjusted accordingly.

Table 2. Bangladesh: Monitoring and Reporting Requirements (attached)

Table 2. Bangladesh: Monitoring and Reporting Requirements

Item	Reporting Requirement	Periodicity / Reporting Lag
Item 1: Net domestic assets of BB	Balance Sheet of BB (Form 10G), Consolidated Balance Sheet of DMBs (Form 20G), Monetary Survey (Form	Monthly / within six weeks of end of corresponding period.
Item 2: Net domestic financing of central government Item 3: Net bank borrowing of central government 1/	Balance Sheet of BB (Form 10G) Consolidated Balance Sheet of DMBs (Form 20G), Monetary Survey (Form 30G) outstanding stock of national savings certificates, nonbank holdings of government securities	Monthly / within six weeks of end of corresponding period.
Item 4: Net international reserves of BB	Foreign Assets and Liabilities of BB	Monthly / within three weeks of end of corresponding period.
Item 5: Contracting of short-term external debt Item 6: Contracting or guaranteeing of new medium- and long-term nonconcessional external debt	Contracting or guaranteeing of new external debt by the public sector/government, with details on creditor, amount and terms of each loan	Monthly / within three weeks of end of corresponding period.
Item 7: External payments arrears	Level of external payments arrears during period	Monthly / within three weeks of end of corresponding period.

1/ Performance criteria in Item 3 to be dropped starting January 2006.

Statement by the IMF Staff Representative
February 3, 2006

1. This statement contains information that has become available since the staff report was circulated to the Executive Board on January 20, 2006. This information does not alter the thrust of the staff appraisal.

2. Despite a backdrop of security concerns and political confrontation (as outlined in ¶4 of the staff report) the growth outlook remains robust. Industrial production grew by 20 percent (y/y) in November, led by a healthy expansion in construction and manufacturing, especially the garment and pharmaceutical sectors. Exports continue to perform better than expected in the wake of the phase out of MFA quotas, with total exports growing by 13 percent during July-November (compared with the same period in the previous fiscal year) on account of strong growth in knitwear, frozen foods, and jute products. Import demand remains strong, reflecting high international prices for petroleum products, although overall import growth slowed to 11 percent in the July-November period with non-oil import growth having declined to 9 percent.

3. Policy interest rates, the exchange rate, and international reserves have remained broadly stable since the issuance of the staff report. On January 26, Bangladesh Bank released a monetary policy statement for the first time. The statement published the authorities' monetary policy framework supported by the PRGF program and also projects that the steps already taken to tighten monetary policy would be sufficient to contain inflation at 7 percent, notwithstanding the expectation of further fuel price adjustments. The statement also pledges that the central bank will remain alert to the need for further monetary policy measures. Staff welcomes the monetary measures the authorities have taken and continues to believe that a slightly more pro-active stance may be needed to achieve monetary objectives (as emphasized in the appraisal).

4. Preliminary data indicate that tax revenue collection during the first half of the fiscal year (through December 2006) was about Tk 8.6 billion, or 5.6 percent short of the Tk 54 billion indicative target. The shortfall was largely due to poor performance in the collection of customs revenue. On the positive side, income tax and VAT revenue grew by 19 and 17 percent, respectively, compared with the same period in the previous fiscal year. Very preliminary expenditure data suggest that current expenditure has remained in line with budget estimates and, as in past years, spending under the Annual Development Program fell below budget targets reflecting limitations in implementation capacity. Accordingly, preliminary financing data suggest that the December indicative target for domestic financing of the government was met by a small margin.

5. The government continues to take steps to strengthen the bank restructuring process. For Rupali Bank, a road show will be held starting in mid-February after which qualified bidders will be invited to conduct due diligence. The Privatization Commission expects to finalize the divestment of the bank by end-July. For Agrani Bank, discussions are currently

underway with the World Bank to strengthen the role of the consulting teams and introduce explicit performance targets.

6. The World Bank Executive Board met on Thursday, January 26 to discuss the authorities' *National Strategy for Accelerating Poverty Reduction* and the Joint IDA-IMF Staff Advisory Note (JSAN). Directors commended Bangladesh's macroeconomic management and recent strong growth record, and urged the authorities to continue to make progress in these areas, while addressing critical elements such as revenue collection, tax reforms, state enterprise reform, public financial management, and structural reforms in the banking sector.

Press Release No. 06/23
FOR IMMEDIATE RELEASE
February 3, 2006

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Fourth Review Under Bangladesh's PRGF Arrangement and Approves US$97.2 Million Disbursement

The Executive Board of the International Monetary Fund (IMF) today completed the fourth review of Bangladesh's economic performance under the Poverty Reduction and Growth Facility (PRGF) arrangement. The completion of this review makes available to Bangladesh a disbursement in an amount equivalent to SDR 67.28 million (about US$97.2 million), after which disbursements will total SDR 283.06 million (about US$409.1 million).

The Board also today reviewed Bangladesh's poverty reduction strategy paper, *Unlocking the Potential—the National Strategy for Accelerated Poverty Reduction*, and the associated joint World Bank-IMF staff advisory note. Further, the Board approved Bangladesh's request for waivers for the nonobservance of quantitative and structural performance criteria.

The IMF's Executive Board approved Bangladesh's three-year PRGF arrangement on June 20, 2003 (see Press Release No. 03/92) for an amount equivalent to SDR 347 million (about US$501.5 million). The Board also approved on July 28, 2004 Bangladesh's request for activation of the newly created Trade Integration Mechanism with an augmentation of the PRGF amounting to SDR 53.33 million (about US$77.1 million—see Press Release No. 04/161). As a result, the total amount under the PRGF arrangement increased to SDR 400.33 million (about US$578.6 million).

Following the Executive Board discussion, Mr. Takatoshi Kato, IMF Deputy Managing Director and Acting Chair, said:

“Bangladesh's economy has performed well under the PRGF-supported program. The economy has continued to expand, and inflation has been kept in check. Nonetheless, Bangladesh remains a country with a high degree of poverty, serious capacity constraints, and heavy reliance on donor inflows. The authorities will need to maintain sound policies and steadily pursue key structural reforms and capacity building for many years to achieve the objectives outlined in the poverty reduction strategy. After some slippages, key reform measures in tax administration and in the nationalized commercial banks (NCBs) have been implemented.

"A full poverty reduction strategy, titled *Unlocking the Potential—the National Strategy for Accelerated Poverty Reduction* (NSAPR) was finalized and published. The authorities' policies under the PRGF arrangement have been designed to enable Bangladesh to make progress in achieving its economic and poverty reduction goals. Meeting these challenges will require steadfast implementation of structural reforms and credible actions to enhance governance. Accelerated implementation of reforms of the NCBs, tax administration, and the trade system will also contribute to improved governance and the investment climate. In view of the authorities' limited technical capacity, continued donor assistance will be required for successful implementation of the NSAPR.

"The implementation of fiscal policy has continued to be prudent, and the authorities remain committed to protecting fiscal sustainability. However, determined efforts to improve revenue collections are vital for funding development expenditure and social spending aimed at poverty reduction without jeopardizing fiscal sustainability. While revenue performance has improved, it has still slightly fallen short of the targets set under the program. Efforts need to be stepped up to address the chronic revenue shortages, including by accelerating reforms in revenue administration and reducing tax exemptions and incentives in the context of the FY07 budget.

"The proposed monetary program in Bangladesh Bank's monetary policy statement is consistent with the authorities' inflation and international reserves objectives. Given still high money and credit growth, however, the Bangladesh Bank will likely need to use open market operations more actively to tighten the monetary stance further and to raise interest rates on treasury securities in order to contain inflation. The central bank has taken steps to improve the functioning of the interbank and treasury securities markets with technical assistance from donors. The flexible exchange rate regime has worked well for Bangladesh, and should help mitigate the potential impact of the removal of Multifiber Arrangement (MFA) quotas and high oil prices, thereby safeguarding the balance of payments position.

"The successful divestment of Rupali Bank will help improve market sentiment and facilitate the implementation of the entire bank restructuring program. Despite some improvements, the continued poor financial condition of the NCBs underlines the urgency for decisive actions in this area. The implementation of the bank-by-bank resolution strategies will require strong political support, close monitoring, and technical assistance.

"The energy sector state-owned enterprises (SOEs) continue to be a source of fiscal risk. The increases in global oil prices were only partially passed through to domestic prices, resulting in significant financial losses to the energy sector SOEs that are not sustainable. Further oil price adjustments will be needed. In this connection, the authorities plan to identify measures to mitigate the impact of price adjustments on vulnerable groups.

"Further trade reform will contribute to growth momentum and help bolster confidence in the export sector, particularly following the phasing out of MFA quotas. In light of adverse implications on government revenue of further trade reform, the authorities will need to protect revenue through reforms in revenue policy and administration," Mr. Kato said.

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in the Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.