

**Bangladesh: 2009 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion**

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2009 Article IV consultation with Bangladesh, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on October 29, 2009, 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 December 23, 2009. 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 supplement of December 29, 2009, on the joint IMF/World Bank debt sustainability analysis.
- A Public Information Notice (PIN).

The document listed below has been or will be separately released.

Selected Issues Paper

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BANGLADESH

**Staff Report for the 2009 Article IV Consultation**

Prepared by the Staff Representatives for the 2009 Consultation with Bangladesh

Approved by Kalpana Kochhar and Tom Dorsey

December 23, 2009

**Mission:** Discussions were held in Dhaka during October 19-29, 2009. The staff team met with Finance Minister A.M.A. Muhith, Finance Secretary M. Tareque, Advisor on Finance to the Prime Minister Mashiur Rahman, Central Bank Governor Atiur Rahman, and other senior officials. The team also met with representatives of donors, NGOs, business, labor, the media and academics. The mission's concluding statement was published at <http://www.imf.org/external/np/ms/2009/102909.htm>

**Team:** Mr. Miyazaki (head), Mr. Almekinders, Ms. Maslova (all APD), Mr. Arze del Granado (FAD), and Mr. Maino (MCM), assisted by the resident representative, Mr. Dunn. Mr. Patra (Senior Advisor to the Executive Director) participated in key meetings.

**Focus:** Discussions centered on (i) short-term policies to deal with excess liquidity and to prevent an acceleration of inflation; and (ii) longer-term policies to boost growth through tax policy reform and higher public investment.

**The 2008 Article IV Consultation was completed on September 19, 2008.**

Directors' comments are at <http://www.imf.org/external/pubs/cat/longres.cfm?sk=22419.0>

**Exchange regime:** The *de jure* regime is a float but the *de facto* regime is stabilized as the exchange rate has remained close to 69 taka per U.S. dollar since the end of 2006. A restriction remains in place on the convertibility and transferability of proceeds of current international transactions in nonresident taka accounts.

**Statistical issues:** Data are adequate for surveillance and deficiencies, identified through technical assistance, are being addressed.

## Contents

I. Background.....	4
II. Recent Economic Developments .....	4
III. Economic Outlook .....	6
IV. Macroeconomic Policy Discussions .....	8
A. Containing Excess Liquidity.....	8
B. Improving Exchange Rate Management.....	9
C. Boosting Growth Through Higher Capital Spending.....	10
D. Reforms of Energy Prices and State-Owned Enterprises (SOEs).....	12
E. Financial Sector Reforms .....	13
V. Other Issues.....	14
VI. Staff Appraisal .....	14
Boxes	
1. How did Bangladesh double central bank reserves amid the global crisis? .....	5
2. Challenges in Cash Management.....	9
3. Is the level of the REER appropriate? .....	11
Figures	
1. Real and Fiscal Sector Indicators, 2001-09 .....	16
2. Monetary and External Sector Indicators, 2001-09 .....	17
3. Recent Developments in Money and Foreign Exchange Markets.....	18
Tables	
1. Key Economic Indicators, 2007-2014 .....	19
2. Balance of Payments, 2007-2014 .....	20
3. Central Government Operations, 2007-2014.....	21
4. Central Bank Balance Sheet, 2007-2010 .....	22
5. Monetary Survey, June 2007-2010.....	23
6. Financial Soundness Indicators, 2004-2008 .....	24

## Executive Summary

### Economic Developments

- Bangladesh's economy has held up remarkably well, despite the global recession. Growth decelerated only modestly from the pace recorded in recent years and remained broad-based. Strong remittances, resilient exports and weak imports caused the current account of the balance of payments to record a surplus of almost 3 percent of GDP in FY09 (July 2008-June 2009). Gross reserves doubled to over US\$10 billion in the year to November 2009, raising reserve coverage to 4.8 months of prospective imports, a 15-year high.
- A decline in international food and commodity prices contributed to easing inflation.
- The FY09 budget deficit remained below the budget target, despite revenue shortfalls, owing to continued problems in implementing the Annual Development Program.
- Monetary policy was accommodative through the summer. The injection of liquidity from unsterilized interventions to maintain the *de facto* peg to the U.S. dollar pushed interest rates down and inflated banks' excess reserves. Faced with a possible pickup in inflation, and a rapid rise in share prices, monetary conditions were subsequently tightened, but insufficiently, and through large high-cost government borrowing—with excess funds deposited in Bangladesh Bank (BB)—rather than sustained monetary policy operations.
- Progress on structural reforms was mixed.
- Growth momentum was subdued during the first months of FY2010. However, as growth and imports recover, the need for official foreign exchange purchases will be reduced. This should allow monetary policy to focus on addressing the injection of liquidity that will occur when the government starts to draw on its accumulated deposits with BB.

### Policy Issues

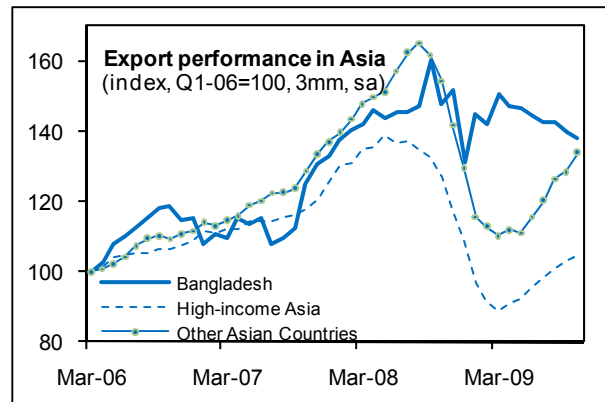
- Bangladesh seems stuck in a low revenue-low capital spending equilibrium and infrastructure bottlenecks are holding back growth. Staff and the authorities agreed on the need to raise government capital spending, financed from higher tax revenues, in order to boost medium-term growth and raise living standards.
- Rather than contemplating greater exchange rate flexibility, as recommended by staff, the authorities indicated that their priority was to make the existing framework for monetary and exchange rate policy work, including by gradually reducing banks' excess liquidity.
- Financial soundness indicators are generally favorable although the weak state of the state-owned commercial banks (SCBs) remains a concern. The authorities were receptive to the recommendations of the July 2009 FSAP Update mission and indicated that they had already started to make improvements based on the advice.

## I. BACKGROUND

1. **The political environment has settled down following successful elections.** A military-backed caretaker government, which had been in control for 2 years, left office in favor of Sheikh Hasina's Awami League (AL)-led government in January 2009. Amid high voter turnout, the AL won more than the two-thirds parliamentary majority needed to pass constitutional amendments unchallenged.
2. **However, despite a large popular mandate for reform, progress has been limited.** The government declared alleviating poverty and reducing consumer prices to be its top priorities. Accordingly, administered prices of fertilizer and diesel were reduced. But implementation of the ambitious election manifesto for economic reforms—needed to unlock Bangladesh's potential through private sector-led growth—is progressing slowly.

## II. RECENT ECONOMIC DEVELOPMENTS

3. **Bangladesh's economy has held up remarkably well despite the global recession.** Financial contagion was contained by low levels of financial integration. Growth, estimated at 5.9 percent for FY09, decelerated only modestly from the pace recorded in recent years and remained broad-based. Monetary conditions were increasingly loosened through the summer. However, unlike in some neighboring countries (e.g. India), no fiscal stimulus measures were put in place, apart from a modest budget reallocation aimed at supporting sectors affected by the global downturn. The limited impact of the global downturn on Bangladesh's growth partly reflects the relatively low overall trade openness, and the large share of basic textiles and garments in total exports, which fared relatively well (Box 1). The resilience of Bangladesh's exports contrasts with the experience in other countries in Asia where exports are still substantially below the pre-crisis peak.



4. **The external position strengthened considerably in FY2009 and the first four months of FY2010.** Strong remittances, resilient exports and weak imports caused the current account of the balance of payments to record a surplus of almost 3 percent of GDP in FY09, up from less than 1 percent of GDP in FY08. Gross international reserves exceeded US\$10 billion in November, almost double the level in November 2008. This is equivalent to 4.8 months of prospective imports, a 15-year high.
5. **This put pressure on Bangladesh Bank (BB)'s monetary policy framework.** The improvement in the current account put upward pressure on the taka which BB countered

### Box 1. How did Bangladesh double central bank reserves amid the global crisis?

**The capital account remains effectively closed.** Therefore, Bangladesh was not affected by the global “flight to safety” towards the end of 2008 and in the first half of 2009.

**FDI inflows have stayed at only about 1 percent of GDP per annum**, owing to a relatively unfavorable business climate. This level was maintained in FY09 thanks to a large sale of telecom shares.

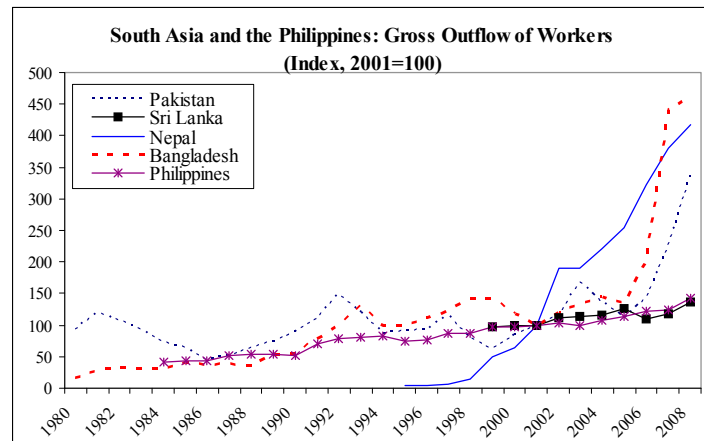
	Imports of RMG 1/ (in US\$ bn)	Bangladesh's share (in percent)
1999	103	3.0
2005	148	4.0
2007	169	4.6
2008	176	5.2
2008 H1	85	5.3
2009 H1	76	6.4

**Exports held up well.** Bangladesh’s ongoing gains in global market share accelerated during the first half of 2009 thanks to strength in the lower market segment which held up relatively well.

1/ Data covers Canada, the EU, Japan, and the US

**Various factors contributed to a strong deceleration of imports:** an abundant harvest, lower international oil and commodity prices, a deceleration of credit to the private sector, and a wait-and-see attitude in the private sector, which depressed the import of capital machinery.

**The continued strong increase in remittances reflected a surge in manpower exports through mid-2008.** Reflecting strong demand for unskilled workers in the GCC countries and Malaysia, almost 1 million Bangladeshi nationals migrated in the year through June 2008. The growth of manpower exports from Bangladesh exceeded that from other countries in the region. While Bangladesh is now experiencing a large decline in hiring from abroad (Box 3), remittances are still recording robust year-on-year growth reflecting lags between migration and remittances.



through unsterilized foreign exchange purchases. This caused banks’ excess reserves to rise sharply, sending short-term interest rates below 1 percent (Figure 3). In the absence of reverse repo transactions, the monetary policy framework was rendered virtually inoperative.

6. **The accommodative monetary policy pushed up asset price inflation.** A decline in international food and commodity prices contributed to a fall in inflation to 2.2 percent in June. But with the accommodative monetary policy, upward pressure on real estate prices has become visible and the stock market has risen by 40 percent since March. As international food and commodity prices began to rise again, inflation rose to 6.7 percent in October.

7. **The FY09 budget deficit remained below the budget target, despite revenue shortfalls, owing to continued problems in implementing the Annual Development Program (ADP).** Held back by lower imports, customs revenue fell short of the target. As a result, the ratio of NBR revenue to GDP declined by 0.2 percent of GDP to 8.2 percent of GDP, falling short of the original budget target by 0.7 percent of GDP. ADP spending fell short of the original budget by 1 percent of GDP reflecting implementation bottlenecks. The overall fiscal deficit (including grants) amounted to 3 percent of GDP, almost 1 percentage point of GDP smaller than envisaged in the original budget.

8. **In the area of structural reforms progress was mixed.** Comprehensive plans to address infrastructure bottlenecks, such as the power and gas shortages which are holding back growth, remain under discussion. Progress in Public Private Partnerships (PPP) has been very slow. The reintroduction of interest rate ceilings on important categories of bank lending was a setback to financial market development. The recent appointments made at the Boards of Directors of three state-owned commercial banks (SCBs) were not fully in line with established regulations. The FY2010 budget's extension of para-tariffs and the introduction of a regulatory duty to a large number of consumer goods raised nominal protection and is second-best to comprehensive tax policy reform.

### III. ECONOMIC OUTLOOK

9. **Bangladesh's growth momentum is likely to remain somewhat subdued in the near term but inflation seems set to increase.** Staff projects growth to decelerate to 5 percent in FY2010 as economic activity is likely to be held back by weak imports, particularly of capital machinery, sluggish exports and private sector credit, and subdued hiring of Bangladeshi workers by employers abroad. The ample availability of liquidity along with adverse base effects related to last year's unprecedented decline in international food and commodity prices is likely to drive up inflation throughout FY2010, possibly to double digits by the summer. As imports recover, the need for official foreign exchange purchases will be reduced in the second half of FY2010, reducing external pressure on monetary policy.

10. **Over the medium term, as global growth and trade recover, Bangladesh's growth should edge up as well, to around 6 percent per annum** (Text Table 1), building on increasing trade integration with countries in the region and the rest of the world, and growth momentum in the agriculture, services, and construction sectors. The current account can be expected to remain in surplus with the import coverage of reserves remaining robust.

**Text Table 1. Bangladesh: Key Macroeconomic Indicators under the Baseline Scenario**

(In percent of GDP, unless otherwise indicated)

	FY08	FY09	FY10	FY11	FY12	FY13	FY14
		Est	Projections				
Real GDP growth (in percent)	6.2	5.9	5.0	5.8	6.0	6.0	6.0
CPI inflation (in percent, annual average)	9.9	6.7	7.8	7.0	6.0	5.0	4.5
Central government total revenue	10.8	10.4	10.7	10.5	10.6	10.7	10.7
<i>Of which</i> : Tax revenue	8.8	8.6	8.8	8.8	8.9	9.0	9.0
Central government total expenditure	15.9	14.1	14.8	14.8	14.9	14.9	14.9
<i>Of which</i> : Annual Development Program	3.4	3.2	3.3	3.3	3.3	3.3	3.3
Central government overall balance (excl. grants)	-5.1	-3.7	-4.0	-4.3	-4.2	-4.2	-4.1
Total central government debt	46.7	45.3	44.0	44.1	44.0	43.8	43.6
External current account balance	0.9	2.8	2.9	1.4	0.8	0.8	0.8
Gross official reserves (in billions of U.S. dollars)	6.1	7.5	10.9	12.3	13.2	14.5	16.2
Export growth (in percent)	17.4	10.1	3.2	7.6	11.1	13.3	12.9
Import growth (in percent)	25.6	4.2	3.5	11.7	11.0	11.5	11.2

Sources: Bangladesh authorities and Fund staff estimates and projections.

11. **There are both downside and upside risks to the baseline projections.** A prolonged global slump could hold back exports and remittances. As the U.A.E. accounts for almost one-fifth of remittances, a slowdown in Dubai, following the recent financial problems, would also have adverse effects. Continued shortages of energy may further discourage private-sector investment and FDI. On the other hand, private sector investment may jump, if the global recovery is deemed more robust than expected. An acceleration of structural reforms could also boost growth substantially.

12. **The staff's updated Debt Sustainability Analysis (DSA) suggests that Bangladesh has a low risk of debt distress.** Continued prudent foreign borrowing amid robust economic growth and recent real appreciation of the taka has put the external debt to GDP ratio on a declining path both in face value and in net present value terms. However, taking into account domestic public debt, which amounted to 21 percent of GDP at the end of FY09, the risk of debt distress is somewhat more elevated. In the staff's baseline scenario, the ratio of total public debt to GDP remains at around 44 percent of GDP over the medium term.

13. **Other macroeconomic vulnerabilities are also low.** Stress tests conducted during the recent FSAP update suggest that the banking system is mainly vulnerable to a deterioration in domestic credit quality, whereas vulnerability to exchange or interest rate movements is low. The stock market continues to play a limited role in the overall economy. However, with the increasing engagement of banks in the market, risks to capital from a fall in the market could be large for some banks.



#### IV. MACROECONOMIC POLICY DISCUSSIONS

Discussions centered on policies required to maintain near-term macroeconomic stability, including by reducing excess liquidity in the financial system, and longer-term policies to boost growth through tax policy reform and higher public investment.

##### A. Containing Excess Liquidity

14. **Through the summer, monetary policy was accommodative.** The injection of liquidity from unsterilized interventions, conducted to maintain the stability of the exchange rate, pushed short-term interest rates substantially below the notional corridor of policy interest rates from April onwards and inflated banks' excess reserves to unprecedented levels (Figure 3). In order to boost lending and activity, BB also capped banks' interest rates on lending to priority sectors. These actions were taken against the backdrop of a declining inflation rate and a deceleration of private sector credit.

15. **The subsequent tightening of monetary policy was inadequate.** Faced with large excess liquidity in the banking system and a rapid rise in share prices, BB started to mop up liquidity through the issuance of BB bills (from August) and reverse repo operations (from mid-October, after having reduced the reverse repo rate by 200 basis points to 2.5 percent). However, the total amount of liquidity taken out of the market by BB remained limited.

16. **The reduction in excess liquidity and reserve money was mostly achieved through high-cost government borrowing beyond what was needed to finance the fiscal deficit.** Strong net sales of National Savings Certificates (NSCs) and Treasury Bills and Bonds caused an accumulation of government deposits with BB (Box 2). For instance, during October alone, BB's net claims on government declined by Tk 40 billion. Staff noted that BB would need to start issuing a sufficiently large amount of BB bills—the authorities' main instrument to mop up liquidity—to bring down excess liquidity further if the government began to draw on its deposits with BB. The resulting higher market interest rates would be a small price to pay to prevent a harmful acceleration of inflation. BB emphasized that it would take strong actions to bring excess liquidity down further if inflation and credit demand were to pick up. The government made clear that it stood ready to bear the (quasi-)fiscal costs of the needed mopping up operations.

17. **There is scope to strengthen the monetary policy framework and stabilize systemic liquidity.** To enhance the credibility and predictability of monetary policy, staff proposed to move, in due course, to a standing facility for repo and reverse repo operations and adoption of an interest rate corridor. The authorities concurred but noted that this would have to wait until fully functional open market operations are in place. Staff also noted that averaging reserve requirements on a two-week maintenance period would help control short-term volatility.

### **Box 2: Challenges in Cash Management**

Bangladesh faces challenges in cash management on both the expenditure and funding sides of the budget. This raises the government's interest bill and could undermine fiscal control owing to the resulting build up of deposits at BB and commercial banks over which the Ministry of Finance has limited control.

- Alongside the funds flowing through the treasury single account (TSA), Ministries and Departments retain substantial amounts of cash in commercial bank accounts (1.1 percent of GDP at the end of FY2009). There is no law or rule in place that requires unspent funds held in commercial banks to be swept back into the TSA at the end of the fiscal year. Commercial bank deposits of autonomous and semi-autonomous government bodies are also rising steadily and amounted to 1.8 percent of GDP at the end of FY2009. This suggests that budget allocations to these bodies have systematically exceeded their spending needs.
- Unlike in most countries, retail government savings instruments (NSCs) form a large proportion of outstanding government debt in Bangladesh and now amount to 8 percent of GDP. There are no effective controls on NSC sales as they are entirely demand driven. Interest rates on NSCs are administered and have been changed only four times in the past ten years. At present, NSC interest rates vary from 8½ to 12 percent. In the current environment of low inflation and excess liquidity, rates on bank deposits and on treasury bills of similar maturity are 400–500 basis points lower. As a result, there has recently been a large shift toward NSCs: with net sales in Q1 FY2010 of Tk 28 billion, the annual net sales target of Tk 33 billion is likely to be exceeded. Moreover, despite these large NSC sales the government has mostly adhered to its treasury bill and bond auction calendar, causing a major increase in unremunerated government cash balances with BB.

### **B. Improving Exchange Rate Management**

18. **Greater exchange rate flexibility could help reduce the costs of managing liquidity for BB, while dampening inflationary pressures.** Staff believes that the taka is somewhat undervalued, though not far out of line with fundamentals (Box 3). Staff expressed the view that allowing a modest nominal appreciation of the taka could help reduce excess liquidity in the financial system, thereby reducing the pressure on monetary policy. A modest appreciation would help dampen inflation and would be unlikely to affect the competitiveness of Bangladesh's exports, especially because of the recent sharp nominal

depreciation vis-à-vis the euro and the yen. Staff underscored that greater exchange rate flexibility would also be in the longer-term interest of the economy, especially if the balance of payments would remain stronger than currently envisaged. In addition to helping financial sector development (e.g. through encouraging the development of a foreign exchange derivatives market for hedging purposes), it would reduce the need for costly sterilization operations which risk exacerbating vulnerabilities related to the rising domestic debt.

19. **The authorities indicated that they would not contemplate greater exchange rate flexibility.** While they also felt that the taka was somewhat undervalued, they were concerned that a nominal appreciation would add to the problems of exporters.

### C. Boosting Growth Through Higher Capital Spending

20. **Bangladesh seems stuck in a low revenue-low capital spending equilibrium but would break into a higher growth trajectory with decisive tax reforms.** Bangladesh has a track record of overall fiscal prudence. However, two key issues are preventing a sustainable rise in growth-enhancing government spending:

- Bangladesh's tax-to-GDP ratio (stable at around 8.5 percent for the past several years) is 4 percentage points lower than the average of countries in the region at a similar development stage, constraining the scope for higher spending in key fields.
- Capacity constraints and governance issues are causing chronic under-implementation of the ADP. The 56 percent increase in ADP spending envisaged in the FY2010 budget over the FY09 outturn looks unrealistic given also that the implementation rate has averaged 73 percent over the past 5 years.

21. **Staff outlined a reform scenario which illustrates how a higher growth trajectory can be achieved with higher capital spending** (Text Table 2). However, it would require a break from the past, when recurring plans for tax policy and tax administration reforms were invariably watered down and capacity constraints and governance issues prevented increased ADP implementation. Raising tax revenue to the level envisaged in the scenario, i.e. 11.6 percent—still one percentage point of GDP below the regional average—would require fundamental changes in income tax and VAT policy.

### Box 3: Is the level of the REER appropriate?

*While the taka appears to be somewhat undervalued, staff believes that the assessment made during last year's Article IV consultation, that the real effective exchange rate is close to its estimated equilibrium level, remains valid.*

Between 2000 and 2008, Bangladesh broadly maintained its share of global exports, owing to the strong performance of the textile and garments sector (see also Box 1). Of Bangladesh's regional competitors, India and Vietnam managed to increase their share of global exports thanks to their more diversified production base, more business-friendly macroeconomic and structural policies, and better-quality governance (See also Chapter II in IMF Country Report No. 08/335).

Over the medium term, Bangladesh's current account balance is projected to narrow to less than 1 percent of GDP. Import growth is projected to recover and the growth of remittances is projected to slow as the effect of a slowdown in the hiring of Bangladeshi workers will begin to be felt.

Application of four different quantitative approaches suggests that the REER and the current account balance are broadly in line with macroeconomic fundamentals (Table 1, see accompanying Selected Issues Paper for more details). Using the CGER-based trade elasticity for Bangladesh (0.11) suggests that the taka is undervalued by more than 20 percent when applying the ES and MB approaches. However, applying a Bangladesh-specific trade elasticity (0.29) suggests that the taka is undervalued by about 10 percent. The latter elasticity takes into account (i) the composition of Bangladesh's exports; (ii) incomplete pass through of changes in exchange rates and international prices to import and export prices; and (iii) Bangladesh's price-taking behavior on international markets.

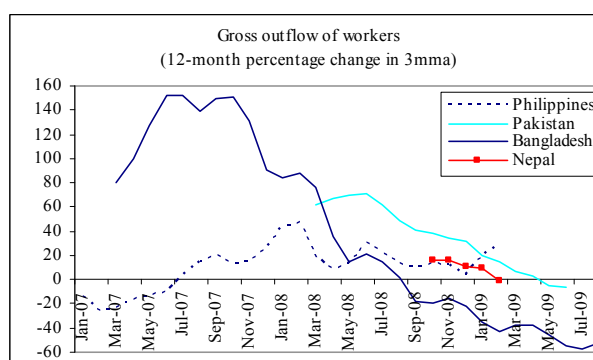
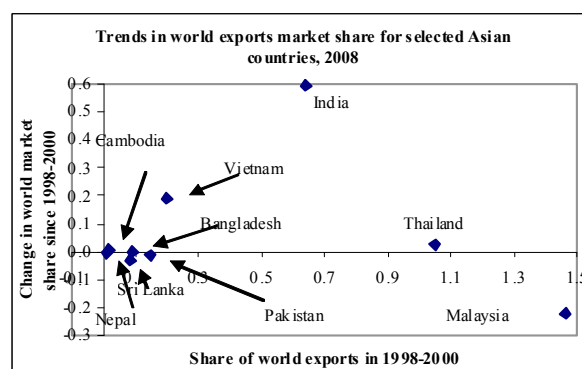
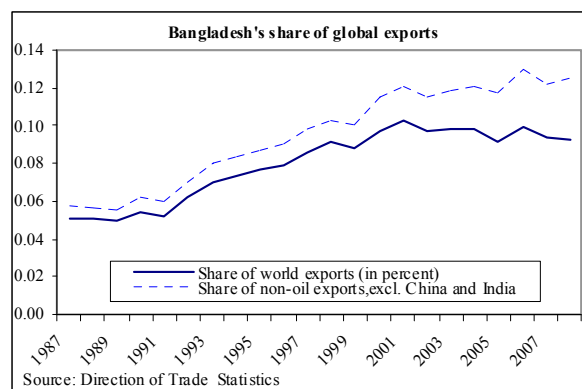


Table 1. Estimates of overvaluation of the taka

Approach	Estimated overvaluation (in percent)
Purchasing power parity	8
External sustainability	-24 to -10
Macro balance	-23 to -9
Equilibrium exchange rate	-8

22. **Staff emphasized that tax reforms are vital to unleash Bangladesh's potential, while maintaining fiscal prudence and sustainability.** While Bangladesh's external debt position does not pose immediate risk, escalating foreign borrowing, especially non-concessional loans, could weaken its external debt position. Besides, foreign donors may not be able to meet increasing borrowing demand from Bangladesh. In fact, despite the large budget support from the ADB, there may be a shortfall in net external financing in FY2010. Financing higher capital spending domestically from high-cost NSCs could quickly undermine fiscal sustainability by raising the interest bill and the overall fiscal deficit.

23. **The government is committed to boosting growth through tax policy reform and higher public investment.** The authorities reaffirmed their intention to submit new VAT legislation to Parliament in the context of the FY2011 budget. Raising the ADP implementation ratio has become a political priority. And the FY2010 budget included an allocation to commence Public Private Partnerships (PPPs).

**Text Table 2. Bangladesh: Key Macroeconomic Indicators under the Reform Scenario**

(In percent of GDP, unless otherwise indicated)

	FY08	FY09	FY10	FY11	FY12	FY13	FY14
		Est.	Projections				
Real GDP growth (in percent)	6.2	5.9	5.0	6.3	6.9	7.5	8.0
CPI inflation (in percent, annual average)	9.9	6.7	7.8	7.0	6.0	5.8	5.3
Central government total revenue	10.8	10.4	10.7	11.3	12.0	12.7	13.5
<i>Of which</i> : Tax revenue	8.8	8.6	8.8	9.4	10.1	10.8	11.6
Central government total expenditure	15.9	14.1	14.8	15.4	15.9	16.7	17.4
<i>Of which</i> : Annual Development Program	3.4	3.2	3.3	4.0	4.7	5.7	6.6
Central government overall balance (excl. grants)	-5.1	-3.7	-4.0	-4.1	-4.0	-4.0	-4.0
Total central government debt	46.7	45.4	44.0	43.8	43.1	42.3	41.3
External current account balance	0.9	2.8	2.9	1.4	0.5	0.1	-0.5
Gross official reserves (in billions of U.S. dollars)	6.1	7.5	10.9	12.5	13.6	14.6	15.5
Export growth (in percent)	17.4	10.1	3.2	11.9	15.5	15.9	15.4
Import growth (in percent)	25.6	4.2	3.5	14.6	14.6	14.8	14.7

Sources: Bangladesh authorities and Fund staff estimates and projections.

#### **D. Reforms of Energy Prices and State-Owned Enterprises (SOEs)**

24. **Energy and fertilizer subsidies look set to rise again.** Losses of SOEs, which for the most part have been brought on the budget, arise mainly from administered prices that do not cover input costs. As a result of the rapid decline in international oil prices during FY09, losses at the state-owned oil company were contained. However, international oil prices have been rising in recent months and domestic prices for petroleum products and electricity are again below the levels needed to cover the costs of the relevant SOEs. Staff recommends that the authorities opt for early and more frequent adjustment of retail energy prices, combined with targeted compensation for the poor. This would prevent the accumulation of large losses

and an eventual large price adjustment, as was experienced in FY08. Also, by reducing infrastructure bottlenecks, including oil-import facilities, the transportation and distribution costs can be substantially reduced, which would lessen the need to raise retail prices.

### **E. Financial Sector Reforms**

25. **Successful financial sector reforms are key to securing Bangladesh’s growth potential.** The July 2009 FSAP Update mission found that considerable progress has been made in strengthening the soundness and resilience of the financial sector since the 2003 FSAP. Financial soundness indicators are generally favorable although the asset quality of the commercial loan portfolio remains weak, with a large share of loans classified in the substandard, doubtful, and loss categories. The recommendations of the FSAP Update mission provide a roadmap to a more efficient and resilient financial sector.

26. **The weak state of the state-owned commercial banks (SCBs) remains a concern.** The banking sector remains structurally weak, reflecting low capitalization and distortions due to the presence of weak and systemically important SCBs. Three large SCBs were corporatized in 2007 and brought under BB’s regulatory authority. Their Boards and management were strengthened, and their operations were upgraded through a monitorable program. The SCBs’ finances have improved but remain much worse than those of the private banks.

27. **Staff underscored that strategic guidance and robust decisions—based on business principles at the Board and management level—remain critical to further promote SCBs’ soundness,** especially in view of the recent relaxation of the cap on the loan portfolio growth from 5 to 10 percent. In this context, it urged BB to closely monitor the performance of the three corporatized SCBs using agreed verifiable indicators. In order to prevent an increase in non-performing loans in the medium term, BB should use its supervisory powers to take corrective measures, as necessary, if there is evidence that these banks are not being run appropriately. In particular, it would be important to monitor whether all of the recently appointed directors and chairmen live up to the expectations that they will be able to help further strengthen the SCBs. And Rupali Bank, the weakest of the four major SCBs, should be brought under the same restructuring and monitoring program as the other three SCBs as quickly as possible.

28. **The authorities noted the progress they had already made in implementing many of the recommendations put forward by the FSAP update mission.** Recent improvements included (i) preparing for the introduction of Basel II regulations effective January 1, 2010; (ii) raising the quality of banks’ capital; (iii) creating risk management units at all banks; (iv) strengthening BB’s in-house capacity for stress testing; and (v) requesting commercial banks to run their merchant banking business through separately formed subsidiary companies. The authorities had also requested a resident advisor to assist with strengthening BB’s banking supervision capacity.

29. **Staff noted the FSAP Update mission’s recommendations to strengthen accounting practices, and to unify and broaden regulations.** Weaknesses in the implementation of accounting standards by banks appear to cause an overestimation of the decline in the NPL ratio and allowed “paper” recapitalizations of some of the SCBs. Prudential and regulatory enforcement would need to be improved in order to ensure that all microcredit and non-bank financial institutions (NBFIs) are eventually brought fully within the regulatory perimeter. The authorities argued that banks are using appropriate accounting standards and NBFIs and microfinance institutions are properly regulated but acknowledged that there was scope to strengthen accounting practices and the enforcement of regulations.

30. **Measures should also be taken to increase efficiency in the financial markets.** Non-prudential interventions, such as ceilings on lending rates for priority sectors, moral suasion, directed lending, and easing debt service for some sectors, are counterproductive in the long run. In light of this, staff welcomes BB’s pronouncement that the ceilings on lending rates are temporary. In the staff’s view, they and other intervention instruments should be removed as soon as possible and in any case before market interest rates rise with higher inflation. The high fixed interest rates on NSCs are a burden on the budget and distort the monetary policy transmission mechanism. Increased flexibility of interest rates would make the auction process for government securities more efficient and eliminate the devolvement of securities onto the primary dealers at rates that frustrate trading. It would also facilitate the development of a more active secondary market in government paper which would help financial sector deepening and monetary policy implementation, and reduce borrowing costs.

## V. OTHER ISSUES

31. **Improving the quality and timeliness of economic statistics would strengthen policy making.** Staff noted the efforts underway to improve trade statistics. Adoption of a Statistics Act would clarify responsibilities in the compilation of statistics and provide needed autonomy to the Bangladesh Bureau of Statistics (BBS). Other key priorities include improving and updating the source data for national account statistics, moving towards Government Financial Statistics Manual 2001 standards for fiscal statistics, and ensuring that the BBS has sufficient staff and other resources to compile statistics.

## VI. STAFF APPRAISAL

32. **Bangladesh’s economy has held up remarkably well, despite the global recession.** Growth has been supported by buoyant domestic activity, including in agriculture and services. Resilience in exports as well as continued strong inflows of remittances also played an important role. In addition, fiscal conservatism of the government has paid large dividends. Going forward, these trends are expected to continue and the staff’s baseline scenario projects medium-term growth at a respectable 6 percent. However, staff identified two policy issues.

33. **First, preventing an increase in inflation is the immediate policy concern.** By stabilizing the exchange rate of the taka in the face of strong remittance inflows, monetary policy has been too accommodative for the domestic conditions. Staff welcomes the commitment made by BB to employ all available instruments to contain inflation if and when there are clear signs of a pickup in prices. However, staff sees a need for preemptive and bold action by BB. The resulting higher market interest rates would be a small price to pay to prevent a harmful acceleration of inflation, which hurts the poor most severely.

34. **Greater flexibility in the exchange rate would support monetary policy objectives.** Staff is of the view that the authorities should move towards greater flexibility in the exchange rate to lessen the constraints on macroeconomic policies. The export sector should be able to sustain such a move, since staff believes that the taka is somewhat undervalued, though not far out of line with fundamentals. Increased day-to-day movements in the exchange rate would also help deepen the foreign exchange market.

35. **Second, for the medium term, measures should be taken to unleash Bangladesh's potential, while maintaining fiscal prudence and sustainability.** Bangladesh seems stuck in a low revenue-low capital spending equilibrium and infrastructure bottlenecks are holding back growth. Higher growth could be achieved through higher revenue and higher capital spending. Therefore, pushing through the plans for VAT reforms is crucial.

36. **Further financial deepening is needed to allow Bangladesh to achieve its growth potential.** Ceilings on lending rates and other non-prudential interventions should be removed as soon as possible. Increased flexibility of interest rates, including for NSCs, would make the auction process for government paper more efficient and give impetus to an active secondary market. It would also help offset the government's higher interest costs related to the needed monetary tightening. Restructuring of SCBs must be accelerated.

37. **Continued improvement in the quality and timeliness of statistics would improve policy making.** Improvements in national account statistics are particularly urgent.

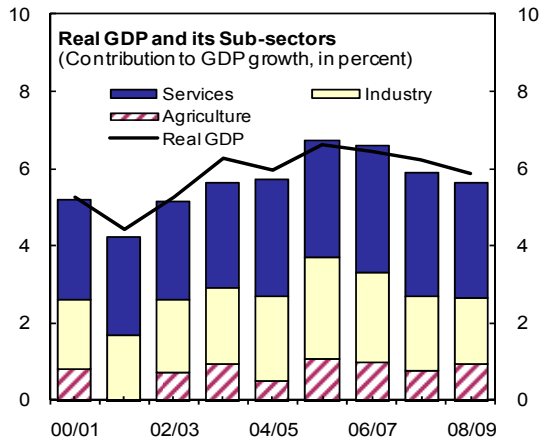
38. **As there is no timetable for the removal of the one remaining exchange restriction on the transferability of funds in nonresident taka accounts, staff does not recommend its approval by the Board.**

39. **It is recommended that the next Article IV consultation with Bangladesh take place on the standard 12-month cycle.**

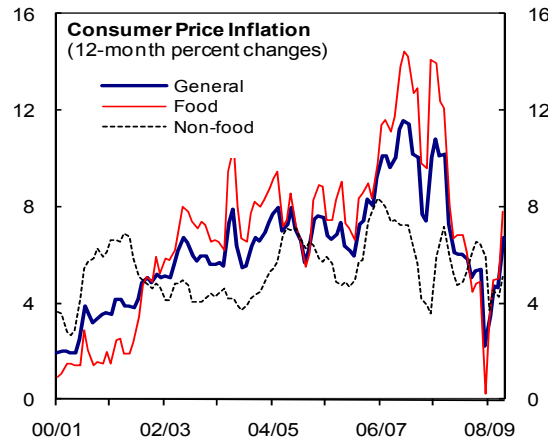


Figure 1. Bangladesh: Real and Fiscal Sector Indicators, FY2001–09 1/

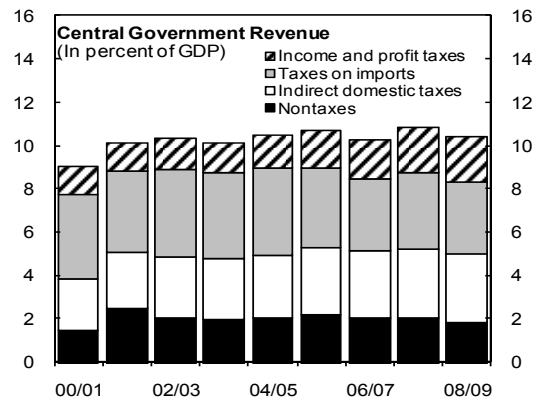
Growth has remained robust



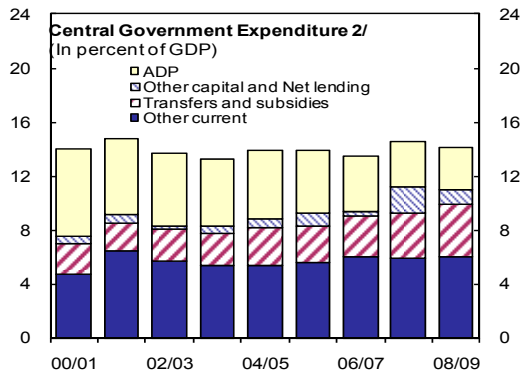
Inflation eased rapidly since the onset of the global crisis in September 2008.



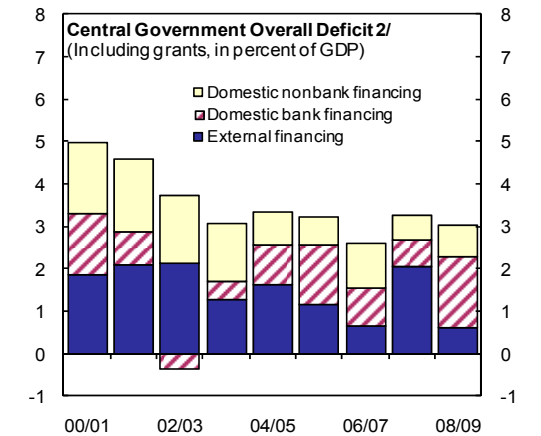
Government revenue remains low.



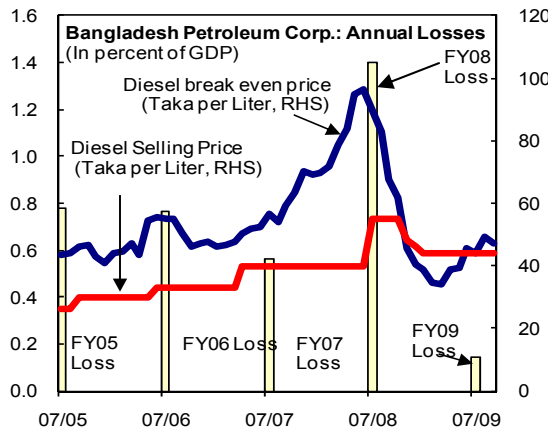
With an upward drift in current spending...



...and lower foreign financing, domestic bank financing reached a multi-year high.



Lower international oil prices allowed BPC to reduce its losses in FY2009.



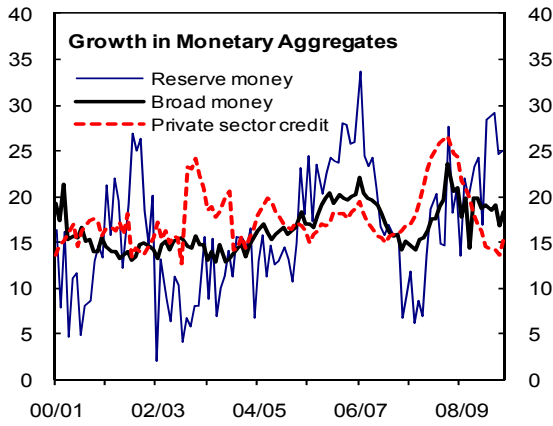
Sources: Data provided by the Bangladesh authorities; IMF, Information Notice System, *International Financial Statistics*; and Fund staff projections.

1/ Estimates for 2008/09 central government expenditure and deficit.

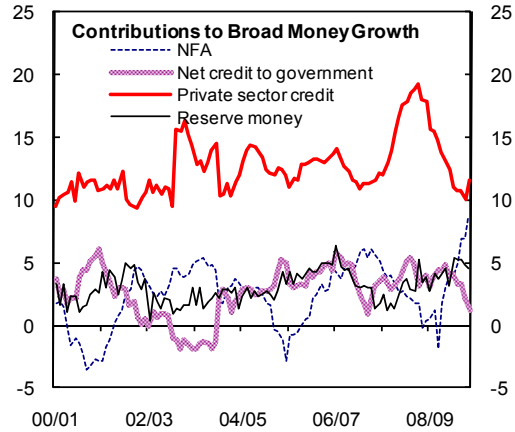
2/ For 07/08 excludes BPC debt operation.

Figure 2. Bangladesh: Monetary and External Sector Indicators, FY2001–09

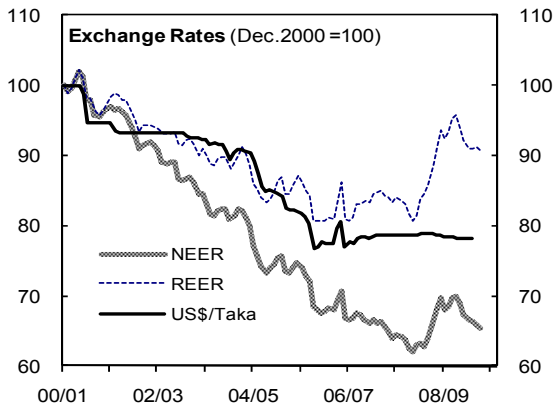
Reserve money is accelerating. Private credit slowed after the onset of the crisis...



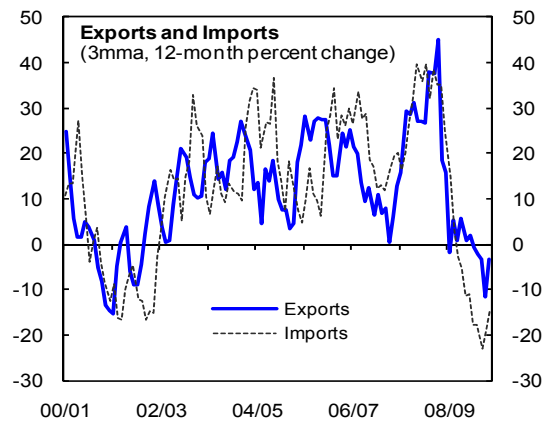
...but remains the main driver of M2 growth.



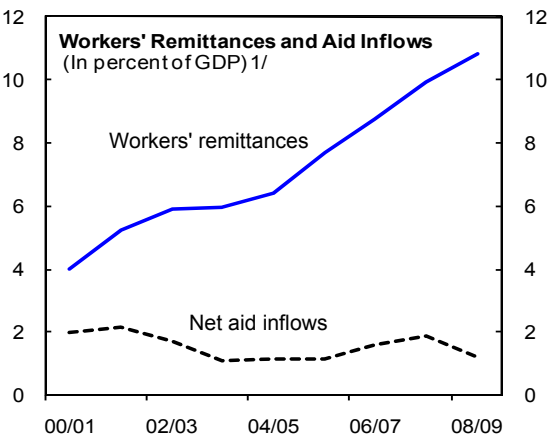
The taka/US\$-rate has been stable; the REER is now 9 percent higher than in 2007



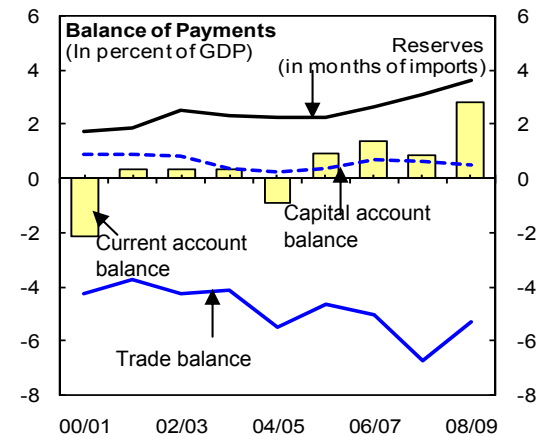
Imports declined; exports held up better.



Remittances have continued to surge but external assistance declined in FY09.



The narrower trade deficit and higher remittances contributed to higher reserves.

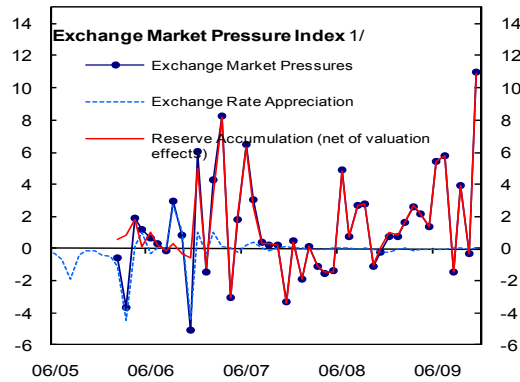


Sources: Data provided by the Bangladesh authorities; IMF, Information Notice System, International Financial Statistics; and Fund staff estimates and projections.

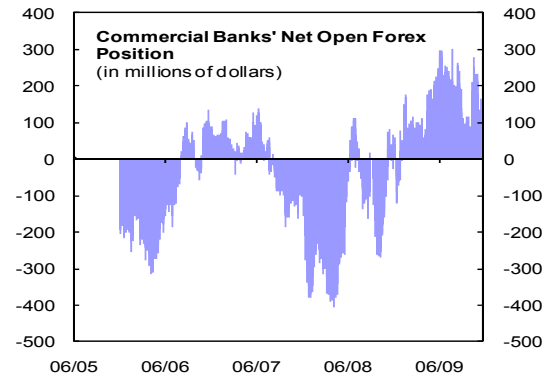
1/ Projection for 08/09.

Figure 3. Bangladesh: Recent Developments in Money and Foreign Exchange Markets

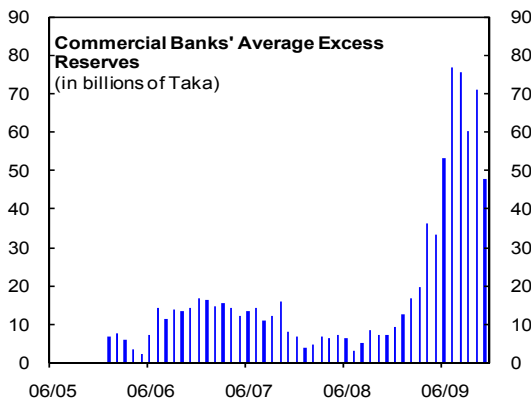
Appreciation pressure on the taka remains substantial



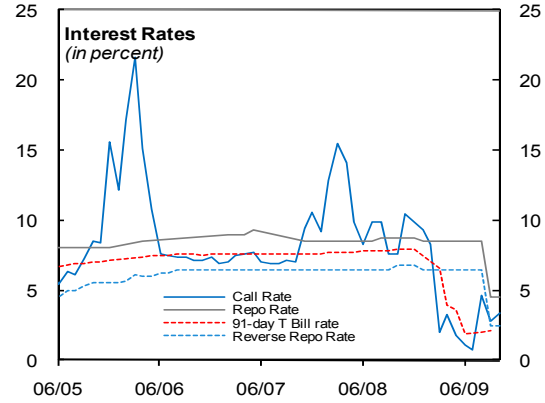
Banks' net open position limits were relaxed in September



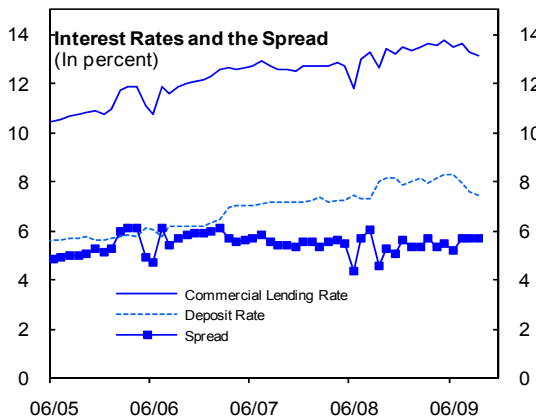
The liquidity injection from unsterilized interventions has boosted banks' liquidity...



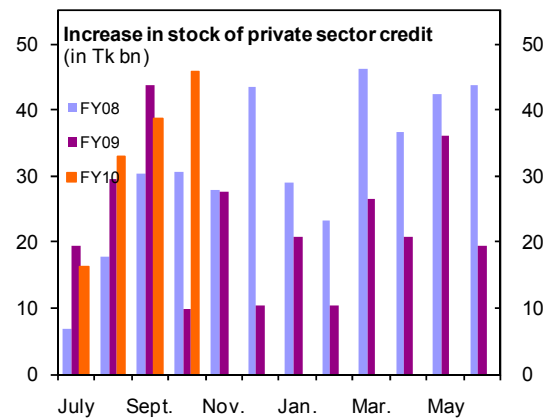
...and pushed short-term interest rates down, as BB discontinued its repo/reverse repo monetary policy framework over the summer



Lending rates have started to ease but the spread has shown little movement



Private sector credit is picking up rapidly



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

1/ The exchange market pressure (EMP) index is defined as: percentage change in the Tk/US\$-exchange rate plus the change in international reserves (net of currency valuation changes) scaled by reserve money.

**Table 1. Bangladesh: Key Economic Indicators, FY2007–14 1/**

	FY07	FY08	Est. Projections					
			FY09	FY10	FY11	FY12	FY13	FY14
Nominal GDP (FY09): US\$89 billion			Main export (percent of total): garments and textiles (79)					
Population (FY08): 142.5 million			FDI (percent of GDP, FY09): US\$941 million (1.0)					
GDP per capita (FY08): US\$554			Government debt: 45.4 percent of GDP					
Poverty rate (FY05): 40.8 percent			Foreign government debt: 53 percent of total debt					
National income and prices (percent change)								
Real GDP	6.4	6.2	5.9	5.0	5.8	6.0	6.0	6.0
GDP deflator	6.8	8.0	6.4	6.4	6.0	5.0	5.0	4.5
CPI inflation (annual average)	7.2	9.9	6.7	7.8	7.0	6.0	5.0	4.5
CPI inflation (end of period)	9.2	10.0	2.2	10.0	7.2	5.0	5.0	4.0
Investment and savings (percent of GDP)								
Gross investment	24.5	24.2	23.3	24.2	24.4	24.6	24.8	25.4
Private	19.0	19.3	18.6	19.0	19.2	19.4	19.5	20.2
Public	5.4	5.0	4.7	5.2	5.2	5.2	5.2	5.2
National savings	25.9	25.1	26.2	27.1	25.8	25.4	25.6	26.2
Private	24.1	23.4	24.9	25.7	24.7	24.3	24.4	25.0
Public	1.7	1.7	1.3	1.4	1.1	1.2	1.2	1.2
Central government operations (percent of GDP)								
Total revenue	10.2	10.8	10.4	10.7	10.5	10.6	10.7	10.7
Tax	8.2	8.8	8.6	8.8	8.8	8.9	9.0	9.0
Nontax	2.0	2.0	1.8	1.9	1.7	1.7	1.7	1.7
Total expenditure	13.4	15.9	14.1	14.8	14.8	14.9	14.9	14.9
Current expenditure	9.1	9.6	9.8	10.0	10.1	10.2	10.2	10.2
Of which: Interest payments	1.9	2.5	2.4	2.3	2.4	2.5	2.5	2.5
Of which: Subsidies and transfers	3.0	3.4	3.8	3.9	3.9	3.8	3.8	3.8
Annual Development Program	4.0	3.4	3.2	3.3	3.3	3.3	3.3	3.3
Other expenditures	0.3	3.0	1.1	1.5	1.4	1.4	1.4	1.4
Overall balance (excluding grants)	-3.2	-5.1	-3.7	-4.0	-4.3	-4.2	-4.2	-4.1
Primary balance	-1.3	-2.6	-1.3	-1.7	-1.9	-1.8	-1.7	-1.6
Financing (net)	3.2	5.1	3.7	4.0	4.3	4.2	4.2	4.1
Domestic	1.9	2.6	2.4	2.6	3.0	3.0	2.9	2.8
External	1.3	2.5	1.3	1.5	1.2	1.2	1.3	1.3
Total central government debt (percent of GDP)	48.8	46.7	45.3	44.0	44.1	44.0	43.8	43.6
Money and credit (end of fiscal year; percent change)								
Net domestic assets	12.6	18.3	17.6	14.7	16.6	16.9	16.5	16.1
Credit to private sector	15.1	25.1	14.6	15.7	16.6	16.6	17.1	17.2
Broad money (M2)	17.1	17.6	19.2	18.8	17.2	16.6	16.4	16.2
Balance of payments (in billions of U.S. dollars)								
Exports, f.o.b.	12.1	14.2	15.6	16.1	17.3	19.2	21.8	24.6
(Annual percent change)	15.8	17.4	10.1	3.2	7.6	11.1	13.3	12.9
Imports, f.o.b.	-15.5	-19.5	-20.3	-21.0	-23.5	-26.0	-29.0	-32.3
(Annual percent change)	16.6	25.6	4.2	3.5	11.7	11.0	11.5	11.2
Current account	1.0	0.7	2.5	2.9	1.5	0.9	1.0	1.1
(Percent of GDP)	1.4	0.9	2.8	2.9	1.4	0.8	0.8	0.8
Gross official reserves (in billions of U.S. dollars)	5.1	6.1	7.5	10.9	12.3	13.2	14.5	16.2
In months of imports of goods and services	2.7	3.1	3.6	4.7	4.8	4.6	4.6	4.6
Exchange rate (taka per US\$; period average)	68.8	68.6	68.8	...	...	...	...	...
Nominal effective rate (2000=100)	66.9	63.6	66.8	...	...	...	...	...
Real effective rate (2000=100)	83.8	84.9	90.2	...	...	...	...	...
Terms of trade (percent change)	-3.0	0.7	2.5	...	...	...	...	...
Nominal GDP (in billions of taka)	4,725	5,458	6,149	6,867	7,698	8,568	9,536	10,563

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

1/ Fiscal year begins July 1.

2/ Consists of other capital, net lending, food account balances, check float and discrepancy.

3/ Includes assumption of BPC liabilities of 1.4 percent of GDP in FY08.

**Table 2. Bangladesh: Balance of Payments, FY07–14 1/**  
(In millions of U.S. dollars, unless otherwise indicated)

	FY07	FY08	Est. FY09	Projections				
				FY10	FY11	FY12	FY13	FY14
Trade balance	-3,459	-5,330	-4,708	-4,927	-6,170	-6,829	-7,255	-7,709
Exports (f.o.b.)	12,053	14,151	15,583	16,076	17,296	19,213	21,772	24,580
<i>Of which:</i> RMG sector	9,211	10,700	12,348	12,780	13,675	15,179	17,152	19,211
Imports (f.o.b.)	-15,511	-19,481	-20,291	-21,003	-23,466	-26,042	-29,026	-32,289
<i>Of which:</i> Crude oil and petroleum products	-2,018	-2,480	-2,581	-2,918	-3,185	-3,470	-3,764	-4,024
Services	-1,255	-1,525	-1,621	-1,909	-2,254	-2,647	-3,111	-3,598
Income	-884	-994	-1,361	-1,350	-1,477	-1,570	-1,680	-1,802
Transfers	6,554	8,551	10,226	11,057	11,400	11,969	13,018	14,161
Official current transfers 2/	97	149	72	90	95	98	102	105
Private transfers	6,457	8,402	10,154	10,966	11,305	11,871	12,917	14,056
<i>Of which:</i> Workers' remittances	5,979	7,915	9,689	10,464	10,778	11,317	12,335	13,446
Current account balance	957	702	2,536	2,870	1,500	922	973	1,052
Capital and financial account balance	360	-371	-478	-123	-43	237	471	735
Capital account	490	509	451	609	670	737	795	859
Financial account	-130	-880	-929	-732	-712	-499	-324	-124
Foreign direct investment	760	748	941	700	764	828	906	1,000
Portfolio investment	106	47	-159	36	40	44	48	53
Medium and long term loans	508	823	563	796	586	635	734	831
Disbursements	1,037	1,403	1,204	1,510	1,335	1,426	1,551	1,686
Amortization	-529	-580	-641	-714	-749	-791	-818	-855
Other capital 3/	-1,504	-2,498	-2,274	-2,265	-2,103	-2,006	-2,012	-2,009
Overall balance	1,317	331	2,058	2,747	1,457	1,160	1,444	1,787
Financing items	-1,317	-331	-2,058	-2,747	-1,457	-1,160	-1,444	-1,787
Bangladesh Bank	-1,317	-331	-2,058	-2,747	-1,457	-1,160	-1,444	-1,787
Assets (- increase)	-1,602	-799	-1,883	-2,709	-1,374	-963	-1,268	-1,704
Liabilities 4/	285	468	-175	-39	-83	-197	-176	-83
Memorandum items:								
Current account balance (percent of GDP)	1.4	0.9	2.8	2.9	1.4	0.8	0.8	0.8
Export growth rate (percent)	15.8	17.4	10.1	3.2	7.6	11.1	13.3	12.9
Import growth rate (percent)	16.6	25.6	4.2	3.5	11.7	11.0	11.5	11.2
Gross official reserves (in millions of U.S. dollars)	5,077	6,149	7,471	10,905	12,279	13,242	14,510	16,214
(In months of imports of goods and services)	2.7	3.1	3.6	4.7	4.8	4.6	4.6	4.6
Net international reserves (in millions of U.S. dollars)	3,538	4,013	5,345	8,092	9,549	10,708	12,152	13,939
Medium and long-term external public debt (in US\$)	19,897	20,219	21,564	22,360	22,947	23,581	24,315	25,146
(In percent of GDP)	29.1	25.6	24.1	22.5	21.4	20.7	19.9	19.2
Net aid flows/GDP (in percent)	1.6	1.9	1.2	1.5	1.3	1.3	1.3	1.4
Nominal GDP (in millions of U.S. dollars)	68,420	79,561	89,385	99,526	107,248	113,867	122,045	130,811

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

1/ Fiscal year begins July 1.

2/ Excludes official capital grants.

3/ Includes trade credits, long-term borrowing, short-term financing for Bangladesh Petroleum Company (BPC), commercial bank net borrowing, and errors and omissions.

4/ Includes Asian Clearing Union balances.

Table 3. Bangladesh: Central Government Operations, FY2007–2014 1/

	FY07	FY08	FY09			FY10		FY11	FY12	FY13	FY14
			Original Budget	Revised Budget	Est.	Budget	Proj. Staff	Proj.	Proj.	Proj.	Proj.
(In billions of taka)											
Total Revenue and Grants	511	615	757	741	682	846	785	862	970	1,083	1,206
Total revenue	483	591	694	692	640	795	737	811	911	1,018	1,133
Tax revenue	390	481	568	555	529	640	606	679	765	854	953
NBR taxes	371	458	545	530	502	610	576	646	728	813	907
Non-NBR taxes	19	23	23	25	27	30	30	33	37	41	45
Nontax revenue	94	110	126	137	111	155	132	132	147	163	181
Foreign Grants	28	24	63	49	42	51	47	52	59	66	73
Total expenditure	634	869	1,000	941	868	1,138	1,015	1,139	1,274	1,421	1,570
Current expenditure	430	521	619	639	602	707	690	781	871	973	1,082
Pay and allowances	129	127	155	151	135	160	165	192	214	238	264
Goods and services	62	71	83	92	79	89	89	99	108	121	134
Interest payments	90	135	126	133	150	158	158	183	212	239	269
Subsidies and transfers	143	186	245	259	236	258	271	298	329	366	405
Block allocations	6	2	11	4	2	43	7	8	9	10	11
Annual Development Program	191	183	256	230	196	305	225	252	285	317	343
Non-ADP capital spending	28	59	88	59	45	103	77	87	97	107	119
Net lending 2/	-11	121	20	6	19	16	16	18	20	23	25
Other expenditures 3/	-4	-16	17	8	1	7	7	0.0	0.0	0.0	0.0
Overall balance (including grants)	-123	-254	-243	-200	-186	-292	-230	-276	-303	-338	-363
Net financing	123	254	243	200	186	292	230	276	303	338	363
External	31	113	73	58	39	87	55	42	48	57	67
Domestic	91	141	170	142	147	206	176	234	256	280	296
Banks	41	110	135	107	103	168	118	176	192	210	222
Nonbanks	50	32	35	35	44	38	58	59	64	70	74
(In percent of GDP, unless otherwise specified)											
Total Revenue and Grants	10.8	11.3	12.3	12.1	11.1	12.3	11.4	11.2	11.3	11.4	11.4
Total revenue	10.2	10.8	11.3	11.2	10.4	11.6	10.7	10.5	10.6	10.7	10.7
Tax revenue	8.2	8.8	9.2	9.0	8.6	9.3	8.8	8.8	8.9	9.0	9.0
NBR taxes	7.9	8.4	8.9	8.6	8.2	8.9	8.4	8.4	8.5	8.5	8.6
Non-NBR taxes	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Nontax revenue	2.0	2.0	2.0	2.2	1.8	2.3	1.9	1.7	1.7	1.7	1.7
Foreign grants	0.6	0.4	1.0	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Total expenditure	13.4	15.9	16.3	15.3	14.1	16.6	14.8	14.8	14.9	14.9	14.9
Current expenditure	9.1	9.6	10.1	10.4	9.8	10.3	10.0	10.1	10.2	10.2	10.2
Pay and allowances	2.7	2.3	2.5	2.6	2.2	2.3	2.4	2.5	2.5	2.5	2.5
Goods and services	1.3	1.3	1.3	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Interest payments	1.9	2.5	2.0	2.2	2.4	2.3	2.3	2.4	2.5	2.5	2.5
Subsidies and transfers	3.0	3.4	4.0	4.2	3.8	3.8	3.9	3.9	3.8	3.8	3.8
Block allocations	0.1	0.0	0.2	0.1	0.0	0.6	0.1	0.1	0.1	0.1	0.1
Food account surplus(-)/deficit(+)	-0.1	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Annual Development Program	4.0	3.4	4.2	3.7	3.2	4.4	3.3	3.3	3.3	3.3	3.3
Non-ADP capital spending	0.6	1.1	1.4	1.0	0.7	1.5	1.1	1.1	1.1	1.1	1.1
Net lending 2/	-0.2	2.2	0.3	0.1	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Other expenditures 3/	-0.1	-0.3	0.3	0.1	0.0	0.1	0.1	0.0	0.0	0.0	0.0
Overall balance (including grants)	-2.6	-4.6	-3.9	-3.3	-3.0	-4.3	-3.4	-3.6	-3.5	-3.5	-3.4
Primary balance (including grants)	-0.7	-2.2	-1.9	-1.1	-0.6	-2.0	-1.1	-1.2	-1.1	-1.0	-0.9
Overall balance (excluding grants)	-3.2	-5.1	-5.0	-4.1	-3.7	-5.0	-4.0	-4.3	-4.2	-4.2	-4.1
Net financing	2.6	4.6	3.9	3.3	3.0	4.3	3.4	3.6	3.5	3.5	3.4
External	0.7	2.1	1.2	0.9	0.6	1.3	0.8	0.5	0.6	0.6	0.6
Domestic	1.9	2.6	2.8	2.3	2.4	3.0	2.6	3.0	3.0	2.9	2.8
Banks	0.9	2.0	2.2	1.7	1.7	2.4	1.7	2.3	2.2	2.2	2.1
Nonbanks	1.1	0.6	0.6	0.6	0.7	0.5	0.8	0.8	0.7	0.7	0.7
Memorandum items:											
Nominal GDP (in billions of taka)	4,725	5,458	6,149	6,149	6,149	6,867	6,867	7,698	8,568	9,536	10,563

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

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

2/ Includes bonds (Tk 75 billion) issued to three SCBs to assume BPC's liabilities in FY08.

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

Table 4. Bangladesh: Central Bank Balance Sheet, June 2007–June 2010

	Actual							Proj.
	Jun-07	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Jun-10
	(End of period; in billions of taka)							
Net international reserves 1/	243	274	279	264	287	366	462	558
Net domestic assets 1/	151	202	268	285	246	261	217	101
Net credit to central government	243	245	243	231	236	271	213	271
Credit to other nonfinancial public sector	0	1	1	1	1	1	1	1
Credit to deposit money banks	57	67	66	65	67	61	60	61
Other items, net 1/	-149	-111	-42	-12	-57	-71	-57	-231
Reserve money	394	476	547	549	533	627	679	659
Currency	288	356	421	408	381	394	447	470
Reserves 2/	106	118	125	140	151	232	231	189
	(Change since start of fiscal year; in billions of taka)							
Net international reserves 1/	89	30	5	-9	13	93	96	192
Net domestic assets 1/	-34	51	66	83	44	59	-44	-161
Net credit to central government	6	3	-2	-14	-9	25	-57	0
Credit to other nonfinancial public sector	0	1	0	0	0	0	0	0
Credit to deposit money banks	-2	9	-1	-2	0	-6	-1	0
Other items, net 1/	-38	38	69	99	53	40	14	-161
Reserve money	55	81	71	74	57	152	52	32
Currency	39	69	64	52	25	38	53	76
Reserves 2/	16	12	7	22	33	114	-1	-43
	(Year-on-year percent change)							
Net international reserves 1/	57	12.4	5.1	3.8	12.6	33.8	65.7	52.5
Net domestic assets 1/	-18	34.0	78.2	33.4	49.3	29.4	-18.9	-61.5
Net credit to central government	3	1.2	10.4	-0.6	37.6	10.3	-12.2	0.0
Credit to other nonfinancial public sector	0	3.0	0.0	0.0	0.0	0.0	0.0	0.0
Credit to deposit money banks	-4	16.5	14.9	-15.9	-20.3	-8.7	-9.6	0.0
Other items, net 1/	34	-25.7	-67.3	-87.8	-37.1	-36.1	35.2	227.2
Reserve money	16	20.6	31.5	17.3	27.0	31.9	24.3	5.0
Currency	16	23.8	37.6	15.2	19.3	10.7	6.3	19.1
Reserves 2/	17	11.7	15.2	24.0	51.6	96.2	84.6	-18.4
Memorandum items:								
Net international reserves (in millions of U.S. dollars) 1/	3,538	4,013	4,132	3,872	4,182	5,345	6,698	8,092
Flow since start of fiscal year (in millions of U.S. dollars) 1/	1,316	475	119	-141	169	1,332	1,354	2,747
Required domestic cash reserves (in billions of taka)	101	118	123	129	133	143	147	167
Excess domestic cash reserves (in billions of taka)	5	0	2	11	18	89	84	22
Exchange rate, end of period (taka/dollar)	68.8	68.5	68.5	68.9	69.0	69.0	69.1	69.0
Nominal GDP (in billions of taka)	4,725	5,458	5,631	5,804	5,977	6,149	6,329	6,867

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

1/ Calculated from monetary data using end-of-period exchange rates.

2/ Liabilities from banks' foreign currency clearing accounts and non-bank deposits are not included in reserves.

Table 5. Bangladesh: Monetary Survey, June 2007–June 2010

	Jun-07	Jun-08	Sep-08	Dec-08	Mar-09	June-09	Sep-09	Proj. Jun-10
(End of period; in billions of taka)								
Net foreign assets	326	371	373	347	376	475	559	667
Bangladesh Bank	243	274	279	264	287	366	462	558
Commercial banks	83	97	94	83	89	109	97	109
Net domestic assets	1,788	2,116	2,295	2,372	2,406	2,489	2,561	2,855
Domestic credit	1,982	2,417	2,557	2,619	2,681	2,798	2,874	3,254
Net credit to central government	338	448	475	489	495	551	536	669
Credit to other nonfinancial public sector	139	84	105	106	104	88	91	88
Credit to private sector	1,506	1,884	1,977	2,025	2,083	2,159	2,247	2,497
Other items, net	-194	-300	-262	-247	-275	-309	-314	-399
Broad money (M2)	2,114	2,487	2,668	2,719	2,782	2,964	3,119	3,522
Currency in circulation	266	313	336	343		360	409	428
Deposits	1,848	2,174	2,332	2,376		2,603	2,710	3,093
(Change since start of fiscal year; in billions of taka)								
Net foreign assets	108	45	2	-24	5	104	84	192
Net domestic assets	200	328	179	256	290	373	72	366
Domestic credit	250	434	141	203	265	381	76	456
Net credit to central government	41	110	27	41	47	103	-15	118
Credit to other nonfinancial public sector	12	-54	21	21	20	4	3	0
Credit to private sector	197	378	93	141	198	275	88	338
Other items, net	-50	-106	39	53	25	-9	-5	-90
Broad money (M2)	308	372	181	232	295	477	156	558
(Year-on-year percent change)								
Net foreign assets	49.7	13.6	10.0	2.7	12.3	28.0	49.8	40.5
Net domestic assets	12.6	18.3	26.1	20.5	21.1	17.6	11.6	14.7
Domestic credit	14.5	21.9	25.4	20.4	18.8	15.8	12.4	16.3
Net credit to central government	14.0	32.6	17.3	16.7	26.9	23.0	12.9	21.4
Credit to other nonfinancial public sector	9.3	-39.2	43.4	12.2	-1.5	4.5	-13.3	-0.1
Credit to private sector	15.1	25.1	26.7	21.8	18.2	14.6	13.6	15.7
Other items, net	35.1	54.8	19.8	19.4	2.0	2.9	19.8	29.1
Broad money (M2)	17.1	17.6	23.5	17.9	19.8	19.2	16.9	18.8
(In billions of taka, unless otherwise noted)								
Memorandum items:								
Broad money multiplier	5.4	5.2	4.9	5.0	5.2	4.7	4.6	5.3
Broad money velocity	2.2	2.2	2.1	2.1	2.1	2.1	2.0	1.9
Net domestic financing (since beginning of FY)	91	141	38	63	80	147	0	176
Bank	41	110	27	41	47	103	-15	118
Nonbanks	50	32	11	22	33	44	14	58
Government securities held by nonbanks	451	483	494	506	517	539	567	596
Net foreign assets of DMBs (millions of US\$)	1,203	1,336	1,373	1,198	1,290	1,310	1,399	1,310
Change since beginning of FY	299	133	37	-175	92	-26	89	0
Exchange rate, eop (tk/\$)	68.8	68.5	68.5	68.9	69.0	69.0	69.1	69.0
Nominal GDP (billions of taka)	4,725	5,458	5,631	5,804	5,977	6,149	6,329	6,867

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



**Table 6. Bangladesh: Financial Soundness Indicators**

	2004	2005	2006	2007	2008
<b>Capital Adequacy</b>					
Regulatory capital to risk-weighted assets	6.9	7.3	5.1	7.4	10.1
State-owned commercial banks (BB)	7.9	7.9	8.0	1.9	2.4
State-owned commercial banks (Corrected)	8.4	9.4	-7.8	6.4	7.8
Specialized development banks	8.0	8.1	8.0	8.6	8.8
Private commercial banks	6.9	6.6	6.7	7.8	8.6
Foreign commercial banks	20.3	20.6	19.7	17.8	19.2
Regulatory capital to assets	4.3	4.7	3.3	4.6	6.5
Regulatory Tier I capital to risk-weighted assets	5.7	6.0	3.3	5.3	7.4
Regulatory Tier I capital to total assets	3.5	3.8	2.1	3.3	4.8
Non-performing loans to regulatory capital	265.1	195.9	275.3	205.9	116.1
<b>Asset Quality Standards</b>					
Non-performing loans to total loans	17.5	13.2	12.8	14.5	11.2
State-owned commercial banks	8.6	8.9	22.8	29.0	28.0
Specialized development banks	25.0	18.0	14.3	13.5	11.7
Private commercial banks	7.4	5.1	4.9	5.4	5.1
Foreign commercial banks	4.3	3.1	2.8	2.9	3.7
Loan provisions to total non-performing loans	26.8	28.3	45.2	43.0	50.1
Loan provisions to total loans	4.7	3.7	5.8	6.2	5.6
<b>Profitability</b>					
Return on equity	-12.1	12.1	-37.3	18.7	20.3
State-owned commercial banks	-213.6	-41.8	-419.0	-16.3	68.5
Specialized development banks	-17.8	-29.2	-15.8	-10.5	-9.5
Private commercial banks	61.1	65.0	73.7	59.0	46.4
Foreign commercial banks	57.3	42.0	46.2	48.6	46.1
Return on assets	-0.5	0.6	-1.2	0.9	1.3
State-owned commercial banks	-3.2	-0.6	-6.6	-0.3	1.1
Specialized development banks	-1.0	-1.6	-0.9	-0.6	-0.6
Private commercial banks	1.4	1.4	1.5	1.4	1.4
Foreign commercial banks	3.3	3.4	3.3	3.2	2.9
<b>Sensitivity to market risk</b>					
Net open position in foreign exchange to capital	20.3	15.2	31.5	14.7	9.9
<b>Composition of credit (in percent of total)</b>					
Oil and Gas	1.2	1.4	1.8	0.8	0.9
Industry (other)	33.4	31.3	32.2	34.5	36.0
Agriculture	9.8	9.0	8.2	7.7	6.8
Forestry	3.1	2.5	2.4	2.1	1.8
Trade	24.5	22.6	22.1	24.3	24.0
Construction	3.3	3.8	4.1	3.4	3.3
Households	3.4	3.4	3.3	4.7	4.8
Other	21.2	26.1	26.0	22.6	22.5

Sources: Bangladesh Bank; and Fund staff estimates.

INTERNATIONAL MONETARY FUND  
INTERNATIONAL DEVELOPMENT ASSOCIATION

BANGLADESH

**Joint IMF/World Bank Debt Sustainability Analysis 2009<sup>1</sup>**

Prepared by the Staffs of the International Monetary Fund and  
the International Development Association

Approved by Kalpana Kochhar and Tom Dorsey (IMF)  
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December 23, 2009

*Bangladesh's risk of debt distress is low based on external debt indicators. Bangladesh's external debt burden indicators do not breach the relevant policy-dependent indicative thresholds under the baseline scenario and also do not breach the thresholds under the stress tests<sup>2</sup>. Debt burden indicators are significantly worse when domestic debt is included. Accordingly, this analysis reveals a more elevated risk of debt distress on public debt compared to results based solely on external debt. Staffs will continue to monitor closely the evolution of domestic debt and the government's ability to mobilize domestic resources, especially tax revenues.*

1. **The results of this DSA are similar to those of the previous DSA.**<sup>3</sup> The primary difference between the two is that, whereas in the previous DSA one of the thresholds was

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<sup>1</sup> This DSA has been prepared jointly by World Bank and IMF staffs and in consultation with the Asian Development Bank using the debt sustainability framework for low-income countries approved by the Boards of both institutions. The DSA is based on macroeconomic data gathered in the context of IMF missions to Dhaka in 2009. Estimated debt outstanding and disbursed as of end-FY2009 provides the basis for the debt figures. The starting point for the previous DSA was estimated debt outstanding and disbursed as of end-FY2007.

<sup>2</sup> The low-income country debt sustainability framework (LIC DSF) recognizes that better policies and institutions allow countries to manage higher levels of debt, and thus the threshold levels are policy-dependent. Bangladesh's policies and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA), place it as a "medium performer." The relevant indicative thresholds for this category are: 40 percent for the NPV of debt-to-GDP ratio, 150 percent for the NPV of debt-to-exports ratio, 250 percent for the NPV of debt-to-revenue ratio, 20 percent for the debt service-to-exports ratio, and 30 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed external debt.

<sup>3</sup> IMF Country Report No. 08/334 (Annex I).

marginally breached in the most extreme stress test, this is not the case in the current DSA.<sup>4</sup> The projections of the external debt to GDP ratio in the previous DSA were, by and large, accurate as the outturns for FY2008 and FY2009 deviated only marginally from the projections. Compared to the previous DSA, the baseline assumptions for economic growth are more conservative, the projected rate of external debt accumulation is somewhat lower and, reflecting lower global interest rates, the discount rate is reduced from 5 percent to 4 percent.<sup>5</sup> Longer-term debt dynamics are adversely affected by the lower growth assumptions but positively affected by the lower projected rate of debt accumulation. The lower discount rate raises the net present value of external debt across the board.

2. **Box 1 summarizes the medium-term macroeconomic framework underlying the DSA.** Most notably, it is based on projections for growth that are in line with the average growth rate over the past ten years and somewhat lower than those in Bangladesh's own medium-term framework.

### I. EXTERNAL DEBT SUSTAINABILITY ANALYSIS

3. **All external debt indicators remain well below the policy-dependent debt burden thresholds under the baseline scenario, and no thresholds are breached under standardized stress test.**<sup>6</sup> Bangladesh's external debt was equivalent to 24 percent of GDP at the end of FY2009, down from 27 percent of GDP at the end of FY2007. The declining trend in the external debt to GDP ratio reflects prudent borrowing and strong economic growth. The main results of the external DSA are as follows:

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<sup>4</sup> The relative magnitude of the most extreme shock in last year's DSA (the combination of one-half standard deviation shock to net transfers, export growth, GDP growth, and the GDP deflator) is now smaller than in last year's DSA because the historical averages of the macroeconomic variables are somewhat higher and the standard deviations are somewhat lower for the period 2000-2009 used in this DSA than for the period 1998-2007 used in the previous DSA. For instance, the 10-year average of the growth of exports of goods and services is now 11.5 percent, up from 11.0 in the previous DSA, and the standard deviation is now 7.2 percent, down from 7.7 percent in the previous DSA. Since the values of the key variables under the shock are simulated to be the historical average subtracted of half a standard deviation, exports of goods and services are now somewhat higher vis-à-vis the baseline compared to the analysis done in the previous DSA.

<sup>5</sup> The discount rate was reduced by a full percentage point after the six-month average U.S. dollar commercial interest reference rate fell below the earlier 5 percent discount rate by more than a full percentage point for a period of six months (see staff guidance note <http://www.imf.org/external/np/pp/eng/2008/070308.pdf>).

<sup>6</sup> Private sector external debt remains very small. Capital controls generally impede borrowing from abroad. And while industrial projects in Bangladesh can access medium and long-term external borrowing with prior BOI approval, the absence of a sovereign credit rating raises the country risk premium, making external borrowing relatively expensive.

### Box 1. Bangladesh: Macroeconomic Assumptions Underlying the DSA

**Real GDP growth** in the medium term is projected at 6 percent, slightly above the 10-year average of 5.8 percent. It is assumed to average 6¼ percent in the long run. This is lower than in Bangladesh's own medium-term framework, reflecting the fact that the government which came to power in January 2009 is still in the process of articulating an agenda of growth-enhancing structural reforms.

**Inflation**, as measured by the GDP deflator in domestic currency, decelerates from 6.4 percent in FY09 to 4.5 percent in FY14, reflecting declining import prices and moderating demand pressures.

The growth of **exports** and **imports** of goods and services is strong in the medium term (12½ percent and 12 percent, respectively). As the economy continues to become more open, exports and imports both will increase in terms of GDP. **Remittances** are projected to increase by 9 percent per annum.

The **current account** (including grants) continues to show a surplus as remittances continue to offset the merchandise trade deficit. Deeper macroeconomic and structural reforms, which are not envisaged in this baseline, would boost imports further and push the current account to a deficit. Such reforms would trigger larger FDI inflows and donor support which would finance part of the higher imports.

**Net aid inflows** (disbursements of grants and loans net of amortization payments) amount to about 1.3 percent of GDP in the medium and long term. The strong balance of payments, limited momentum for structural reforms, and slow implementation of existing donor-supported projects are holding back the disbursement of project and program loans. And amortization payments are edging up over time (they will amount to about US\$720 million in FY2010 and rise to US\$850 million in FY14, up from US\$580 million in FY08). The larger net aid inflows in FY08 (1.9 percent of GDP) was in response to the two cyclones that hit Bangladesh that year. The net aid inflow in FY2010 (1.5 percent of GDP) is also expected to exceed the longer-term average because of the large budget support from the ADB (¾ percent of GDP) in response to the global recession.

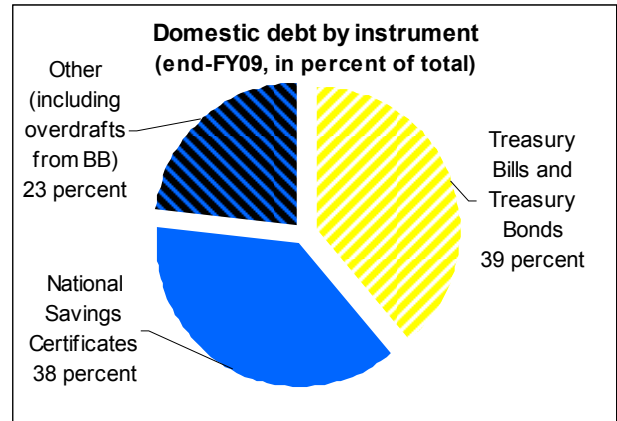
The **grant element of new external borrowing** is assumed to remain at about 30 percent.

The **primary fiscal deficit** (including grants) is assumed to average 1 percent of GDP over the medium term, about 0.4 percent of GDP smaller than the average of the past 10 years. Domestic revenue is projected to remain below 11 percent of GDP over the medium-term.

**Real interest rates** on domestic currency government debt are assumed to average about 6 percent in the medium term, and decline gradually as financial markets develop.

- **All debt indicators in the baseline scenario are expected to decline over the 20-year projection period** (Table 1 and Figure 1). The NPV of external debt-to-GDP ratio decreases from about 20 percent in 2009 to less than 10 percent (compared to an indicative threshold of 40 percent) during the projection period, while the NPV of external debt-to-exports ratio decreases from 99 percent in 2009 to 25 percent (compared to an indicative threshold of 150 percent), and the debt service ratio decreases from 6 percent in 2010 to 2½ percent (compared to an indicative threshold of 20 percent).

- The standard stress tests do not reveal serious vulnerabilities<sup>7</sup>** although the NPV of debt to revenues threshold is almost breached in the most extreme test, in which net non-debt creating flows (e.g. official transfers, remittances, and FDI) are at their historical average minus one standard deviation in 2011-12 (Table 2, Figure 1). The strong increase in remittances in Bangladesh in recent years, from about 8 percent of GDP in FY06 to almost 11 percent of GDP in FY09, has improved the capacity to repay beyond what is recognized in the DSA framework—which only uses GDP, exports, and government revenues as proxies for countries’ capacity to repay.<sup>8</sup> The increase in remittances—a relatively stable source of foreign inflows—has reduced vulnerabilities.



## II. PUBLIC DEBT SUSTAINABILITY

### ANALYSIS<sup>9</sup>

- Domestic debt has been rising modestly in recent years, from 20 percent of GDP in FY06 and FY07 to 21.2 percent of GDP in FY09.** Close to 40 percent of the domestic debt is in the form of treasury bills and treasury bonds, held mostly by domestic commercial banks. National savings certificates, mostly held by the nonbank private sector, constitute another large share of the domestic debt (38 percent). Bangladesh Bank holds more than 20 percent of the government’s domestic debt, in the form of nontradable overdrafts and a small amount of devolved treasury bills and bonds (0.6 percent of GDP at end-FY09).<sup>10</sup>

<sup>7</sup> Debt and debt burden indicators in the “historical scenario” in Figure 1 and Figure 2 are less favorable than in the baseline. The historical scenario puts key variables such as real GDP growth and the non-interest current account in percent of GDP during 2010-2030 at their historical averages recorded during 2000-2009. The baseline scenario builds on the recent favorable developments in remittances and exports of textiles and garments. If these assumptions are replaced, in the historical scenario, by the somewhat less favorable numbers realized during 2000-09, then the debt and debt burden indicators develop less favorably.

<sup>8</sup> A recent review of some aspects of the Low-Income Country Debt Sustainability Framework recommended greater recognition of remittances in DSAs for countries where they are large, including in the determination of risk ratings (see <http://www.imf.org/external/pp/longres.aspx?id=4358>).

<sup>9</sup> Public debt includes domestic central government debt and external public and publicly guaranteed debt.

<sup>10</sup> It should be noted that the government of Bangladesh maintains large and growing deposit balances with commercial banks. According to the monetary survey, these balances amounted to Tk 183 billion or 3 percent of GDP at the end of FY2009, up from Tk 122 billion or 2.6 percent of GDP at the end of FY2007. Therefore, net domestic government debt was about 18.2 percent of GDP at the end of FY2009. The substantial government deposits reflect inefficiencies in budget and cash management. They are mostly held by autonomous and semi-autonomous government bodies. Because the deposits are largely outside the control of the central government, the public debt sustainability analysis does not take them into account and focuses on the gross public debt.

5. **In the baseline scenario, the NPV of public debt-to-GDP ratio remains steady at about 40 percent of GDP.** The decline in the NPV of external public debt to GDP ratio is offset by a rising domestic debt-to-GDP ratio. The NPV of total public debt remains at 40 percent of GDP through FY2015 and declines to 37 percent of GDP in FY2030. The NPV of public debt-to-domestic revenue ratio follows a similar trend, remaining broadly steady between FY2010 and FY2015 and gradually declining in the long run.

6. **The alternative scenarios and bound tests indicate that the projected paths of debt indicators are sensitive to alternative assumptions and point to sizeable risks** (Table 4). Subsidies to loss-making state-owned enterprises have for the most part been brought onto the budget. This has reduced fiscal risks. However, energy (e.g. electricity and diesel) and imported fertilizer remain underpriced and a further rise in world market prices could create contingent liabilities of the government to state-owned enterprises as no mechanisms exist to automatically adjust domestic retail prices to reflect higher import costs. Under the assumption of a one-off debt creating flow of 10 percent of GDP—to securitize the contingent liabilities, as was done in FY08 at a smaller scale to regularize BPC’s debts to state-owned commercial banks—the debt service to revenue ratio reaches 36 percent in FY2015, compared with the baseline ratio of 28 percent.

7. **It should be noted that the baseline assumes continued under-implementation of the government’s Annual Development Program (ADP).**<sup>11</sup> Full implementation of the ADP in FY2010, while desirable to boost long-term growth, could raise the overall fiscal deficit by more than one percent of GDP. The bulk of the ADP is typically financed by concessional external financing. Therefore, full implementation of the ADP would likely entail additional concessional external financing—over and above what is assumed in the baseline scenario. To the extent that the higher ADP spending would be financed through the issuance of additional domestic debt, some of which carries interest rates of 12 percent, this would put key public debt and public debt service ratios on higher and possibly rising paths over the medium term.

### III. DEBT MANAGEMENT

8. **In response to a request from the authorities, a joint Bank/Fund mission visited Bangladesh in November 2009 to provide technical assistance in developing a reform plan for improving debt management functions and operations.** The mission built on the findings of previous work done by the Bank and the Fund in Bangladesh, which included assessing strengths and weaknesses in debt management performance and capacity and designing a medium-term debt management strategy (MTDS).<sup>12</sup>

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<sup>11</sup> During the past five fiscal years, successive governments on average managed to implement 73 percent of the amount included in the original budget for ADP spending. In FY09, ADP spending fell short of the original budget by 1 percentage point of GDP.

<sup>12</sup> There was a joint Bank-Fund mission to develop a MTDS (January 2008), followed by a Bank mission to apply the Debt Management Performance Assessment (DeMPPA) tool (February 2008).

9. **The November 2009 mission focused recommendations on several key areas where procedural and capacity issues have been identified**, including (i) improving institutional arrangements for managing total public sector debt, with a view also to better integrate domestic debt in the debt recording system; (ii) developing capacity and procedures for improved cash balance management and cash-flow forecasting; and (iii) reducing operational risks, given deficiencies with regard to the recording and reconciliation of data.

#### IV. CONCLUSION

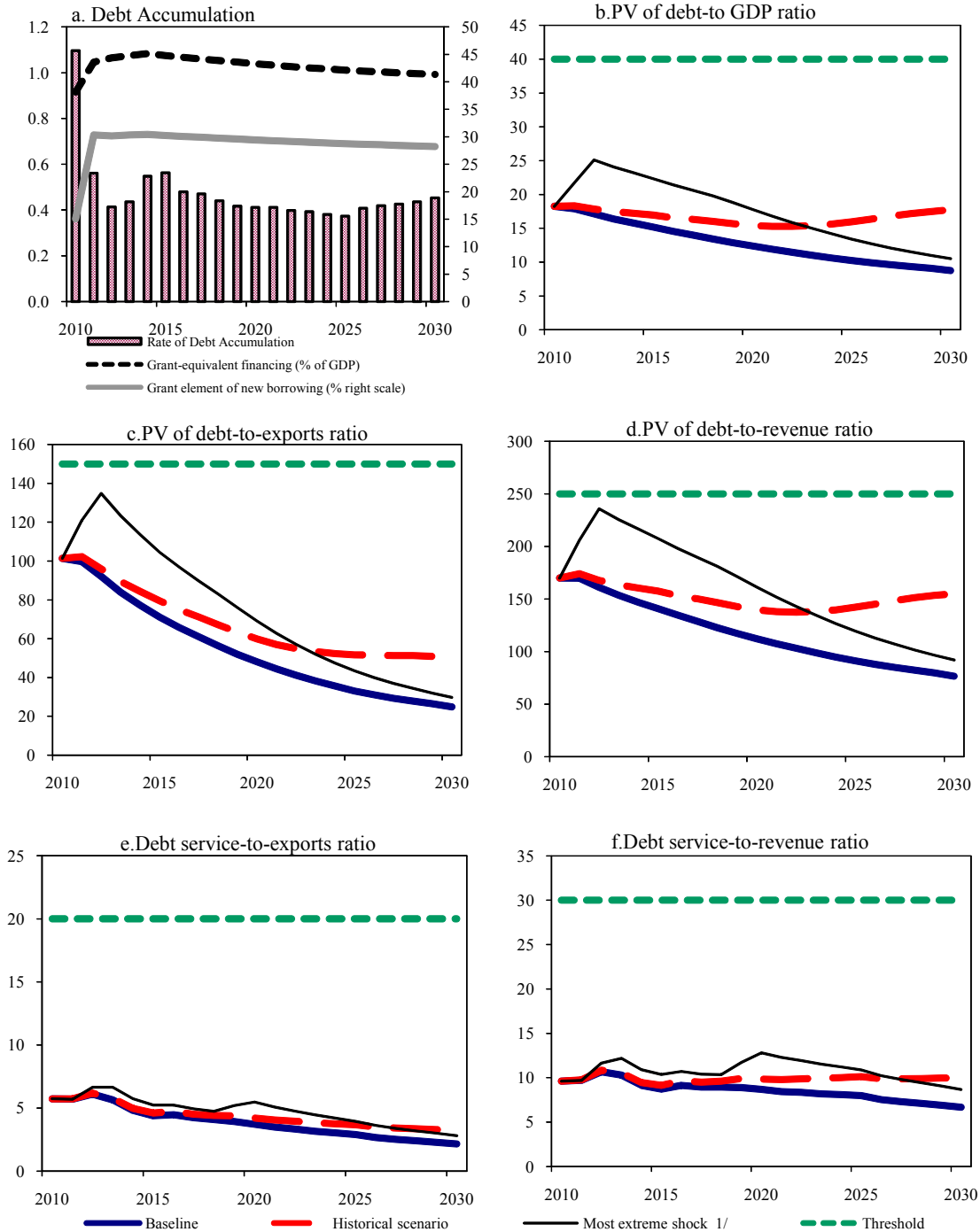
10. **In the staffs' view, Bangladesh should be considered at low risk of debt distress based on external indicators, but the analysis reveals a more elevated risk of debt distress on public debt.** The baseline projections and the associated standard stress tests show little risk related to external debt given that none of the indicators breaches the indicative debt burden thresholds. However, in view of Bangladesh's continued low domestic revenue base, risks to domestic debt accumulation raise concerns.

11. **The substantial increase in debt ratios when domestic debt is included calls for careful management of the public debt.** While the NPV of public debt-to-revenue ratio would decline over the 20-year horizon under the baseline assumptions, the ratio would remain high over the medium term and rises in some of the alternative scenarios and bound tests.

12. **Efforts to mobilize domestic revenues, as well as the appropriate management of contingent liabilities, and continued prudent management of expenditures while protecting priority spending are the keys to ensure improvement in the debt indicators.** This exercise also underscores the importance of effective management of the existing debt and new debt accumulation.

13. **The staff encourages the authorities to build on recent steps and move forward as quickly as possible to strengthen debt management capacity.** In this regard, it will be important to continue the work underway to develop a comprehensive public debt data base which covers both domestic and external debt and to integrate it with centralized reporting of all external aid flows.

Figure 1. Bangladesh: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2010-2030 1/ 2/



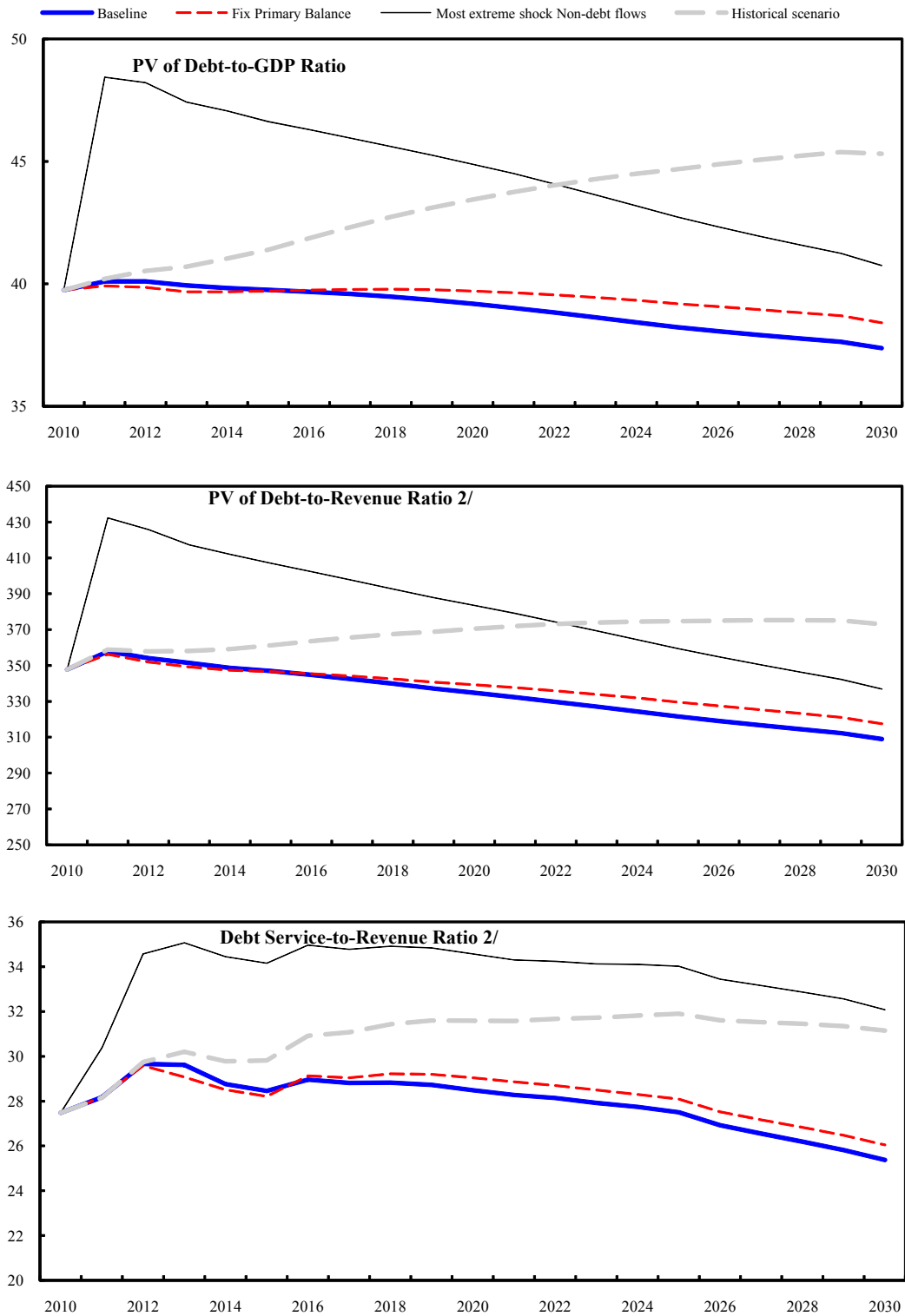
Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2020. In figure b. it corresponds to a Non-debt flows shock; in c. to a Non-debt flows shock; in d. to a Non-debt flows shock; in e. to a Non-debt flows shock and in figure f. to a Non-debt flows shock

2/ The large rate of debt accumulation in FY2010 compared to later years reflects large program loans from the AsDB (almost 0.8 percent of GDP) to help Bangladesh weather the global crisis. The bulk of these loans were disbursed in November 2009.



Figure 2. Bangladesh: Indicators of Public Debt Under Alternative Scenarios, 2010-2030 1/



Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2020.

2/ Revenues are defined inclusive of grants.

Table 1. Bangladesh: External Debt Sustainability Framework, Baseline Scenario, 2007-2030 1/  
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average	Standard Deviation	Projections											
	2007	2008	2009			2010	2011	2012	2013	2014	2015	2010-2015 Average	2020	2030	2016-2030 Average		
<b>External debt (nominal) 1/</b>	<b>27.3</b>	<b>26.6</b>	<b>24.3</b>			<b>22.6</b>	<b>22.0</b>	<b>21.0</b>	<b>20.1</b>	<b>19.3</b>	<b>18.6</b>			<b>15.5</b>	<b>12.0</b>		
o/w public and publicly guaranteed (PPG)	27.0	26.4	24.1			22.3	21.7	20.8	19.8	19.0	18.2			15.0	11.4		
Change in external debt	-1.7	-0.6	-2.3			-1.8	-0.6	-0.9	-1.0	-0.8	-0.7			-0.5	-0.4		
Identified net debt-creating flows	-4.6	-5.5	-6.8			-4.7	-3.3	-2.8	-2.7	-2.7	-2.6			-2.5	-3.0		
<b>Non-interest current account deficit</b>	<b>-1.0</b>	<b>-1.0</b>	<b>-3.1</b>	<b>-0.7</b>	<b>1.3</b>	<b>-3.2</b>	<b>-1.7</b>	<b>-1.1</b>	<b>-1.1</b>	<b>-1.1</b>	<b>-1.0</b>			<b>-1.5</b>	<b>-0.9</b>	<b>-1.1</b>	<b>-1.2</b>
Deficit in balance of goods and services	7.2	8.8	7.1			6.9	7.9	8.3	8.5	8.6	8.9			9.7	10.9		
Exports	20.3	20.1	19.5			18.0	17.9	18.6	19.5	20.4	21.3			25.8	35.3		
Imports	27.4	28.9	26.6			24.9	25.8	27.0	28.0	29.1	30.2			35.4	46.2		
Net current transfers (negative = inflow)	-9.3	-10.9	-11.4	-7.6	2.3	-11.1	-10.6	-10.5	-10.7	-10.8	-10.9			-10.8	-11.6	-13.2	-12.1
o/w official	-0.1	-0.2	-0.1			-0.1	-0.1	-0.1	-0.1	-0.1	-0.1			-0.1	0.0		
Other current account flows (negative = net inflow)	1.1	1.1	1.3			1.1	1.1	1.1	1.1	1.1	1.1			1.1	1.1		
<b>Net FDI (negative = inflow)</b>	<b>-1.0</b>	<b>-0.9</b>	<b>-1.1</b>	<b>-0.8</b>	<b>0.3</b>	<b>-0.7</b>	<b>-0.7</b>	<b>-0.7</b>	<b>-0.7</b>	<b>-0.8</b>	<b>-0.8</b>			<b>-0.7</b>	<b>-0.9</b>	<b>-1.4</b>	<b>-1.1</b>
<b>Endogenous debt dynamics 2/</b>	<b>-2.5</b>	<b>-3.6</b>	<b>-2.7</b>			<b>-0.8</b>	<b>-0.9</b>	<b>-0.9</b>	<b>-0.9</b>	<b>-0.8</b>	<b>-0.8</b>			<b>-0.7</b>	<b>-0.7</b>	<b>-0.5</b>	
Contribution from nominal interest rate	0.2	0.3	0.2			0.3	0.3	0.3	0.3	0.3	0.3			0.3	0.3		
Contribution from real GDP growth	-1.7	-1.5	-1.4			-1.1	-1.2	-1.2	-1.2	-1.1	-1.1			-0.9	-0.7		
Contribution from price and exchange rate changes	-1.1	-2.4	-1.5			...	...	...	...	...	...			...	...		
<b>Residual (3-4) 3/</b>	<b>2.9</b>	<b>4.8</b>	<b>4.5</b>			<b>2.9</b>	<b>2.7</b>	<b>1.8</b>	<b>1.7</b>	<b>1.9</b>	<b>1.8</b>			<b>1.9</b>	<b>2.6</b>		
o/w exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0			0.0	0.0		
PV of external debt 4/	...	...	19.5			18.5	18.1	17.4	16.7	16.1	15.5			12.9	9.4		
In percent of exports	...	...	100.1			102.6	101.1	93.5	85.3	78.7	72.7			50.0	26.7		
<b>PV of PPG external debt</b>	<b>...</b>	<b>...</b>	<b>19.3</b>			<b>18.2</b>	<b>17.9</b>	<b>17.2</b>	<b>16.4</b>	<b>15.8</b>	<b>15.2</b>			<b>12.4</b>	<b>8.8</b>		
In percent of exports	...	...	99.0			101.4	99.7	92.1	83.9	77.1	71.0			48.1	24.9		
In percent of government revenues	...	...	185.3			169.9	169.7	161.3	153.5	146.9	140.9			112.2	76.7		
<b>Debt service-to-exports ratio (in percent)</b>	<b>5.2</b>	<b>4.9</b>	<b>4.5</b>			<b>6.0</b>	<b>6.0</b>	<b>6.4</b>	<b>6.0</b>	<b>5.2</b>	<b>4.8</b>			<b>4.2</b>	<b>2.3</b>		
<b>PPG debt service-to-exports ratio (in percent)</b>	<b>4.9</b>	<b>4.7</b>	<b>4.2</b>			<b>5.7</b>	<b>5.7</b>	<b>6.1</b>	<b>5.6</b>	<b>4.8</b>	<b>4.4</b>			<b>3.7</b>	<b>2.2</b>		
<b>PPG debt service-to-revenue ratio (in percent)</b>	<b>9.8</b>	<b>8.6</b>	<b>7.9</b>			<b>9.6</b>	<b>9.7</b>	<b>10.7</b>	<b>10.3</b>	<b>9.2</b>	<b>8.7</b>			<b>8.7</b>	<b>6.7</b>		
Total gross financing need (Billions of U.S. dollars)	-0.7	-0.7	-2.9			-2.8	-1.4	-0.7	-0.8	-1.0	-1.0			-1.4	-6.7		
Non-interest current account deficit that stabilizes debt ratio	0.7	-0.4	-0.7			-1.4	-1.1	-0.2	-0.1	-0.3	-0.3			-0.3	-0.7		
<b>Key macroeconomic assumptions</b>																	
Real GDP growth (in percent)	6.4	6.2	5.9	5.8	0.7	5.0	5.8	6.0	6.0	6.0	6.0			5.8	6.3	6.3	6.3
GDP deflator in US dollar terms (change in percent)	3.9	9.5	6.1	1.2	4.8	6.0	1.9	0.2	1.1	1.1	1.6			2.0	1.1	1.1	1.1
Effective interest rate (percent) 5/	0.9	1.1	0.9	1.1	0.1	1.3	1.4	1.4	1.5	1.6	1.6			1.5	1.9	2.2	2.0
Growth of exports of G&S (US dollar terms, in percent)	18.0	15.2	9.0	11.5	7.2	2.9	7.3	10.3	12.4	12.2	12.5			9.6	11.7	10.3	11.2
Growth of imports of G&S (US dollar terms, in percent)	19.8	22.4	3.4	11.2	9.6	4.2	11.7	11.0	11.5	11.2	11.8			10.2	10.9	10.4	10.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	15.1	30.3	30.1	30.3	30.4	30.3			27.8	29.4	28.2	29.1
Government revenues (excluding grants, in percent of GDP)	10.2	10.8	10.4			10.7	10.5	10.6	10.7	10.7	10.8			11.0	11.4	11.1	
Aid flows (in Billions of US dollars) 7/	0.7	0.5	0.9			0.9	1.4	1.5	1.6	1.8	1.9			2.6	5.0		
o/w Grants	0.4	0.4	0.6			0.7	0.7	0.8	0.8	0.9	1.0			1.4	2.7		
o/w Concessional loans	0.3	0.2	0.2			0.2	0.7	0.7	0.8	0.9	0.9			1.2	2.3		
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			0.9	1.0	1.1	1.1	1.1	1.1			1.0	1.0	1.0	1.0
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			41.5	54.7	54.9	54.8	54.7	54.7			54.4	53.8	54.2	
<i>Memorandum items:</i>																	
Nominal GDP (Billions of US dollars)	68.4	79.6	89.4			99.5	107.2	113.9	122.0	130.8	140.9			202.1	416.0		
Nominal dollar GDP growth	10.5	16.3	12.3			11.3	7.8	6.2	7.2	7.2	7.7			7.9	7.5	7.5	7.5
PV of PPG external debt (in Billions of US dollars)	...	...	17.2			18.2	18.7	19.2	19.7	20.3	21.1			24.7	36.5		
(PVI-PVt-1)/GDPt-1 (in percent)	...	...	...			1.1	0.6	0.4	0.4	0.5	0.6			0.6	0.4	0.5	0.4

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt. The years in the table refer to fiscal years. Therefore, 2009 refers to July 2008-June 2009.

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

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

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

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

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

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

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

Table 2. Bangladesh: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2010-2030  
(In percent)

	Projections							
	2010	2011	2012	2013	2014	2015	2020	2030
<b>PV of debt-to GDP ratio</b>								
<b>Baseline</b>	18	18	17	16	16	15	12	9
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2010-2030 1/	18	18	18	17	17	17	15	18
A2. New public sector loans on less favorable terms in 2010-2030 2	18	18	18	17	17	17	15	14
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	18	18	17	16	16	15	12	9
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	18	18	18	18	17	16	13	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	18	18	18	18	17	16	13	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	18	22	25	24	23	22	18	11
B5. Combination of B1-B4 using one-half standard deviation shocks	18	21	25	24	23	22	18	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	18	25	24	23	22	21	17	12
<b>PV of debt-to-exports ratio</b>								
<b>Baseline</b>	101	100	92	84	77	71	48	25
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2010-2030 1/	101	102	96	89	84	79	60	50
A2. New public sector loans on less favorable terms in 2010-2030 2	101	100	95	88	83	78	60	40
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	101	97	90	82	76	70	47	25
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	101	102	107	98	90	83	56	28
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	101	97	90	82	76	70	47	25
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	101	121	135	123	114	105	69	30
B5. Combination of B1-B4 using one-half standard deviation shocks	101	115	130	119	109	101	67	29
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	101	97	90	82	76	70	47	25
<b>PV of debt-to-revenue ratio</b>								
<b>Baseline</b>	170	170	161	153	147	141	112	77
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2010-2030 1/	170	174	168	164	160	158	140	155
A2. New public sector loans on less favorable terms in 2010-2030 2	170	170	166	162	159	156	140	123
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	170	167	160	153	147	141	112	77
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	170	169	173	165	158	152	120	79
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	170	175	174	166	159	153	121	84
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	170	206	236	226	216	207	161	92
B5. Combination of B1-B4 using one-half standard deviation shocks	170	204	235	225	216	207	161	94
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	170	235	224	214	205	197	156	108

Table 2. Bangladesh: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2010-2030 (continued)  
(In percent)

<b>Debt service-to-exports ratio</b>								
<b>Baseline</b>	6	6	6	6	5	4	4	2
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2010-2030 1/	6	6	6	6	5	5	4	3
A2. New public sector loans on less favorable terms in 2010-2030 2	6	6	6	6	5	5	4	3
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	6	6	6	6	5	4	4	2
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	6	6	7	6	5	5	4	2
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	6	6	6	6	5	4	4	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	6	6	7	7	6	5	5	3
B5. Combination of B1-B4 using one-half standard deviation shocks	6	6	7	7	6	5	5	3
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	6	6	6	6	5	4	4	2
<b>Debt service-to-revenue ratio</b>								
<b>Baseline</b>	10	10	11	10	9	9	9	7
<b>A. Alternative Scenarios</b>								
A1. Key variables at their historical averages in 2010-2030 1/	10	10	11	11	9	9	10	10
A2. New public sector loans on less favorable terms in 2010-2030 2	10	10	11	11	10	9	9	9
<b>B. Bound Tests</b>								
B1. Real GDP growth at historical average minus one standard deviation in 2011-2012	10	10	11	10	9	9	9	7
B2. Export value growth at historical average minus one standard deviation in 2011-2012 3/	10	10	11	11	9	9	9	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2011-2012	10	10	12	11	10	10	10	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2011-2012 4/	10	10	12	12	11	10	13	9
B5. Combination of B1-B4 using one-half standard deviation shocks	10	10	12	13	11	11	13	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2011 5/	10	14	15	15	13	12	12	9
<i>Memorandum item:</i>								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	24	24	24	24	24	24	24	24

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3. Bangladesh: Public Sector Debt Sustainability Framework, Baseline Scenario, 2007-2030  
(In percent of GDP, unless otherwise indicated)

	Actual			Average	Standard Deviation	Estimate					Projections				
	2007	2008	2009			2010	2011	2012	2013	2014	2015	2010-15 Average	2020	2030	2016-30 Average
<b>Public sector debt 1/</b>	46.8	46.8	45.3			43.8	44.0	43.7	43.3	43.1	42.8		41.8	40.0	
o/w foreign-currency denominated	27.0	26.4	24.1			22.3	21.7	20.8	19.8	19.0	18.2		15.0	11.4	
Change in public sector debt	-0.1	-0.1	-1.5			-1.4	0.1	-0.2	-0.4	-0.3	-0.2		-0.2	-0.3	
Identified debt-creating flows	-2.6	-1.8	-2.1			-1.4	0.2	-0.1	-0.2	-0.2	-0.3		-0.2	-0.2	
Primary deficit	0.7	2.3	0.6	1.4	0.8	1.0	1.2	1.0	1.0	0.9	0.9	1.0	0.8	0.9	0.9
Revenue and grants	10.8	11.3	11.1			11.4	11.2	11.3	11.4	11.4	11.5		11.7	12.1	
of which: grants	0.6	0.4	0.7			0.7	0.7	0.7	0.7	0.7	0.7		0.7	0.7	
Primary (noninterest) expenditure	11.5	13.5	11.7			12.4	12.4	12.4	12.4	12.3	12.3		12.5	13.0	
Automatic debt dynamics	-3.3	-4.0	-2.7			-2.4	-1.0	-1.1	-1.2	-1.1	-1.1		-1.0	-1.2	
Contribution from interest rate/growth differential	-2.8	-2.4	-1.7			-1.3	-1.4	-1.4	-1.3	-1.2	-1.2		-1.1	-1.1	
of which: contribution from average real interest rate	0.0	0.4	0.9			0.8	1.0	1.1	1.1	1.3	1.3		1.4	1.3	
of which: contribution from real GDP growth	-2.8	-2.7	-2.6			-2.2	-2.4	-2.5	-2.5	-2.5	-2.4		-2.5	-2.4	
Contribution from real exchange rate depreciation	-0.5	-1.6	-1.0			-1.0	0.4	0.2	0.1	0.1	0.1		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	2.4	1.7	0.6			0.0	0.0	-0.2	-0.2	-0.1	0.0		0.0	0.0	
<b>Other Sustainability Indicators</b>															
<b>PV of public sector debt</b>	...	...	40.4			39.7	40.1	40.1	39.9	39.8	39.7		39.2	37.4	
o/w foreign-currency denominated	...	...	19.3			18.2	17.9	17.2	16.4	15.8	15.2		12.4	8.8	
o/w external	...	...	19.3			18.2	17.9	17.2	16.4	15.8	15.2		12.4	8.8	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	3.4	5.3	3.6			4.1	4.3	4.4	4.4	4.2	4.1		4.2	4.0	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	364.5			347.8	357.9	354.1	351.4	348.7	347.0		334.8	309.0	
PV of public sector debt-to-revenue ratio (in percent)	...	...	388.5			370.1	380.6	377.0	374.1	371.2	369.3		355.3	326.8	
o/w external 3/	...	...	185.3			169.9	169.7	161.3	153.5	146.9	140.9		112.2	76.7	
Debt service-to-revenue and grants ratio (in percent) 4/	24.5	27.2	27.5			27.5	28.2	29.7	29.6	28.8	28.5		28.5	25.4	
Debt service-to-revenue ratio (in percent) 4/	25.9	28.3	29.3			29.2	30.0	31.6	31.5	30.6	30.3		30.2	26.8	
Primary deficit that stabilizes the debt-to-GDP ratio	0.9	2.3	2.1			2.4	1.1	1.3	1.4	1.1	1.1		1.0	1.2	
<b>Key macroeconomic and fiscal assumptions</b>															
Real GDP growth (in percent)	6.4	6.2	5.9	5.8	0.7	5.0	5.8	6.0	6.0	6.0	6.0	5.8	6.3	6.3	6.3
Average nominal interest rate on forex debt (in percent)	0.9	1.0	0.8	1.0	0.1	1.5	1.5	1.5	1.6	1.6	1.6	1.5	1.8	1.8	1.8
Average real interest rate on domestic debt (in percent)	3.3	3.4	5.5	4.8	1.8	4.3	4.6	5.7	5.6	5.9	5.8	5.3	5.7	4.7	5.4
Real exchange rate depreciation (in percent, + indicates depreciation)	-1.7	-6.5	-3.9	0.2	4.6	-4.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	6.8	8.8	6.4	4.8	2.2	6.4	6.0	5.0	5.0	4.5	4.5	5.2	4.0	4.0	4.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.0	0.2	-0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	...	...	15.1	30.3	30.1	30.3	30.4	30.3	27.8	29.4	28.2	...

Sources: Country authorities; and staff estimates and projections.

1/ Central government gross debt. The years in the table refer to fiscal years. Therefore, 2009 refers to July 2008-June 2009.

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

3/ Revenues excluding grants.

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

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

Table 4. Bangladesh: Sensitivity Analysis for Key Indicators of Public Debt 2010-2030

	Projections							
	2010	2011	2012	2013	2014	2015	2020	2030
<b>PV of Debt-to-GDP Ratio</b>								
<b>Baseline</b>	40	40	40	40	40	40	39	37
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	40	40	41	41	41	41	43	45
A2. Primary balance is unchanged from 2010	40	40	40	40	40	40	40	38
A3. Permanently lower GDP growth 1/	40	40	40	40	40	40	40	40
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-201	40	40	41	41	41	41	41	40
B2. Primary balance is at historical average minus one standard deviations in 2011-2012	40	41	42	42	41	41	40	38
B3. Combination of B1-B2 using one half standard deviation shocks	40	41	41	41	41	41	41	39
B4. One-time 30 percent real depreciation in 2011	40	48	48	47	47	46	44	41
B5. 10 percent of GDP increase in other debt-creating flows in 2011	40	48	48	47	47	47	45	41
<b>PV of Debt-to-Revenue Ratio 2/</b>								
<b>Baseline</b>	348	358	354	351	349	347	335	309
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	348	359	358	358	359	361	371	373
A2. Primary balance is unchanged from 2010	348	356	352	349	347	347	339	318
A3. Permanently lower GDP growth 1/	348	358	355	353	352	351	344	334
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-201	348	360	360	358	357	356	347	327
B2. Primary balance is at historical average minus one standard deviations in 2011-2012	348	365	370	366	362	360	345	315
B3. Combination of B1-B2 using one half standard deviation shocks	348	363	366	363	361	359	347	322
B4. One-time 30 percent real depreciation in 2011	348	433	424	417	410	405	379	340
B5. 10 percent of GDP increase in other debt-creating flows in 2011	348	432	426	417	412	407	383	337
<b>Debt Service-to-Revenue Ratio 2/</b>								
<b>Baseline</b>	27	28	30	30	29	28	28	25
<b>A. Alternative scenarios</b>								
A1. Real GDP growth and primary balance are at historical averages	27	28	30	30	30	30	32	31
A2. Primary balance is unchanged from 2010	27	28	30	29	29	28	29	26
A3. Permanently lower GDP growth 1/	27	28	30	30	29	29	29	28
<b>B. Bound tests</b>								
B1. Real GDP growth is at historical average minus one standard deviations in 2011-201	27	28	30	30	30	29	30	27
B2. Primary balance is at historical average minus one standard deviations in 2011-2012	27	28	30	32	32	30	29	26
B3. Combination of B1-B2 using one half standard deviation shocks	27	28	30	31	31	30	29	27
B4. One-time 30 percent real depreciation in 2011	27	30	35	35	34	34	35	32
B5. 10 percent of GDP increase in other debt-creating flows in 2011	27	28	33	54	32	36	30	30

Sources: Country authorities; and staff estimates and projections.

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

2/ Revenues are defined inclusive of grants.

INTERNATIONAL MONETARY FUND

BANGLADESH

**Staff Report for the 2009 Article IV Consultation—Informational Annex**

Prepared by the Asia and Pacific Department  
(In consultation with other departments)

December 23, 2009

	Contents	Page
I.	Fund Relations .....	2
II.	Relations with the World Bank Group.....	4
III.	Relations with the Asian Development Bank .....	5
IV.	Statistical Issues .....	7
V.	Millennium Development Goals, 1990-2008 .....	9

**ANNEX I. BANGLADESH: FUND RELATIONS**  
(As of November 30, 2009)

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

II. <b>General Resources Account:</b>	<u>SDR million</u>	<u>Percent Quota</u>
Quota	533.30	100.00
Fund holding of currency	666.33	124.94
Reserve position in Fund	0.30	0.06

III. <b>SDR Department:</b>	<u>SDR million</u>	<u>Percent Allocation</u>
Net cumulative allocation	510.40	100.00
Holdings	464.04	90.92

IV. <b>Outstanding Purchases and Loans:</b>	<u>SDR million</u>	<u>Percent Quota</u>
Emergency Assistance	133.33	25.00
PRGF arrangements	301.88	56.61

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	6/20/03	6/19/07	400.33	316.73
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 the Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	2009	2010	2011	2012	2013
Principal	4.95	29.70	83.22	130.01	91.73
Charges/Interest	<u>0.76</u>	<u>3.22</u>	<u>2.93</u>	<u>1.93</u>	<u>0.86</u>
Total	<u>5.71</u>	<u>32.92</u>	<u>86.15</u>	<u>131.94</u>	<u>92.59</u>

VII. **Article IV Consultation**

The previous Article IV consultation was concluded on September 19, 2008 (IMF Country Report No. 08/334).



## VIII. Safeguards Assessment

Under the Fund's safeguards assessment policy, Bangladesh Bank (BB) is subject to an assessment with respect to the PRGF arrangement, which was approved on June 20, 2003. A safeguards assessment of the BB was completed on January 24, 2005. The assessment concluded that substantial risks exist in the legal structure, financial reporting, internal audit, and internal control systems. Implementation of the measures by BB is monitored by staff.

## IX. Exchange Arrangement

**Exchange regime.** The *de jure* exchange rate regime is a managed float. The *de facto* regime is stabilized.

**Exchange restriction.** At the last Article IV consultation, the Executive Board urged the authorities to adopt a timetable to remove the remaining exchange restriction on the convertibility and transferability of proceeds of current international transactions in nonresident taka accounts.

## X. Resident Representative

The resident representative office was established in 1972. Ms. Eteri Kvintradze will take over as Resident Representative in February from Mr. Jonathan Dunn, who represented the Fund in Dhaka between August 2004 and December 2009.

## XI. Technical Assistance

Since the last Article IV consultation, departments have continued to provide technical assistance (TA). Recent and prospective TA includes the following:

Department	Topic	Timing
LEG	Assistance with drafting tax laws	October 2008, January 2010
MCM	Foreign Exchange Market development	October 2008
	FSAP Update (joint with World Bank)	July 2009
	Central bank accounting/internal audit	Multiple visits, 2008-10
	Government debt market	Multiple visits, 2008-10
	Banking supervision	Resident advisor 2010
FAD	Debt management (joint with World Bank)	November 2009
STA	Trade statistics	January 2009
	National accounts statistics	Sept. 2009, 3 follow-up visits
	Price statistics	Two missions in 2010

## ANNEX II. BANGLADESH: RELATIONS WITH THE WORLD BANK GROUP<sup>1</sup>

1. The World Bank Group Program in Bangladesh consists of an integrated package of financial assistance including concessional IDA credits and IFC investments, along with complementary analytical and advisory services. Collaboration and coordination between the IMF and the World Bank on Bangladesh was described in last year's Article IV staff report.

2. Bangladesh is among the largest recipients of financial assistance from IDA. IDA's engagement in Bangladesh is guided by its Country Assistance Strategy which was discussed and endorsed the Bank's Board of Executive Director's in April 2006. The CAS supports a program of technical and financial assistance aimed at: (i) improving the investment climate and (ii) empowering the poor. Cutting across both these goals, was a focus on improving governance. During the CAS period, in line with its objectives, IDA committed US\$2.69 billion, of which around 40 percent went for improving the investment climate by strengthening infrastructure (energy, roads, transportation, water and sanitation), 17 percent for empowering the poor by improving the delivery of education and health services, and 25 percent for strengthening governance.

3. As part of this strategy, IFC provides direct support to the private sector in Bangladesh, with an emphasis on: (i) private infrastructure; (ii) energy, including investments in gas production and related infrastructure; (iii) manufacturing and service sector companies; and (iv) innovative private sector sponsored projects in health and education. IFC is also supporting the development of local capital markets and a competitive banking sector through direct investments and institution building. Furthermore, to promote SME development, IFC's regional SME Facility, the South Asia Enterprise Development Facility (SEDF), will continue to provide technical assistance to financial intermediaries, SMEs and the professional service firms that support these SMEs. A separate facility, the Bangladesh Investment Climate Facility (BICF), launched in 2007, will assist the Government of Bangladesh to reforms its Investment Climate.

4. Looking ahead, a new CAS is being prepared for Bangladesh covering (FY10-14). It will be aligned with the Poverty Reduction Strategy (PRS) II that is currently being finalized by the government. This new CAS will build on the World Bank Group's work in Bangladesh so far and also help the government deal with some emerging challenges. Specifically, the CAS is expected to focus on:

- Increased resilience to climate change impact.
- Improved Human Development and Social Protection
- Improved Environment for Private Sector Investment and Growth:

The CAS will also continue to focus on improving governance as a cross cutting issue given the important role it plays in strengthening service delivery.

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<sup>1</sup> Prepared by World Bank staff. Contact person: Ms. Moorty, Senior Economist, (SASEP).

### ANNEX III. BANGLADESH: RELATIONS WITH THE ASIAN DEVELOPMENT BANK<sup>2</sup>

#### Lending and technical assistance operations

Bangladesh joined the Asian Development Bank (AsDB) in 1973 and, as of 31 December 2008, cumulative public sector lending amounted to almost US\$10 billion for 192 loans, with \$183 million for technical assistance (TA) grants for 331 projects. The country is one of the largest borrowers of concessional Asian Development Fund resources. The loans and TAs have supported all key sectors including energy, transport, social infrastructure, agriculture, and natural resources. AsDB has also supported eight private sector projects worth \$242 million, including the Meghnaghat Power Project—the first build-own-operate power project in the country—and GrameenPhone, which substantially expanded rural access to mobile phone services.

In 2008, the AsDB approved a total amount of US\$592 million in loans. This included loans to (i) enhance the capacity of the technical and vocational education and training system (US\$50 million); (ii) fill infrastructure financing gaps, encourage private sector investment, and promote public–private partnership in infrastructure (US\$165 million); (iii) support the improvement of urban governance, infrastructure and service delivery (US\$87 million); (iv) contribute to sustainable economic growth by minimizing the devastating impact of severe floods and a cyclone, and reducing future risk from similar disasters (US\$120 million); and (v) help expand targeted safety net programs (emergency assistance of US \$170 million).

Financial support from the AsDB is set to more than double in FY2010 from the level recorded in FY2009 (US\$599 million, see table). In October 2009, the AsDB approved a loan of US\$500 million under the countercyclical support facility (CSF, established in June 2009 to support AsDB's developing member countries needing to increase fiscal spending to counter the global economic crisis) and three loans totaling US\$244 million under the public expenditure support facility (PESF) for Bangladesh. The PESF loans will support government measures to introduce economic and social policy reforms essential for achieving higher and more inclusive long-term growth and strengthening social safety net programs.

	ADB loan disbursements to Bangladesh, FY08-FY10 (in US\$m)		
	FY08	FY09	FY10 Projection
Project loans	289	535	545
Power sector	78	141	159
Gas Transmission and Development	9	18	94
Emergency Assistance	69	203	21
Other	133	173	272
Program loans	141	64	800
Power sector development	64	0	0
Good governance program	52	53	0
Emergency assistance	0	11	0
Countercyclical support	0	0	500
Public expenditure support	0	0	245
Other	25	0	55
Total loans	430	599	1,345

<sup>2</sup> Based on material provided by AsDB staff.

## Country Partnership Strategy

The current results-based country partnership strategy (CPS), covering the period 2006–10, is part of a joint strategy prepared with the UK’s Department for International Development, Government of Japan, and World Bank. Under this CPS, the AsDB is playing a major role in the energy, transport, education, urban health, and urban water supply and sanitation sectors. In other areas, such as agriculture (i.e., agribusiness), water resources management, the financial sector and small- and medium-sized enterprise development, AsDB is supporting initiatives led by other development partners. Disaster mitigation, regional cooperation, gender, and environment continue to be addressed as key crosscutting issues. The CPS emphasizes designing projects that are better prepared for implementation. This means projects that are simpler; take into consideration capacity constraints; and include covenants that are realistic, focused, and properly sequenced.

The Bangladesh country operations business plan for 2010-2012, approved in August 2009, comprises 25 projects totaling about US\$2.4 billion, including assistance for construction of the Padma Multipurpose Bridge and promoting regional cooperation in South Asia. The TA program for 2010-2012 consists of 29 projects, with an annual allocation of about of \$6.2 million.

Cofinancing operations enable AsDB’s financing partners—governments or their agencies, multilateral financing institutions, and commercial organizations—to participate in financing AsDB projects. The additional funds are provided in the form of grants, official loans, or credit enhancement products. In 2008, the Emergency Disaster Damage Rehabilitation (Sector) Project was provided with US\$80 million loan cofinancing, of which US\$60 million was from Japan and US\$20 million was from the OPEC Fund for International Development. This project was also provided US\$10 million in grant cofinancing from Canada. Switzerland provided US\$6 million and US\$2.5 million in grant cofinancing for the Skills Development Project and Post-Literacy and Continuing Education (Supplementary) Projects, respectively. As of year-end 2008, cumulative direct value-added cofinancing for Bangladesh amounted to US\$1.2 billion for 26 investment projects, and US\$58.4 million for 68 TA projects.

## Economic and sector work program

Each year, the AsDB publishes its *Asian Development Outlook*, in which it assesses macroeconomic performance. AsDB’s Bangladesh Resident Mission also publishes the *Bangladesh Quarterly Economic Update*. A bimonthly *Economic Indicators Update* has also been launched. In support of AsDB’s Country Partnership Strategy (2006-2010) exercise, several thematic assessments and sector studies were completed. These include: thematic assessments for poverty, growth, and poverty reduction, private sector development, governance, environment, and gender, and various sector studies.

<b>ANNEX IV. BANGLADESH—STATISTICAL ISSUES</b> As of December 9, 2009	
<b>I. Assessment of Data Adequacy for Surveillance</b>	
<b>General:</b> Data provision has some shortcomings, but is broadly adequate for surveillance. The most affected areas are national accounts, fiscal and trade statistics.	
<p><b>Real Sector Statistics:</b> The paucity of source data remains the principal impediment to improving national accounts statistics and adversely affects the ability of the Bangladesh Bureau of Statistics (BBS) to absorb technical assistance aimed at improving compilation techniques. The BBS does not conduct an annual national accounts survey of business enterprises, and source data are primarily from benchmark surveys, a census of manufacturing establishments conducted every two years, and biannual household expenditure surveys. Many of the benchmark surveys were conducted over five years ago and are based on outdated sample frames.</p> <p>The shortcomings in the data also affect compilation practices. And a system of price indices for estimating national accounts at constant prices needs to be developed. A September 2009 TA mission developed and agreed a detailed work program with the BBS for undertaking the exercise of updating the base year from 1995/96 to 2005/06 and creating a comprehensive benchmark estimate and new series with the new base year.</p> <p><b>Price statistics:</b> The CPI and PPI weights are outdated, which introduces uncertainty.</p>	
<b>Government finance statistics:</b> A 2008 STA multi-sector mission recommended additional actions to strengthen the analytical usefulness of fiscal data, including to: improve the integration of debt stocks and related financial flows; sensitize donors to the need to promptly provide complete data on Direct Project Assistance; and establish an inter-agency committee to prepare a migration plan to the <i>GFSM2001</i> .	
<b>Monetary statistics:</b> Bangladesh Bank compiles monetary data using the standardized report forms (SRFs) framework. The SRFs are reported electronically to the IMF on a regular basis. As a result a consistent time series based on SRF data is available from December 2001.	
<b>Balance of Payments:</b> In the area of goods transactions, the data are collected from different data sources—exports are based on information from customs declarations and imports are based on foreign exchange settlements. But efforts are underway to unify the source data based on customs declarations only, in line with STA’s recommendations. This should help resolve inconsistencies with the national accounts, where customs trade data are used in compiling net exports of goods and services.	
<b>II. Data Standards and Quality</b>	
Participant in the GDDS since March 2001.	The Data Module of the ROSC was published in December 2005.

**Bangladesh: Table of Common Indicators Required for Surveillance  
December 15, 2009**

	Date of latest observation	Date received	Frequency of data <sup>7</sup>	Frequency of reporting <sup>7</sup>	Frequency of publication <sup>7</sup>	Memo Items:	
						Data Quality-Methodological soundness <sup>8</sup>	Data Quality-Accuracy and reliability <sup>9</sup>
Exchange Rates	12/15/09	12/15/09	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>	12/14/09	12/15/09	D	D	D		
Reserve/Base Money	12/14/09	12/15/09	D	D	M	O, O, LO, LO	O, LO, O, O, O
Broad Money	Oct. 2009	12/14/09	M	M	M		
Central Bank Balance Sheet	Oct. 2009	12/14/09	W/M	W/M	M		
Consolidated Balance Sheet of the Banking System	Oct. 2009	12/14/09	M	M	M		
Interest Rates <sup>2</sup>	12/14/09	12/15/09	W	W	D		
Consumer Price Index	Sept. 2009	11/25/09	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – General Government <sup>4</sup>	n/a	n/a	n/a	n/a	n/a	O, LO, LNO, LO	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> – Central Government	June 2009	9/30/09	M/Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>	Aug. 2009	11/11/09	M	M	M		
International Investment Position <sup>6</sup>	2008	June 2009	A	A	A		
External Current Account Balance	Sept 2009	Nov. 2009	M	M	M	O, LO, O, LO	LO, LO, LO, O, O
Exports and Imports of Goods and Services	Oct. 2008	Dec. 2009	M	M	M		
GDP/GNP	FY2008/09	June 2009	A	A	A	O, LNO, LO, LO	LNO, LO, LNO, LNO, O
Gross External Debt	Jun. 2009	Sept. 2009	A	A/M	A		

<sup>1</sup>Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

<sup>2</sup>Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

<sup>3</sup>Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup>The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup>Including currency and maturity composition.

<sup>6</sup>Includes external gross financial asset and liability positions vis-à-vis nonresidents.

<sup>7</sup>Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

<sup>8</sup>Reflects the assessment provided in the data ROSC published on December 8, 2005, and based on the findings of the mission that took place during March 2–16, 2005 for the dataset corresponding to the variables in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

<sup>9</sup>Same as footnote 8, except referring to international standards concerning source data, assessment and validation of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

## Annex V. Bangladesh: Millennium Development Goals, 1990–2008 1/

	Base 1990-95	Current 2000-02	2005-09	Target 2015	Status
<b>Goal 1: Eradicate extreme poverty and hunger</b>	<b>Goal will probably be met</b>				
<b>Target 1: Halve by 2015 the proportion of people living below the poverty line</b>					
Poverty headcount ratio	59	50	40	29	On Track
Poverty gap ratio	17	13	9	8	On Track
Share of income or consumption held by poorest 20 percent (percent)	7	...	5	...	
<b>Target 2: Halve by 2015 the proportion of people who suffer from hunger</b>					
Prevalence of child malnutrition (percent of children under 5)	67	51	40	33	On Track
Population below minimum level of dietary energy consumption (percent)	28	...	20	14	On Track
<b>Goal 2: Achieve universal primary education</b>	<b>Goal will probably be met</b>				
<b>Target 3: Ensure that all boys and girls complete a full course of primary schooling</b>					
Net enrollment ratio in primary education	61	83	87	100	On Track
Percentage of cohort reaching grade 5 (percent)	43	...	67	100	Needs attention
Adult literacy rate	37	39	54	100	Needs attention
<b>Goal 3: Promote gender equality and empower women</b>	<b>Goal will probably be met</b>				
<b>Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and at all levels by 2015</b>					
Ratio of girls to boys in primary and secondary education (percent)	77	104	106	100	Achieved
Ratio of girls to boys in tertiary education (percent)	33	56	56	100	Needs attention
Ratio of literate females to males (percent of ages 20–24)	65	77	71	100	Needs attention
Share of women employed in the nonagricultural sector (percent)	41	...	59	50	On track
Proportion of seats held by women in national parliament (percent)	10	...	15	...	
<b>Goal 4: Reduce child mortality</b>	<b>Goal will probably be met</b>				
<b>Target 5: Reduce by two thirds by 2015 the under 5 mortality rate</b>					
Under 5 mortality rate (per 1,000)	151	82	62	50	On track
Infant mortality rate (per 1,000 live births)	94	56	45	31	On track
Immunization, measles (percent of children under 12 months)	54	69	87	100	On track
<b>Goal 5: Improve maternal health</b>	<b>Goal will probably be met</b>				
<b>Target 6: reduce by three quarters, by 2015, the maternal mortality ratio</b>					
Maternal mortality ratio (modeled estimate, per 100,000 live births)	574	320-400	290	147	On track
Births attended by skilled health staff (percent of total)	5	12	20	50	Needs attention
<b>Goal 6: Combat HIV/AIDS, malaria, and other diseases</b>	<b>Goal will potentially be met</b>				
<b>Target 7: Have halted by 2015 and begin to reverse the spread of HIV/AIDS</b>					
Contraceptive prevalence rate (percent of women ages 15–49)	40	...	58	...	Insufficient data
<b>Target 8: Have halted by 2015 and begin to reverse the incidence of malaria and other major diseases</b>					
Notified cases of malaria per 100,00 population	42	...	34	...	Insufficient data
Incidence of tuberculosis (per 100,000 people)	...	233	406	...	Insufficient data
Tuberculosis cases detected under DOTS (percent)	34	34	71	100	On track
<b>Goal 7: Ensure environmental sustainability</b>	<b>Goal will potentially be met</b>				
<b>Target 9: Integrate the principles of sustainable development into country policies and reverse the loss of environmental resources</b>					
Forest area (percent of total land area)	9.0	10.2	13.0	20	Needs attention
Nationally protected areas (percent of total land area)	...	0.0	2.0	...	Insufficient data
Energy use(kg oil equivalent) per \$1,000 (PPP)	123.2	92.4	...	...	Insufficient data
CO2 emissions (metric tons per capita)	0.1	0.2	0.3	...	Low contribution 2/
<b>Target 10: Halve, by 015, the proportion of people without sustainable access to safe drinking water and sanitation</b>					
Proportion of urban population with access to safe drinking water	98.8	82.0	99.9	100	On track
Proportion of rural population with access to safe drinking water	93.1	72.0	79	96.5	Needs attention
Proportion of urban population with access to sanitary latrines	56.2	56.0	88.0	85.5	On track
Proportion of rural population with access to sanitary latrines	15.3	29.0	85.0	55.5	On track
<b>Target 11: By 2020 have achieved a significant improvement in the lives of at least 100 million slum dwellers</b>					
Proportion of households with access to secure tenure	...	...	36.4	...	Insufficient data
<b>Goal 8: Develop a global partnership for development</b>	<b>Goal will potentially be met</b>				
<b>Target 12: Develop and implement strategies for decent and productive work for youth</b>					
Youth unemployment rate (percent of total labor force ages 15–24)	2.9	8.0	13.4	...	Needs attention
<b>Target 13: Make available the benefits of new technologies, specially information and communication</b>					
Fixed line and mobile telephones (per 100 people)	0.2	1.3	13.6	...	On track
Internet users (per 100 people)	...	0.2	0.2	...	Insufficient data
<b>General indicators</b>					
Population (in millions)	104.0	131.5	142.5	...	
Gross national income (in billions of U.S. dollars)	31.0	49.6	79.6	...	
GNI per capita (in U.S. dollars)	300.0	380.0	487.0	...	

Sources: Bangladesh Planning Commission and United Nations Development Program

1/ In some cases the data are for earlier or later years than those stated.

2/ The country makes low contribution to the CO2 emission in global context



INTERNATIONAL MONETARY FUND

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## **IMF Executive Board Concludes 2009 Article IV Consultation with Bangladesh**

On January 5, 2010, the Executive Board of the International Monetary Fund (IMF) concluded the 2009 Article IV consultation with Bangladesh.<sup>1</sup>

### **Background**

Bangladesh's economy has held up remarkably well despite the global recession. Financial contagion was contained by low levels of financial integration. Growth, estimated at 5.9 percent for FY2009 (July 2008-June 2009), decelerated only modestly from the pace recorded in recent years and remained broad-based. The limited impact of the global downturn on Bangladesh's growth partly reflects the relatively low overall trade openness, and the large share of basic textiles and garments in total exports, which fared relatively well. The resilience of Bangladesh's exports contrasts with the experience in other countries in Asia where exports are still substantially below the pre-crisis peak.

The external position strengthened considerably in FY2009 and the first four months of FY2010. Strong remittances, resilient exports and weak imports caused the current account of the balance of payments to record a surplus of almost 3 percent of GDP in FY2009, up from less than 1 percent of GDP in FY2008. With the capital and financial account of the balance of payments broadly in balance, the improvement in the current account caused a major rise in gross international reserves during FY09. Reflecting also an SDR allocation from the IMF

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<sup>1</sup> Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>



(US\$0.7 billion) and Asian Development Bank disbursements (US\$0.6 billion), gross international reserves exceeded US\$10 billion in November, almost double the level in November 2008. This is equivalent to 4.8 months of prospective imports, a 15-year high.

The strength of the external position put pressure on Bangladesh Bank (BB)'s monetary policy framework. The improvement in the current account put upward pressure on the taka which BB countered through unsterilized foreign exchange purchases. This caused banks' excess reserves to rise sharply, sending short-term interest rates below 1 percent. Over the summer, with no measures taken to absorb liquidity, the monetary policy framework was rendered virtually inoperative.

The accommodative monetary policy pushed up asset price inflation. A decline in international food and commodity prices contributed to a fall in inflation to 2.2 percent in June 2009. But with the accommodative monetary policy, upward pressures on real estate prices have become visible and stock market prices have risen by 40 percent since end-March. As international food and commodity prices began to rise again, inflation rose to 6.7 percent in October.

The FY2009 budget deficit remained below the budget target, despite revenue shortfalls, owing to continued problems in implementing the Annual Development Program (ADP). Held back by lower imports, customs revenue fell short of the target. As a result, the ratio of tax revenue to GDP declined by 0.2 percent of GDP to 8.6 percent of GDP, falling short of the original budget target by 0.6 percent of GDP. ADP spending fell short of the original budget by 1 percent of GDP reflecting implementation bottlenecks. The overall fiscal deficit (including grants) amounted to 3 percent of GDP, almost 1 percentage point of GDP smaller than envisaged in the original budget. The counterpart to the lower deficit was mostly in lower than budgeted disbursements of foreign loans.

In the area of structural reforms progress was mixed. Comprehensive plans to address infrastructure bottlenecks, such as the power and gas shortages which are holding back growth, remain under discussion. Progress in Public Private Partnerships (PPP) has been slow. The reintroduction of interest rate ceilings on important categories of bank lending was a setback to financial market development. The recent appointments made at the Boards of Directors of three state-owned commercial banks (SCBs) were not fully in line with established regulations. The FY2010 budget's extension of para-tariffs and the introduction of a regulatory duty to a large number of consumer goods raised nominal protection and is second-best to comprehensive tax policy reform.

Amid continued uncertainty about the strength of the global recovery, Bangladesh's growth momentum is likely to remain somewhat subdued in the near term yet inflation seems set to increase. Accordingly, growth could decelerate in FY2010 as economic activity is likely to be held back by weak imports, particularly of capital machinery, sluggish exports and private sector credit, and subdued hiring of Bangladeshi workers by employers abroad. The strong performance of the agricultural sector in FY2009 will also be hard to exceed substantially. The ample availability of liquidity along with adverse base effects related to last year's unprecedented decline in international food and commodity prices is likely to drive up inflation

throughout FY2010, possibly to double digits by the summer. As strong inflows of remittances are expected to continue, the external position should remain strong and gross international reserves should remain above a relatively comfortable 4 months of prospective imports.

Over the medium term, as global growth and trade recover, Bangladesh's growth should edge up as well, to around 6 percent per annum, building on increasing trade integration with countries in the region and the rest of the world, and growth momentum in the agriculture, services, and construction sectors. The current account can be expected to remain in surplus with the import coverage of reserves remaining robust.

### **Executive Board Assessment**

Executive Directors commended the authorities for the strong performance of Bangladesh's economy, despite the global recession. They noted that growth has been supported by buoyant domestic activity, including in agriculture and services. Directors considered that resilience in exports as well as continued strong inflows of remittances also played an important role. They noted that fiscal conservatism of the government has paid large dividends. Going forward, Directors expected these trends to continue with medium-term growth in the baseline scenario projected at a respectable 6 percent. However, they identified two policy issues.

First, Directors considered preventing an increase in inflation to be the immediate policy concern. They observed that by stabilizing the exchange rate of the taka in the face of strong remittance inflows, monetary policy has been too accommodative for the domestic conditions. Directors welcomed the commitment made by BB to employ all available instruments to contain inflation if and when there are clear signs of a pickup in prices. However, they saw a need for preemptive and bold action by BB. Directors considered that the resulting higher market interest rates would be a small price to pay to prevent a harmful acceleration of inflation, which hurts the poor most severely.

Directors noted that greater flexibility in the exchange rate would support monetary policy objectives. They were of the view that the authorities should move towards greater flexibility in the exchange rate to lessen the constraints on macroeconomic policies. Directors observed that the export sector should be able to sustain such a move, since they believed that the taka is somewhat undervalued, though not far out of line with fundamentals. In Directors' view, increased day-to-day movements in the exchange rate would also help deepen the foreign exchange market.

Second, for the medium term, Directors noted that measures should be taken to unleash Bangladesh's potential, while maintaining fiscal prudence and sustainability. Directors observed that Bangladesh seems stuck in a low revenue-low capital spending equilibrium and infrastructure bottlenecks are holding back growth. They agreed that higher growth could be achieved through higher revenue and higher capital spending. Therefore, Directors strongly encouraged the authorities to push through the plans for Value-Added Tax (VAT) reforms.

Directors noted that further financial deepening is needed to allow Bangladesh to achieve its growth potential. In light of this, they observed that ceilings on lending rates and other non-prudential interventions should be removed as soon as possible. They considered that increased flexibility of interest rates, including for National Savings Certificates (NSCs), would make the auction process for government paper more efficient and give impetus to an active secondary market. Directors noted this would also help offset the government's higher interest costs related to the needed monetary tightening. Directors encouraged the authorities to accelerate the restructuring of SCBs.

Directors noted that continued improvement in the quality and timeliness of statistics would improve policy making. They considered improvements in national account statistics to be particularly urgent.

Directors encouraged the authorities to adopt a timetable for the removal of the remaining exchange restriction subject to approval under Article VIII, on the transferability of funds in nonresident taka accounts.

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**Bangladesh: Key Economic Indicators, FY05–09 1/**

	FY05	FY06	FY07	FY08	FY09
National income and prices (percent change)					
Real GDP	6.0	6.6	6.4	6.2	5.9
GDP deflator	5.1	5.2	6.8	8.0	6.4
CPI inflation (annual average)	6.5	7.2	7.2	9.9	6.7
Central government operations (percent of GDP)					
Total revenue	10.5	10.7	10.2	10.8	10.4
Tax	8.5	8.5	8.2	8.8	8.6
Nontax	2.0	2.2	2.0	2.0	1.8
Total expenditure	13.8	13.9	13.4	15.9	14.1
Current expenditure	8.4	8.4	9.1	9.6	9.8
<i>Of which:</i> Interest payments	1.7	1.8	1.9	2.5	2.4
<i>Of which:</i> Subsidies	2.8	2.6	3.0	3.4	3.8
Annual Development Program	5.0	4.7	4.0	3.4	3.2
Other expenditures	0.4	0.8	0.3	3.0	1.1
Overall balance (excluding grants) 2/	-3.3	-3.2	-3.2	-5.1	-3.7
Primary balance 2/	-1.7	-1.4	-1.3	-2.6	-1.3
Overall balance (including grants) 2/	-3.0	-2.8	-2.6	-4.6	-3.0
Financing (net)	3.3	3.2	3.2	5.1	3.7
Domestic 2/	1.7	2.1	1.9	2.6	2.4
External (including grants)	1.6	1.2	1.3	2.5	1.3
Total central government debt (percent of GDP)	49.1	49.1	48.8	46.7	45.3
Money and credit (end of fiscal year; percent change)					
Net domestic assets	17.5	19.2	12.6	18.3	17.6
Credit to private sector	17.0	18.3	15.1	25.1	14.6
Broad money (M2)	16.7	19.3	17.1	17.6	19.2
Balance of payments (in billions of U.S. dollars)					
Exports, f.o.b.	8.6	10.4	12.1	14.2	15.6
(Annual percent change)	14.0	21.4	15.8	17.4	10.1
Imports, f.o.b.	-11.9	-13.3	-15.5	-19.5	-20.3
(Annual percent change)	20.6	12.1	16.6	25.6	4.2
Current account	-0.6	0.6	1.0	0.7	2.5
(Percent of GDP)	-0.9	0.9	1.4	0.9	2.8
Gross official reserves (in billions of U.S. dollars)					
In months of imports of goods and nonfactor services	2.9	3.5	5.1	6.1	7.5
	2.2	2.3	2.7	3.1	3.6
Memorandum item:					
Nominal GDP (in billions of taka)	3,707	4,157	4,725	5,458	6,149

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

1/ Fiscal year begins July 1.

2/ Includes assumption of BPC liabilities of 1.4 percent of GDP in FY08.