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BANGLADESH

2011 ARTICLE IV CONSULTATION

November 2011

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 2011 Article IV consultation with Bangladesh, the following documents have been released and are included in this package:

- **Staff Report** for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on September 15, 2011, 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 October 14, 2011. 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.
- **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- **Informational Annex** prepared bt the IMF.
- **Public Information Notice** (PIN)summarizing the views of the Executive Board as expressed during its October 28, 2011 discussion of the staff report that concluded the ArticleIV consultation.
- **Statement by the Executive Director** for Bangladesh.

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

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BANGLADESH

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION

October 14, 2011

KEY ISSUES

Growth performance in Bangladesh has been strong the past few years, bolstered by efforts to reduce longstanding infrastructure bottlenecks, particularly power generation, and aided by accommodative policies. Despite global uncertainties, near-term prospects remain favorable, supported by resilient garment exports, a more reliable electricity supply, and consumption-boosting remittance inflows.

At the same time, macroeconomic pressures are intensifying. The balance of payments is under strain owing to increased demand for oil and capital goods imports and elevated levels of commodity prices. Fiscal pressures have emerged due to rising subsidy costs, mainly on account of increased fuel consumption. Finally, inflation is at a multi-year high, with aggregate demand pressures and food price increases the major drivers.

Policy discussions focused on upfront actions needed to reduce these pressures, as well as reforms aimed at boosting medium-term growth prospects and reducing poverty.

- **On the macroeconomic front**, official fiscal and monetary targets for FY12 (July 2011–June 2012) provide solid anchors, but achieving them requires timely and well-coordinated policy actions. To this end, subsidy costs should be reduced by adjusting fuel and electricity prices in order to protect priority spending and contain the budget's domestic financing requirement. Interest rates need to be made more flexible to boost demand for government paper, minimize central bank financing of the budget, and allow the envisaged monetary tightening to be transmitted to the real economy. The greater exchange rate flexibility observed recently should help relieve external pressures.

- **In structural areas**, further reforms to tax policy and administration, public financial management, monetary and exchange rate operations, the financial sector, and the trade and investment regime should help bolster growth and poverty reduction efforts and reduce external vulnerability.

Approved By
Masahiko Takeda and Thomas Dorsey

The 2011 Article IV consultation discussions took place in Dhaka and Chittagong during September 5–15. The staff team comprised Messrs. Cowen (head), Almekinders, and Toh, and Ms. Bouza (all APD), Ms. Kaendera (FAD), and Mr. Leichter (SPR). Ms. Kvintradze (Resident Representative) supported the mission. Mr. Arze del Granado (now AFR) and Ms. Maslova (now SPR), as well as Mr. Weerasinghe (OED), joined earlier related discussions. Mses. Kim, Loucks, and Olmedo (APD) assisted in the preparation of this report.

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APPENDIXES

INTRODUCTION

1. **Growth performance in Bangladesh is improving, but macroeconomic imbalances have also emerged.** Official estimates place real GDP growth at 6.7 percent in FY11 (July 2010–June 2011), up from 6.1 percent in FY10 and an average of 5.8 percent over the last decade (Table 1). At the same time, inflation is now in double digits, running at a three-year high. Despite record export growth, the balance of payments (BoP) went into a deficit in FY11 for the first time in a decade. As a result, foreign reserves slipped from their highs in late 2010. To absorb external pressures, the taka was allowed to depreciate vis-à-vis the U.S. dollar over the past 12 months, in contrast to the preceding three years, when the exchange rate was kept stable but imbalances built (Figure 1).

2. **Medium-term growth targets are appropriately ambitious, but they are also likely to intensify macroeconomic pressures if not managed well.** Under the government's Vision 2021 and backed by its Sixth Five-Year Plan (2011–15), growth is targeted to increase to 8 percent by FY15 and 10 percent by FY21.[1] If realized, the poverty rate is expected to decline from 31.5 percent in FY10 to 22.0 percent in FY15, driven down by more inclusive growth. Achieving this vision will require Bangladesh to leave behind the low revenue-low investment-low growth equilibrium highlighted by Directors during the last Article IV consultation. Since then, growth has picked up and other signs of progress have emerged, through a rising tax take, higher public investment, and rapidly expanding exports, although each from a small base. Growth in ready-made garment (RMG) exports, in particular, has been a major employment generator, especially for women, who make up 80 percent of the sector's four million workers. Micro, agricultural, and small-to-medium enterprise credit opportunities continue to multiply. However, the infrastructure deficit is enormous (see Appendix I), foreign direct investment (FDI) remains dismally low (at well under 1 percent of GDP annually), and employment opportunities are still limited, as exemplified by the large number of workers seeking opportunity abroad.

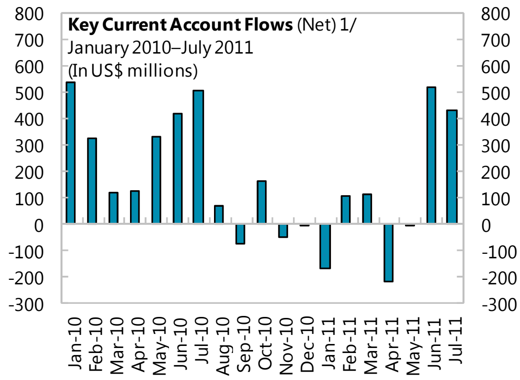
3. **The 2011 Article IV consultation focused on accelerating growth-promoting structural reforms, while ensuring a stable macroeconomic environment.** Discussions took place against the backdrop of an ongoing dialogue on a possible IMF-supported program.[2] In this context, reform priorities of the government are appropriately focused on tax policy and administration, public financial management (PFM), monetary and exchange operations, the financial sector, and the trade and investment regime. They are intended to help bolster growth and poverty reduction efforts and reduce external vulnerability. Until

[1] The authorities intend to use the Sixth Five-Year Plan as their new poverty reduction strategy paper. The plan will replace the National Strategy for Accelerated Poverty Reduction II (FY09–11).

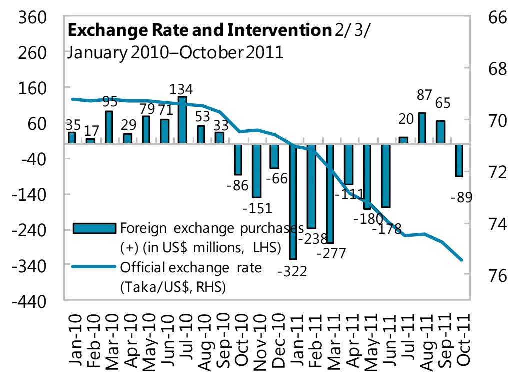
[2] The staff and authorities have been discussing the policy framework for a possible three-year Extended Credit Facility arrangement over the past year. In early 2011, a terms-of-trade shock due to rising oil prices and policy accommodation put additional pressure on the BOP, requiring further adjustment. Since then, policy discussions have continued on a range of issues needed to address these pressures.

Figure 1. Bangladesh: Response to External Pressures

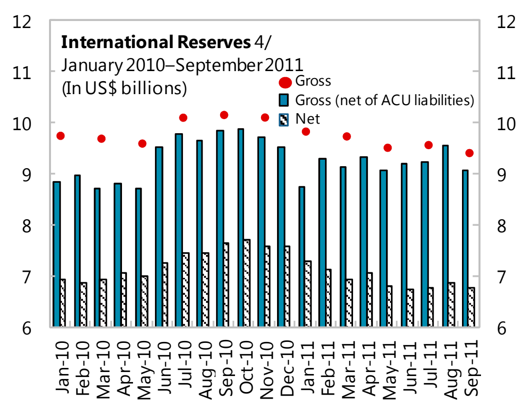
A key indicator of the external position—the sum of net exports and remittances—has weakened, with the uptick lately largely due to pre-Ramadan remittance inflows.



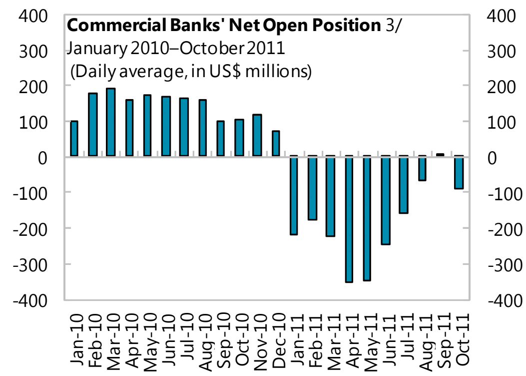
Despite stepped-up intervention by Bangladesh Bank (BB), the taka has remained under downward pressure.



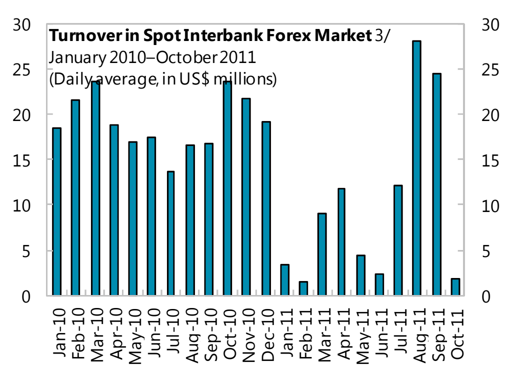
As a result, gross and net international reserves have declined, with gross reserves down by around US$800 million from their late 2010 peak.



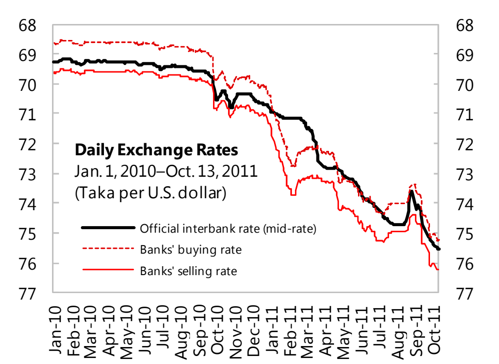
Banks' average monthly net open position turned substantially negative in early-2011, also indicative of external pressures.



Turnover in the official interbank foreign exchange market dwindled in January-February and May-June, as BB intervention was at below market-clearing rates.



Instead, banks started buying and selling at a much more depreciated exchange rate than the official rate, although market and official rates have now reconverged.



Sources: Bangladesh authorities; Bloomberg; CEIC Data Company Ltd; and IMF staff estimates.
1/ Sum of net merchandise exports and remittances.
2/ Monthly average exchange rates and the sum of foreign exchange interventions (including changes in foreign exchange overdrafts) by BB.
3/ Observations for October 2011 are averages and totals through October 11, 2011.
4/ Gross reserves excludes deposits held in offshore accounts of resident financial institutions, noninvestment grade sovereign bonds, and the outstanding stock of foreign exchange overdrafts. Observations for September 2011 are as at September 26, 2011.

these reforms take hold, BOP pressures are likely to intensify. These pressures, in part, stem from import-intensive investment now on the rise as Bangladesh tackles power, transport, and water supply bottlenecks, which have dampened growth performance. Efforts to address electricity shortages are already leading to a surge in oil and capital goods imports, with the immediate focus of the government's *Power and Energy Sector Road Map* on installing fuel-intensive rental power plants to boost the power supply.

RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

A. Macroeconomic Developments

4. The economy expanded at a strong pace in FY11, but external and inflation pressures also intensified.

- **Growth and inflation:** Growth in FY11 was buoyed by services, construction, and manufacturing, led by RMG exports and supported by accommodative policies (Figure 2). Headline inflation has been pushed up the past year primarily by food prices, reaching 11.3 percent (y/y) in August 2011. Nonfood inflation is also on the rise owing to demand pressures, reaching 8.8 percent in August.

- **Balance of payments:** External factors and domestic demand conditions contributed to a marked deterioration in the overall BOP in FY11, with external vulnerability on the rise (Box 1). Weak aid inflows added to BOP pressures. Export growth (42 percent), fueled by gains in global market share for RMGs, was more than offset by import growth (42 percent), with its larger base driven up by demand for oil, RMG- and food-related, and capital goods imports , as well as a surge in commodity prices (Table 2 and Figure 3). At the same time, remittances growth slowed, owing to declines in manpower exports since 2009. As a result, the current account surplus eroded by almost 3 percentage points of GDP in FY11 to about 1 percent of GDP. Performance in FY11 deviated from the recent past, when strong remittance growth and suppressed import demand resulted in large current account surpluses and rapid reserves buildup.

- **Gross official reserves** were US$10.0 billion at end-FY11 (2.9 months of prospective imports of goods and nonfactor services), compared to US$10.1 billion at end-FY10 (3.4 months of import cover). However, this masks underlying pressures, in part owing to valuation gains (US$639 million) and nonreserve asset sales (US$145 million) by Bangladesh Bank (BB) to help finance the BOP deficit. Reserves stood at US$9.4 billion (2.6 months of import cover) as of end-September 2011.

- **Exchange rate:** The taka also came under pressure, having depreciated by around 7 percent against the U.S. dollar over the 12 months to end-September 2011, notwithstanding about US$1.4 billion in official foreign exchange sales by BB, including foreign exchange overdrafts (FXODs), over the same period. In recent months pressures have eased, due partly to seasonal factors, but also owing to increased reliance by Bangladesh Petroleum Corporation (BPC) on short-term nonconcessional suppliers' credit to finance oil imports.

Box 1. Bangladesh: External Vulnerability and Implications of a Global Downturn

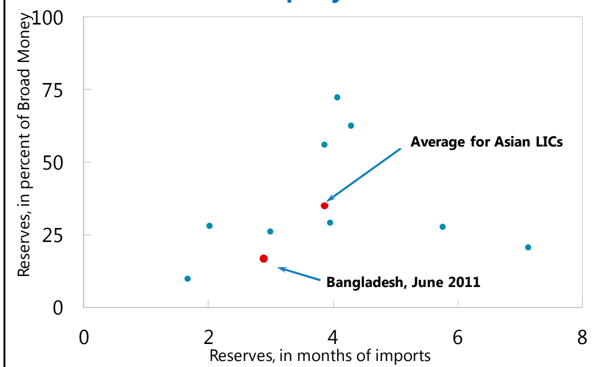
Bangladesh's economy has become increasingly open in recent years, but it still remains insulated compared to regional peers. Despite impressive gains over the past decade, total exports were only 21 percent of GDP in FY11. However, they remain highly concentrated both in terms of products and destinations, which carries some risk, with RMG exports to the E.U. and the U.S. the current mainstay. As a reputable low-cost producer of garments, Bangladesh has gained further global market share in recent years. This trend is expected to continue over the medium term, which could partially mitigate the impact of slow growth in advanced economies.

At a glance, Bangladesh's susceptibility to a global downturn appears limited, but declining foreign reserves makes it increasingly vulnerable to shocks. Under a scenario with a global downturn akin to the 2008–09 global recession, the current account could deteriorate by an additional ½ percentage point of GDP in FY12, while GDP growth could be lower by up to ¾ percentage point relative to the FY12 baseline. This would translate into additional reserve losses of around US$500 million, bringing foreign reserves down to around two months of forward import cover by end-FY12.

Bangladesh's reserves adequacy is low by most measures, including compared to regional peers. Under the current outlook, foreign reserves are projected to decline to around 1½ months of import cover by FY15—again very low by most standards and pointing to fairly sizable financing and adjustment needs to reduce vulnerability. In the past, Bangladesh often relied on administrative measures and moral suasion to cope with low levels of reserves. However, with the increased openness of the economy, a return to these practices would be counterproductive. Most importantly, it could discourage remittance inflows through formal channels. These flows have become a key driver of the current account in recent years and provided important support again in FY11, notwithstanding a slowdown in their growth.

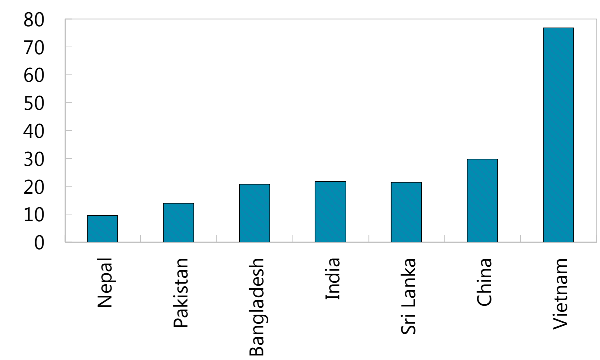
[1] Prepared by Gerard Almekinders (APD).

Asian LICs: Reserve Adequacy, End-2010 1/



Sources: *World Economic Outlook;* and IMF staff estimates.
1/ Excludes Bhutan, Timor-Leste, and Myanmar.

Exports of Goods and Services, 2010
(In percent of GDP)



Sources: *World Economic Outlook*, and IMF staff estimates.

Bangladesh: External Vulnerability Indicators 1/

	FY01	FY09	FY10	FY11 Est.	FY12 Proj.
Export concentration (in percent of total exports)					
Top two products					
Ready-made garments (RMG)	75	79	77	77	...
Jute and jute products	5	3	4	5	...
Destinations					
European Union	45	52	52	49	...
United States	39	26	25	25	...
Emerging and developing economies	7	12	12	15	...
Reserve coverage					
In months of prospective imports of good and services	1.7	3.6	3.4	2.9	2.3
In percent of short-term debt on a remaining maturity basis	234	311	1,072	613	358
In percent of broad money (M2)	12	8	19	17	13
Change in the current account (CA) from previous year (in US$ millions)	-681	1,834	1,201	-2,738	-1,847
Contribution of higher oil imports (percent of the CA change) 2/	28	-6	2	57	116
Contribution of higher remittances (percent of the CA change) 2/	10	97	108	-24	-63
Memorandum items:					
Exports of goods and services (percent of GDP)	15	19	19	23	24
Remittances (percent of GDP)	4	11	11	11	11

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

5. The fiscal stance in FY11 was moderately expansionary, with an overall deficit (including grants) estimated at 3.7 percent of GDP (Tables 3 and 4, and Figure 4). While less accommodative than budgeted, the deficit was financed almost entirely domestically, with a sizable portion from BB.

- **Revenue:** Tax revenue surpassed 10 percent of GDP—a major milestone for Bangladesh, with gains coming mainly through tax buoyancy and administrative reforms (i.e., automation, registration, and enforcement).[3] At the same time, nontax revenue missed the mark, reflecting unanticipated delays in collecting telecommunications fees and other receipts.

- **Expenditure:** Annual Development Program (ADP) spending increased to 4.2 percent of GDP—its highest level in four years, but still below budget.[4] On the other hand, subsidies and transfers, including net lending to BPC, far exceeded the budget. They were driven up by higher-than-anticipated commodity prices, food security measures (see Appendix II), and subsidy-related transfers to energy and fertilizer-related state-owned enterprises (SOEs), notwithstanding recent fuel price and electricity tariff adjustments (Box 2).[5] To cover its losses, BPC also received financing from state-owned commercial banks (SOCBs) and the Islamic Development Bank (IsDB), which could eventually bear on the budget.[6]

- **Budget financing:** External aid inflows fell substantially in FY11, elevated in the previous year by crisis-related budget support from the Asian Development Bank (AsDB). Domestic nonbank financing declined further, too, in part due to less favorable tax treatment and nominal yields on National Savings Certificates. Consequently, domestic bank financing rose sharply. Suppressed treasury yields shifted added burden onto BB, directly through increased ways and means advances and overdrafts to the government and indirectly through targeted liquidity support provided to primary dealers to encourage participation in treasury auctions.

6. Monetary policy remained accommodative in FY11, with BB taking only partial tightening measures, despite the prevailing loose credit conditions and inflation

[3] Tax revenue in Bangladesh is still very low as a share of GDP, comparing collections in its most recently completed fiscal year with those in Vietnam (24 percent), China (18 percent), India (15 percent), Nepal (13 percent), and Sri Lanka (13 percent).

[4] The implementation rate of foreign-financed projects remains low, as was the case in FY11. A July 2010 report prepared by Bangladesh's Ministry of Finance identified overlapping responsibilities of central government agencies and a process- rather than results-oriented approach as main factors in hindering the planning, budgeting, and ultimately implementation of aid-funded development projects.

[5] In February 2011, bulk and retail electricity prices were raised by 5 and 11 percent, respectively. In May, petroleum prices were increased by around 4 percent, and compressed natural gas prices by 49 percent. In September, petroleum prices were raised by a further 11 percent.

[6] In FY08, the government securitized SOCB loans to the BPC, then equivalent to 1.4 percent of GDP. At end-FY11, SOCB loans to SOEs amounted to 1.9 percent of GDP, of which half were to the BPC. In addition, BPC's outstanding debt to the IsDB was estimated at 0.6 percent of GDP at end-FY11; this debt is guaranteed by the government and is captured in the DSA.

Box 2. Bangladesh: The Budgetary Impact of Subsidies[1]

Subsidy costs in Bangladesh are increasing rapidly, mainly due to higher domestic demand and rising import-related costs of heavily subsidized products—namely fuel, electricity, and fertilizer. Currently, broad subsidies are used to shield consumers from the full impact of price movements. For the largest ones, they are initially absorbed in the financial positions of large state-owned enterprises (SOEs)—namely Bangladesh Petroleum Corporation (BPC, fuel), Bangladesh Power Development Board (BPDB, electricity), and Bangladesh Chemical Industries Corporation (BCIC, fertilizer). Operating losses for these SOEs are, in turn, covered by loans from state-owned commercial banks, direct budget transfers, and/or net lending by government (effectively transfers).

The largest single contributor is fuel subsidies, which could undermine fiscal sustainability absent price adjustments. This cost alone could rise to about 1.6 percent of GDP in FY12 from 1.0 percent in FY11 and 0.1 percent in FY10, mainly due to the lack of pass-through of higher oil prices and rising energy demand. Even after the latest price hike, the retail price of diesel in Bangladesh would have to rise by another 44 percent, by staff estimates, for the BPC to break-even, i.e., to cover its import and operating costs. Higher subsidy costs in FY12 do not factor in potential smuggling to India, where diesel prices at end-September 2011 were about 40 percent higher than in Bangladesh. Electricity and fertilizer related subsidies are expected to be around 1½ percent of GDP in FY12. On the other hand, food-related subsidies, though increasing in FY11, appear to be contained to around ¾ percent of GDP (see Appendix II on food security).

Bangladesh: Subsidies, FY2010–12

Year	Total Subsidies (TK bn)	Proportion of Subsidies in Total Spending	Subsidies as a percent of GDP
FY10	90	8.8	1.3
FY11 1/	174	13.8	2.2
FY12 1/	315	19.1	3.4

Sources: Bangladesh authorities; and IMF staff estimates.
1/ Denotes estimates.

The government has indicated that budgetary transfers are expected to fully cover SOE losses, a substantial departure from past practice. Still, major reforms to these SOEs are urgently needed to contain costs. Although below-market pricing has contributed significantly to their poor financial state, some losses also stem from operating inefficiencies. Regular audits of these SOEs are critical to improving their financial health.

Without further fuel and electricity price adjustments, subsidies are likely to rise over the medium term. Greatest concern arises from fuel imports for power generation, notably at new rental power units being set up to provide short-term relief to major electricity shortages (see Appendix I on infrastructure development). These units, as well as several new natural-gas fueled power plants, will drive energy demand over the next few years.

Recent and prospective increases in the price of petroleum products will likely have knock-on effects on other SOEs. For instance, electricity tariff adjustments announced in February 2011 may not be sufficient to contain the BPDB's operating losses if the input costs for its power plants and the newly setup rental power plants rise.

Effect on the poor. Evidence on welfare impact of fuel prices in Bangladesh suggests that there is a high degree of subsidies leakage to mid-to-upper income households. Moving to cost recovery for fuel and electricity would obviate the need for subsidies to loss-making SOEs. Some of the freed-up government resources could be used to enhance safety nets for the most vulnerable groups.

[1] Prepared by Stella Kaendera (FAD).

pressures (Table 5 and Figure 5). As a result, the central bank missed its reserve money target by a wide margin in FY11. In part, monetary policy effectiveness continues to be constrained by weak anchors and objectives (Box 3). Under these conditions, private credit expanded rapidly in 2010 and the first half of 2011, with growth peaking at a record 29 percent (y/y) this past March. It moderated to 23 percent (y/y) in August 2011 (the latest available data). With some delay, BB began raising its repo rate in August 2010—cumulatively now by 275 bps to the current 7.25 percent, while also increasing its cash reserve requirement in December 2010. Nonetheless, repo auctions continued to be severely oversubscribed in much of FY11 owing to strong credit demand and negative real rates. To address emerging liquidity pressures at banks, BB resorted occasionally to open market purchases, in addition to providing regular and emergency repo support. At the same time, most bank lending rate caps were lifted in March 2011, with a subsequent 200–300 bps rise in their base rates.[7] Bank-by-bank credit-to-deposit ratio (CDR) ceilings were imposed around the same time.

7. **Financial sector stability remains a concern** (Box 4). Despite newly adopted Basel II standards, solvency risk among some banks may be increasing, exacerbated by rising liquidity pressures, stock market exposure, and weak supervisory oversight. Recent external audits of the SOCBs pointed to still lax controls. Financial soundness indicators at these and specialized banks remain significantly weaker than at private banks, notwithstanding some recent improvement (Table 6). Equity markets have been volatile, fueled in part by loose credit conditions. The main Dhaka index has fallen by about a third from its December 2010 all-time high (when total stock market capitalization exceeded 50 percent of GDP), after market valuation tripled during 2009–10. Attempts to cushion the fall by relaxing margin lending requirements for retail investors and providing market support through public financial institutions (including through the new Bangladesh Fund) have potentially elevated fiscal risks and created moral hazard.[8] Equity markets remain grossly under-regulated by the Securities and Exchange Commission (SEC) and subject to extensive manipulation, as found by a high-level probe in mid-2011 looking at the preceding market drop.

8. **The debt sustainability analysis (DSA) indicates the risk of external debt distress is low**, reflecting the high degree of concessionality and relatively low level of external debt (22 percent of GDP). However, debt burden indicators are less favorable when domestic debt (21 percent of GDP) is included. Risks are also more elevated when taking into account contingent liabilities and quasi-fiscal activities of SOEs and SOCBs.

[7] Lending rate caps remain on agriculture, industrial-term, and SME loans, as well as loans for the importation of several other items.

[8] The Bangladesh Fund is a Tk 50 billion (0.6 percent of GDP) investment pool set up in March 2011 by the publicly owned Investment Corporation of Bangladesh and subscribed by SOCBs, with the principal aim of providing support to equity markets.

Box 3. Bangladesh: Improving the Effectiveness of Monetary Policy[1]

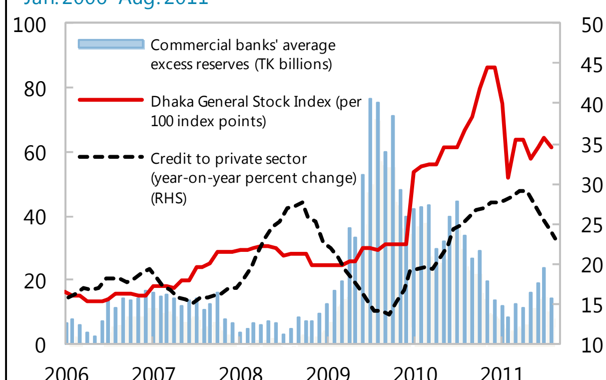
Monetary policy in Bangladesh is constrained by several factors, which limit its effectiveness. At the outset, the multiplicity of objectives in Bangladesh Bank's (BB) half-yearly Monetary Policy Statements (MPS) lead to an obscured focus on price stability, providing a weak anchor for inflation expectations. The July 2010 MPS, for example, stated BB's monetary policy stance as "...designed to support government's policies and programs in pursuit of faster inclusive economic growth and poverty reduction, while also maintaining price stability." The January 2011 MPS speaks to the need to keep monetary expansion in line with GDP growth, but also seeks a "growth supportive approach" involving financial inclusion and directed credit, conflating several objectives. The July 2011 MPS, however, has a clearer focus on restraining credit.

Further clarity is needed on the relationship between monetary aggregates and prices, as well as inflation dynamics, in order to properly calibrate monetary targets. While BB espouses a monetary targeting framework, the link between money growth and inflation has been tenuous. In part, this may be due to the large weight of food in headline inflation, which distorts measurement of core inflation (currently proxied by nonfood inflation). The effect of various lags also needs to be better understood. For example, the second-round effects from food price inflation to nonfood inflation appear to be rising in recent years—a period when global food prices have become more volatile.

Earlier limits to exchange rate flexibility have contributed to deviations from monetary targets. While BB purportedly had in place a monetary targeting framework in recent years, it effectively operated an exchange rate targeting framework until late 2010, with the aim of stabilizing the taka against the U.S. dollar. During this time, amidst heightened external inflows, BB's unsterilized interventions in the foreign exchange market increased net foreign assets, driving reserve money (RM) above programmed levels (see table). The resulting build-up of excess liquidity likely contributed to asset price inflation, including the stock market boom, and also fed into rapid credit growth (see figure), sowing the seeds for rising demand-driven inflation that emerged in FY11.

Policy inconsistency has also undermined the effectiveness of policy instruments. Attempts by the central bank to tighten monetary policy in FY11 via increases in policy rates and reserve requirements were undercut by its own expanded provision of repos to primary dealers and foreign exchange overdrafts to state-owned commercial banks, causing RM to again exceed targets. The RM overshooting has been exacerbated by BB's direct financing of the government deficit, which eventually drove almost half of the expansion in RM, pointing to the need to strengthen the whole monetary policy framework by giving greater independence to the central bank.

Bangladesh: Commercial Banks' Excess Reserves, Private Credit Growth, and the Stock Market
Jan. 2006–Aug. 2011



Sources: Bangladesh Bank; CEIC Data Company Ltd.; and IMF staff estimates.

Bangladesh: Official Monetary Targets and Outturns, FY09–FY12
(Percent change)

	FY09		FY10		FY11		FY12
	Target	Outturn	Target	Outturn	Target	Outturn	Target
Reserve money	17.2	31.9	3.5	18.1	13.0	21.0	16.0
Broad money (M2)	17.5	19.2	15.5	22.4	15.2	21.4	18.5
CPI inflation (average)	9.0	6.7	6.5	7.3	6.5	8.8	7.5

Source: Bangladesh Bank.

[1] Prepared by Seng Guan Toh (APD).

Box 4. Bangladesh: Recent Banking System Developments[1]

Broadly speaking, recent financial soundness indicators (FSIs) point to marginally improved performance for the banking system, but risk factors remain. Capital adequacy ratios (CARs) have improved across all banks, with 40 out of 47 in compliance with new Basel II-consistent requirements at end-June 2011 (i.e., a minimum CAR of 9 percent). Key asset quality and bank profitability indicators have also strengthened for most categories of commercial banks, although private commercial banks saw a slight rise in bad loans and slippage in profit indicators in the first half of 2011.

However, banks' true financial health is likely masked by reporting standards that are not in line with international best practices. For example, loan classification standards, specifically the definition of past-due loans, is more lenient than in most banking systems, with loans delinquent by 3–6 months put in the "special mention" category (against the standard 2–3 months) and loans overdue by more than 18 months considered a "loss" (against the standard 12 months). Loan provisioning standards need to be more clearly conveyed by BB to banks.

The financial performance and capital needs of state-owned commercial banks (SOCBs) require special attention, as evident in their latest FSIs. The same holds for specialized development banks, although these institutions represent under 6 percent of total banking system assets. For the SOCBs, CARs are overstated by most recognized standards. In 2007, the authorities allowed special accounts to be set up on the asset side of these banks' balance sheets, which reflected the difference between the market and the book value of SOCBs' assets. These accounts effectively represent accumulated losses that have not been deducted from the banks' capital base. Each SOCB is expected to amortize these losses against future earnings over a 10-year period. Once the amounts booked in these accounts are deducted from capital, the SOCBs' average CAR drops to 1.5 percent from the reported 9.5 percent at end-June 2011.

Bangladesh Bank has attempted to improve SOCB operations through memoranda of understanding (MOUs) and external audits. The MoUs set out quarterly performance indicators for each bank. However, they are routinely adjusted, potentially undermining their effectiveness. Audit reports of the four large SOCBs for the 2010 financial year drew attention to lags in writing off bad loans, including those classified as such for more than five years. The reports also pointed to shortfalls in provisioning and increased risk, due in some cases to profit concentration in stock market investments rather than from traditional banking activities.

For the banking system as a whole, recent risks have arisen from:

- **Stock market volatility.** Most banks are currently within the overall shareholding limit of 10 percent of total liabilities. However, this limit is more relaxed than the regional norm, which is typically around 25 percent of bank regulatory capital (in Bangladesh, this would be equivalent to 2.3 percent of total liabilities at end-June 2011). Recent stress tests suggest that SOCBs' capital (adjusted for the value of the aforementioned special accounts) would be depleted in the event of further 25 percent decline in stock prices.
- **Merchant bank subsidiaries.** Commercial banks have been allowed to set up subsidiaries since October 2010. These newly created institutions remain under-supervised, with parent institutions possibly off-loading risk. Supervisory weaknesses in the Securities and Exchange Commission, which are directly responsible for overseeing these subsidiaries, remain an issue.
- **Liquidity pressures.** Rapid credit expansion has put liquidity pressure on some banks, exacerbated by the December 2010 stock market correction, heavy funding needs of government, and weak secondary market development. In response, BB imposed a ceiling on banks' credit-to-deposit ratios (CDRs) of 85 percent (90 percent on Islamic banks) in mid-2011 to better align bank credit and deposit growth. As of end-August 2011, 13 banks exceeded the CDR limit.

[1] Prepared by Serpil Bouza (APD).

B. Outlook and Risks

9. The growth outlook in FY12 is favorable, but macroeconomic pressures are likely to become more acute, putting this outlook at risk without policy adjustments. Real GDP growth is projected to be 6.3 percent in FY12, with domestic demand the main driver, bolstered by expansionary policies. However, inflation is expected to remain at an elevated level—projected at 10.7 percent (y/y) at end-FY12—given prevailing aggregate demand conditions and food and energy price pressures. The current account is likely to slip into a deficit in FY12 of around ¾ percent of GDP, with the deterioration driven by oil imports, putting more pressure on foreign reserves and also adding substantially to subsidy costs, without sizable fuel price adjustments. Under this outlook, which itself is subject to considerable uncertainty (see Box 1), gross official reserves are projected to decline to US$9.1 billion (2.3 months of import cover) by end-FY12.

10. The medium-term growth outlook hinges on the government making steady progress on key structural reforms aimed at increasing government revenues; boosting investment rates, including FDI; and expanding the export base. Strong, transparent governance will also be critical to improving the business climate. In the event, real GDP growth is projected to average 6¾ percent during FY13-16 (Table 7). Inflation is expected to fall over the medium term on moderate policy tightening, stable commodity prices, and easing supply constraints. However, BOP pressures are likely to prevail, notwithstanding a favorable export and remittances outlook, as oil import volumes increase and infrastructure investment intensifies. With reserves adequacy already low, even the moderate projected current account and BOP deficits are expected to bring the import cover below 1.5 months over the next several years, highlighting Bangladesh's potential financing and adjustment needs and growing vulnerability to external shocks.

11. Risks to the outlook are tilted to the downside. Continued loose macroeconomic policies and weak policy anchors could be further destabilizing. Possible fuel and electricity price adjustments could add to inflation pressures, if second-round effects are not properly managed. Weaker-than-forecasted growth in mature economies could weigh on RMG exports and remittances, adding to BOP pressures. Likewise, insufficient progress in addressing infrastructure bottlenecks, including generating adequate internal resources through tax reform, could dampen both public and private investment, potentially stifling growth. Lax oversight of financial markets could exacerbate risks, including fiscal ones, especially if excessive market volatility invites further public interventions. On the other hand, unforeseen gains in RMG market share and an uptick in manpower exports could cushion both growth and external prospects.

12. The authorities broadly agreed with staff's assessment of near-term outlook and risks. The official growth target is 7 percent in FY12, pushed up by stronger domestic demand than envisaged by staff. At the same time, the authorities saw potentially larger pressures on the current account owing to investment-related import demand, financed, in part, from timely disbursement of development partner resources, including those associated with the Padma Bridge mega-project (see Appendix I for more details on the project). The authorities believed realization of their near- to medium-term growth and stability objectives required (i) a concerted approach to ease power and infrastructure bottlenecks, including through public-private partnerships (PPPs); (ii) more incentives to the garment sector to diversify to new markets; (iii) new market penetration by Bangladesh's migrant workers, with better facilitation of inward remittances through improved cross-border financial linkages and innovations; and (iv) strengthened regulations and supervision of the banking sector to address potential risks, including those emanating from the stock market.

MACROECONOMIC AND FINANCIAL POLICY DISCUSSIONS

13. Policy discussions for the 2011 Article IV consultation focused on upfront policy actions needed to preserve macroeconomic and financial stability and on structural reform priorities to support medium-term growth. For FY12, staff noted that the fiscal and monetary targets set forth in the FY12 budget and BB's Monetary Policy Statement (MPS) provided solid anchors, but needed to be supported by well-coordinated policy actions, in particular on budget financing. The authorities were also urged to move forcefully on passing new tax laws, bringing down subsidy costs, and further tightening monetary policy, while at the same time maintaining a flexible exchange rate. In addition, staff also noted the need for more progress on strengthening banking supervision and SOCB operations, including their governance.

A. Easing Subsidy Pressures and Creating Fiscal Space

Overview

The official fiscal stance points to a further widening in the overall deficit (including grants) to 4.5 percent of GDP in FY12. However, in staff's view, expenditures are likely to be more heavily tilted toward covering subsidy costs. External financing is also expected to be weaker than budgeted. In the event, the domestic financing requirement will remain large, with the burden expected to continue to fall on BB. If so, monetary targets might be seriously undermined, heightening inflation risk. To ease subsidy pressures, staff urged upfront adjustments to fuel and electricity prices, coupled with further progress on structural fiscal reforms.

Staff's views

14. Main discussions focused on :

- **Containing subsidy costs.** Maintenance of fiscal space for vital social and development spending requires urgent action on fuel prices. In the event domestic prices are not adjusted, total subsidy costs are expected to rise to 3.4 percent of GDP in FY12 from 2.2 percent in FY11, with most of the increase to cover additional losses by BPC. Staff urged that these costs be brought fully on budget, but also noted the need to contain subsidy growth through a committed plan for fuel price adjustments. As a first best option, an automatic adjustment mechanism would depoliticize pricing decisions. Staff urged that any adjustments also come with well-targeted safeguards. Regarding outstanding loans from SOCBs to loss-making energy and fertilizer related SOEs, staff cautioned that securitizing them should be done only as part of broader subsidy reforms.

- **Pressing ahead on tax reforms.** Timely approval of a new VAT law and direct tax code would provide the main anchors to a modern tax regime, as necessary for the government to achieve its medium-term tax revenue target of 13 percent of GDP. A clear, time-bound strategy, inclusive of stakeholder consultations, is needed to finalize each law for Parliament's approval. For the VAT, staff noted that the implementation could take 18–24 months to execute, given extensive training, procedural, and automation needs, with considerable follow up technical assistance (TA) anticipated.[9] On direct taxes, staff urged priority be given to the new income tax provisions, as more controversial wealth and property tax (excluding agricultural lands) sections in the draft law could slow its approval. Staff welcomed the outline by the National Board of Revenue (NBR) of a tax modernization scheme (2011–16), which provides a blueprint for a well-sequenced action plan and future capacity building. The plan envisages moving the NBR to a functional system of organization, which should streamline tax processes currently separated across its income tax, VAT, and customs wings. To strengthen the NBR's capacity, the government approved in FY11 a long-time request to begin hiring new tax officers. The NBR is also rolling out a coordinated system of individual and business taxpayer identification numbers. In addition, it plans to further modernize customs by putting in place the ASYCUDA World System in the next few years, with UNCTAD support.

- **Strengthening PFM.** Reforms to planning, budgeting, and procurement processes are expected to be immediate priorities of the government's Strengthening Public Expenditure Management Project (SPEMP).[10] The project, which will guide PFM reforms, has been slow to start, and in staff's views also should aim to accelerate reforms in cash and debt management. Staff encouraged the government to update its fiscal Report on Standards and Codes (ROSC) to gauge progress against the last ROSC (2003) and benchmark future reforms. A Public Expenditure and Financial Accountability (PEFA) assessment was completed in 2011, identifying the lack of transparency in inter-governmental operations, poor oversight of aggregate fiscal risk from public sector entities, and weaknesses in expenditure controls, internal audit, and fiscal reporting. Regarding ADP implementation, staff urged finalization of a plan to prioritize projects, speed up approvals, and strengthen procurement processes by end-2011. A medium-term macro-fiscal framework is being developed to enhance the coherence between budget formulation, resource availability, and

[9] The World Bank Group, AsDB, and IMF are currently providing TA, with support also from the United Kingdom's Department for International Development.

[10] The SPEMP is financed by a multi-donor trust fund administered by the World Bank and supported by the European Union, United Kingdom, and Denmark.

macroeconomic objectives. Staff welcomed the new cell set up in the Ministry of Finance (MoF) to oversee the use of government funds in PPPs for infrastructure development and encouraged steps to ensure proper budget integration of related projects. A PPP office, to be staffed by professional managers, has been established to guide the overall process.

- **Improving debt management.** A strategy to improve debt management is being formulated by the MOF, which staff urged be finalized by end-2011. On external borrowing, staff pressed the need for continued reliance on concessional borrowing. At the same time, any medium-to-long term nonconcessional borrowing should be limited to high-return infrastructure projects and well-integrated with a medium-term fiscal and debt sustainability framework. With respect to short-term nonconcessional borrowing by the BPC, such borrowing should be done in the context of broader strategies to raise domestic energy prices and to address BOP financing needs. On domestic borrowing, staff urged that treasury bill and bond rates better reflect market conditions. Low, nonmarket clearing yields undermine fiscal discipline, weaken the monetary policy framework, and create myriad distortions in the financial system. In this context, BB, as the government's fiscal agent, should ensure cut-off rates reflect prevailing supply and demand conditions. Currently, primary dealers are being effectively taxed through devolvement, which impinges on banks' profitability and may encourage excessive risk taking in other activities.

Authorities' views

15. The authorities broadly shared the staff's views. They noted their track record of fiscal prudence and indicated that raising revenue and boosting ADP spending were top priorities. The budget framework adopted in FY11 requires quarterly reporting by the MoF to Parliament, which has increased fiscal transparency.

- **On subsidy costs**, the authorities recognized the need to increase cost recovery for energy. They noted that various scenarios for phased increases in retail petroleum prices were under active consideration, with concerns about inflation implications being weighed against budgetary imperatives. The authorities cited their own commitment to semi-annual tariff increases for power over the next three years, with increased electricity supply allowing better service delivery. They also indicated pending TA from the World Bank on better tracking subsidy schemes and effectiveness, potentially delivering cost savings.

- **On tax policy and PFM reform**, the authorities were hopeful new VAT and direct tax laws could be sent to Parliament in the course of FY12, with the necessary political consensus. However, they also recognized a challenging political road ahead, given numerous tax exemptions and flagrant tax avoidance under the current tax regimes. The authorities noted that the SPEMP would continue to guide PFM reforms, focusing initially on strengthening budget planning and execution. The PEFA assessment and a recent SPEMP-related diagnostic study were expected to inform other PFM reform priorities. The authorities also indicated that an inter-ministerial coordinating committee has been established to prioritize ADP projects (including externally funded ones).

- **On debt management and budget financing**, the authorities recognized the need to develop a sound debt management strategy. With Bangladesh having received its first sovereign rating in 2010 (Moody's Ba3 and S&P's BB-), they suggested a sovereign issue could be part of their medium-term borrowing plans. Under current circumstances, the authorities viewed short-term nonconcessional borrowing by BPC as unavoidable, given necessary oil imports. However, they accepted that the recent rise in domestic borrowing was unsustainable and that treasury rates might need to rise further while other steps were taken to bring the deficit under control. The authorities also noted their interest in seeking budget support from the World Bank and other development partners. They see this support as essential until the government can adequately expand its tax base.

B. Allowing Monetary Tightening to Take Hold and Market Rates to Adjust

Overview

Monetary policy in FY12 needs to be appropriately tight, but its effectiveness requires greater policy coordination and consistency. Bangladesh Bank's performance against its own targets has been weak owing to a lack of central bank independence, an inadequate liquidity management framework, and delays in policy responses, all of which have combined lately to undermine BB's nominal anchor and increase inflation risk. In this respect, staff welcomed recent increases in the repo rate, removal of most lending rate caps, and other tightening measures. Increased exchange rate flexibility has also been allowed in FY11, in line with Directors' advice given in the context of the last Article IV consultation, which has prompted staff to reclassify the de facto exchange rate regime from "stabilized" to "crawl-like."

Staff's views

16. Main discussions centered around:

- **Tightening monetary policy.** To achieve its targets for key monetary aggregates and contain inflation risks, BB needs to be prepared to further increase the repo rate and limit its market operations to meeting temporary liquidity needs. Reserve money growth should continue to serve as the nominal anchor, with net domestic assets of BB as an operating target. That said, staff cautioned that fiscal loosening in FY12 could lead to considerable monetary easing, if the government continues to depend heavily on BB to meet its financing needs. In the event, staff expect reserve money growth to be 22 percent in FY12, against an official target of 16 percent.

- **Increasing interest rate flexibility.** Repo, interbank, and treasury bill rates should be made more responsive to supply and demand conditions, in order to improve interest rate signals and strengthen the monetary policy transmission mechanism. Staff noted that the rationing of taka liquidity in repo auctions—where banks currently seek a large uptake from BB at a fixed repo rate—would be better addressed by letting the repo rate respond to excess demand, with the higher emergency repo rate a step in the right direction. Remaining caps on lending rates should be phased out, and moral suasion over deposit rates should be avoided, so banks can meet their retail funding needs.

- **Operating a flexible exchange rate regime.** Bangladesh Bank should continue to allow its buying and selling rates to be guided by the average buying and selling rates set by commercial banks to ensure smooth market operations. To help further develop the interbank foreign exchange market, staff urged BB to limit intervention to smoothing short-term volatility in the exchange rate, ensure all banks remain within their net open position limits, and cease use of moral suasion on banks to keep their rates stable. Bangladesh Bank also needs to modify new reserve management guidelines, approved in September 2011, to incorporate provisions on the terms and use of FXODs. Staff also cautioned that the use of deferred payments for oil imports could put added pressures on reserves in the months ahead.

17. Exchange rate assessment. The exchange rate is broadly in line with fundamentals (Box 5). The estimated size of the taka's undervaluation has fallen during the past year, mostly due to a less favorable current account balance and more robust growth outlook over the medium term, under the current baseline. However, BOP pressures and reserve losses are projected to continue over the medium term, suggesting the exchange rate could face continued downward pressure.

Authorities' views

18. The authorities generally agreed with staff's views on monetary and exchange rate policy. They recognized that monetary conditions could warrant further tightening, especially if nonfood inflation continued to rise. However, they also expressed concerns about the impact of rising lending rates on growth and a weaker taka on inflation. The authorities further noted that bank-by-bank ceilings on CDRs would be phased out once new liquidity management guidelines being formulated were in place and also suggested that remaining lending rate caps might be lifted (mainly on certain export and industrial credits). They pointed out that a more flexible exchange rate had helped increase transaction volumes in the interbank market and reduce BB's stock of FXODs. The authorities acknowledged the need to safeguard reserves. They noted, however, that the central bank would likely continue to facilitate lumpy payments for fuel and food imports, but with foreign exchange transacted in line with commercial bank rates.

C. Ensuring a Stable Financial Sector in Uncertain Times

Overview

Financial sector reforms are an important complement to maintaining macroeconomic stability, securing Bangladesh's growth potential, and minimizing associated fiscal risks. Since the

Box 5. Bangladesh: Exchange Rate Assessment[1]

The application of the three standard methodologies for the exchange rate assessment suggest that the real exchange rate is broadly in line with its long-run equilibrium, consistent with the previous Article IV Consultation staff report (Country Report No. 10/55). Application of a CGER approach to the exchange rate assessment, which takes into account the sizable level of remittances in Bangladesh, supports this view. These remittance inflows, which have been a main driver of the current account over the past decade, now exceed 10 percent of GDP. However, over time, they are expected to decline as a share of GDP, as Bangladesh moves toward middle-income country status. The other CGER approaches do not account explicitly for remittances and find evidence of a slight undervaluation. However, BOP pressures and reserve losses are projected to continue over the medium term, suggesting the exchange rate could face continued downward pressure.

In this context, the specific adjustment made to the CGER approach recognizes the significant impact on the current account of remittance inflows. In particular, if remittances are viewed as an exhaustible resource over the long term, then intertemporal consumption-saving behavior suggests that remittances could cause saving to increase over the medium term to smooth out future consumption, as Bangladesh transitions to being a more mature economy. As a result, CGER estimates of the medium-term equilibrium current account balance (saving less investment) that do not properly account for remittances could result in underestimating the current account balance.

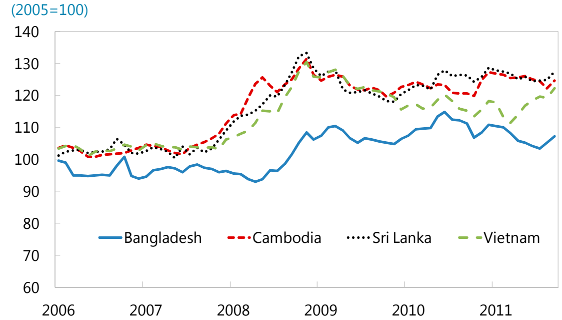
Overall, application of CGER-type methodology yields mixed results for Bangladesh.[2] As noted above, adjusting the macro-balance approach using country-specific dummies for South and East Asian high remittance countries shows that the real effective exchange rate is broadly in equilibrium.[3] However, the same adjustment to the equilibrium RER approach does not find a significant coefficient for remittances, with results showing a slight undervaluation. The external sustainability approach also shows a small undervaluation.

Bangladesh: Exchange Rate Assessment
(In percent)

Approach	Estimated Overvaluation (+)/ Undervaluation (-)
External sustainability	-5
Macro balance	-14
Remittance-adjusted	0
Equilibrium exchange rate	-8

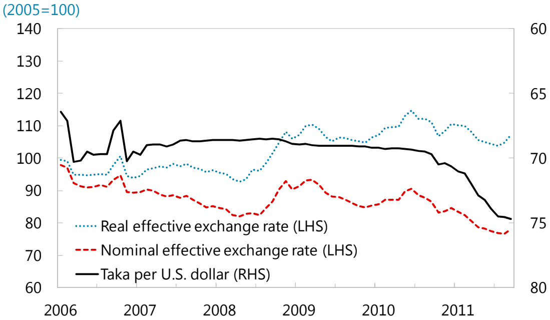
Source: IMF staff estimates.

Asia Region: Real Effective Exchange Rates
Jan. 2006–Sep. 2011
(2005=100)



Source: IMF staff estimates.

Bangladesh: Exchange Rates
Jan. 2006–Sep. 2011
(2005=100)



Sources: Bangladesh authorities; and IMF staff estimates.

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[1] Prepared by Jules Leichter (SPR) and Serpil Bouza (APD).

[2] A Bangladesh-specific trade elasticity of 0.45 is used in this analysis (see WP/10/180).

[3] This adjustment for remittances changes the current account norm from a deficit of 6.6 percent of GDP to a deficit of 0.3 percent of GDP consistent with staff projections. It is also important to note that an STA TA mission has found that a recent widening of the discrepancy between exports reported on a customs basis and settlement basis suggests a potential overstatement of the reported current account balance, which distorts the measurement of the current account gap.

2009 FSAP update, measured reforms have taken place, but rapid growth in the banking system and equity markets is straining supervisory capacity and oversight. The SOCBs remain vulnerable to outside interference, undermining gains from corporatization efforts in recent years.

Staff's views

19. Main discussions covered:

- **Strengthening bank supervision and enforcement.** Bangladesh Bank should continue to strengthen its supervision and oversight of the banking system, focusing on improving the governance and finances of SOCBs and ensuring all banks comply with new capital adequacy requirements. Due to weak capacity at the SEC and lack of a consolidated supervisory framework, staff recommended that merchant bank subsidiaries fall under the supervisory and reporting framework of BB, in order to protect parent banks' capital and limit operational risk. Recently announced new stock market exposure limits for banks (25 percent of regulatory capital) could provide added protection, if implemented in a timely manner. Staff also urged regulatory guidelines on loan loss classification and provisioning standards be brought in line with international best practices by end-2011. Crisis contingency plans, lender of last resort facilities, and a prompt corrective action framework would also help reduce systemic risk. Finally, BB should begin taking steps toward Basel III standards, while ensuring strict Basel II compliance by all banks.

- **Improving bank governance and performance.** Staff urged timely finalization of the draft amendments to the Bank Companies Act and submission to Parliament by end-2011. The amended law should aim to strengthen banks' governance, foremost by giving BB the sole legal authority to take actions against any bank that fails to comply with prudential regulations. The act should also stipulate the fit and proper criteria for directors, officers and key shareholders at all banks, superceding exemptions for SOCBs in this area. Staff further recommended that the government defer approving new banking licenses until supervisory capacity is strengthened, liquidity pressures ease, and strict licensing criteria are in place, following a decision by BB to lift the ban in September 2011. Regarding the SOCBs, staff saw need for further elaboration of plans to strengthen their financial position and internal governance, given underlying inadequacies in their capital bases, using the results of the recent external audits as a guide. The government itself should refrain from interfering in the operations of SOCBs, as this could undermine their profitability, limit proper provisioning, and exacerbate recapitalization needs. In turn, the SOCBs need to accelerate their amortization of unrealized losses being held in special accounts on their balance sheet.

- **Intensifying equity market oversight.** Staff recommended stepped up efforts to improve stock market governance and oversight. The advisory board set up after the high-level probe of market irregularities should possess the necessary expertise, backed by sufficient capacity building. Besides containing risks posed by merchant bank subsidiaries, reforms should concentrate on strengthening the book-building method and listing and reporting requirements, and providing clear sanctions for trading violations and a stable set of margin lending requirements.

Authorities' views

20. The authorities were in broad agreement with the staff's views. They noted that the generally weak state of SOCBs—several of which remain technically insolvent—is an active concern. The authorities stressed that they remain in close contact with the commercial banks that exceed the current stock market exposure limits to bring them in compliance. They also pointed to improved coordination of onsite and offsite bank examinations, which should facilitate movement toward more risk-based supervision, with the support of the new IMF resident advisor in BB. The authorities also expressed a commitment to improve oversight of the securities' market and highlighted the work that was under way to strengthen the laws underpinning the anti-money laundering framework. They also noted plans being formulated to demutualize the Dhaka and Chittagong stock exchanges in order to improve their governance.

OTHER ISSUES

21. Trade reform issues. Bangladesh is making progress in increasing integration with its main trading partners. Addressing its trade barriers, which are high even by regional standards, would support these efforts. Since January 2011, exports have benefitted significantly from a relaxation in rules of origin requirements for RMG exports to the European Union. In September this year, in conjunction with a visit by the Prime Minister of India, duties and quotas on exports to India of 61 items were removed, including on 46 garment products. While the issue is still pending, efforts were also made to open up transit trade and transshipment through Bangladesh for India's northeastern states.

22. Statistics. Macroeconomic statistics are adequate for surveillance, with the authorities committed to strengthening them, in order to better inform policy decisions and monitor outcomes. They aim to seek parliamentary approval of the new Statistics Act by end-2011. Staff welcomed recent actions by the Ministry of Planning's Statistics Division to modernize CPI compilation. Deficiencies in national income accounts and the BOP are expected to be addressed through further IMF TA.

23. Safeguards assessment. Staff encouraged BB to implement recommendations of the recent safeguards assessment over the near to medium term. In particular, early action was encouraged in improving the quality of external audits to ensure compliance with international standards, and in strengthening governance over FXODs and reserves management.

STAFF APPRAISAL

24. The growth outlook in FY12 is favorable, but overheating pressures threaten to undermine macroeconomic stability. Rising oil and capital goods imports and accommodative policies are putting pressure on the BOP, which requires policy rebalancing and tightening. Higher commodity prices and demand pressures are feeding into inflation, with the nonfood rate becoming worrisomely high. Balance of payments pressures are expected to build over the medium term because of import-heavy infrastructure investment and the further large increases in oil demand. Managing them will likely necessitate exceptional financing and upfront policy adjustment.

25. Longer term growth prospects hinge on generating sufficient resources to relieve infrastructure bottlenecks and ensuring a competitive business environment focused on labor-intensive activities. To put Bangladesh in the ranks of emerging economies by end-decade, public and private investment rates will need to rise substantially in the next few years, including FDI. For this to occur, the government must ensure strong tax enforcement and compliance; a stable, well-governed financial system; and a streamlined and transparent trade and investment regime. Achieving these objectives will necessitate an inclusive policy dialogue and strong, transparent governance.

26. Accordingly, the authorities need to build on the momentum of recent reforms. Gains made in revenue mobilization should be consolidated by continuing tax administration reforms and by pushing ahead with the new VAT and income tax laws. Efforts to strengthen PFM, streamline the ADP implementation process, and operationalize the PPP framework should also be stepped up. While debt sustainability indicators suggest a low risk of external debt distress, a sound debt management strategy should concentrate on concessional external borrowing, supporting Bangladesh's development needs. The domestic debt burden should also be managed carefully, properly accounting for contingent liabilities.

27. To ensure a stable macroeconomic environment, vigilance is foremost required on the fiscal front. Subsidy costs need to be brought under control through upfront fuel price and electricity tariff adjustments, combined with targeted safeguards, in order to reduce operating losses of the BPC, ease demand pressures, and protect the integrity of the FY12 budget. This would reopen space for more social and development spending. Even so, the domestic financing requirement could be large, necessitating greater access to external financing.

28. The balance of risks also points to the need for further monetary tightening. As a first step, BB financing of the deficit should be reduced, accompanied by higher policy and treasury rates and limited liquidity support, to better enable the central bank to achieve its FY12 monetary targets. Increased interest rate flexibility should also help strengthen the monetary transmission mechanism.

29. Continued exchange rate flexibility is needed to facilitate external adjustment, and also to safeguard foreign reserves. Staff consider the exchange rate to be broadly in line with fundamentals, although it could face continued downward pressure. Market intervention by BB should be limited to smoothing short-term volatility and consistent with maintaining an adequate reserve cover. New reserve management guidelines come at a critical time, especially in view of volatile global markets.

30. Financial sector vulnerabilities should be addressed as a matter of priority to ensure system soundness and reduce fiscal risks. The regulatory and supervisory framework over commercial banks needs to be strengthened and enforced. Governance over banks, in particular the SOCBs, should be fortified to ensure sound banking practices. Stock market volatility could pose systemic risk to the banking system as well as create fiscal risk, if not managed well. Market oversight should be strengthened and banks' exposure should be carefully monitored.

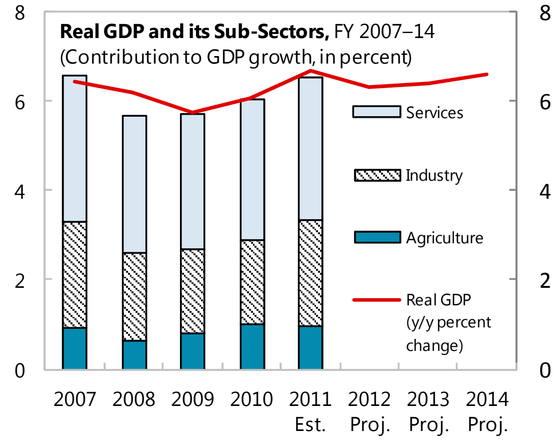
31. Finally, further improvement in the quality and timeliness of statistics would improve policymaking. Progress in addressing weaknesses in national account and BOP statistics is particularly important. Greater autonomy to statistical bodies should allow more accurate measurement of policy outcomes.

32. No timetable exists for the removal of the one remaining exchange restriction on the transferability of funds in nonresident taka accounts. Therefore, staff does not recommend its approval by the Executive Board.

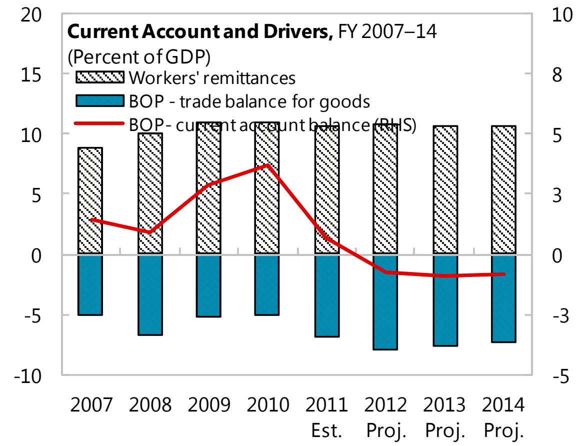
33. It is recommended that the next Article IV consultation with Bangladesh take place on the standard 12-month cycle.

Figure 2. Bangladesh: Real and External Sector Developments

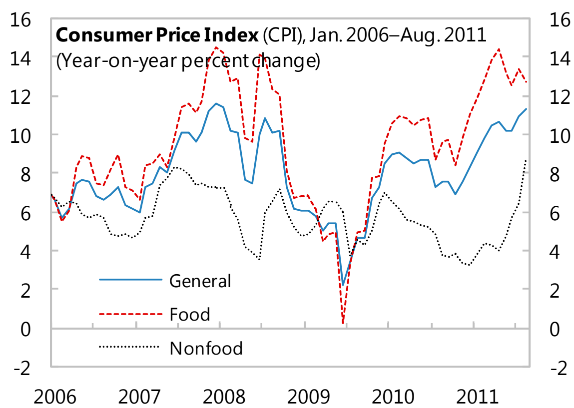
Growth has held up, supported by strong performance of the RMG sector and accommodative policies.



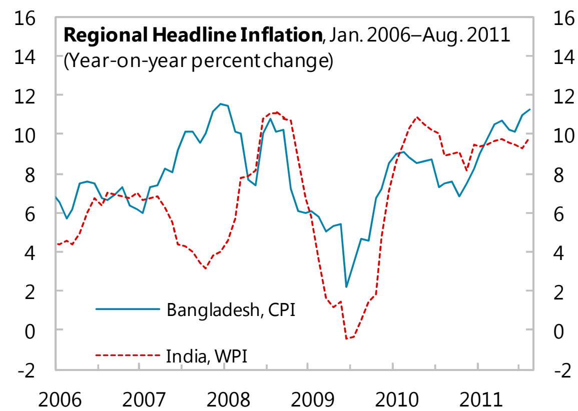
At the same time, the current account balance has deteriorated due to slowing remittance growth, strong domestic demand, and rising oil and capital goods imports.



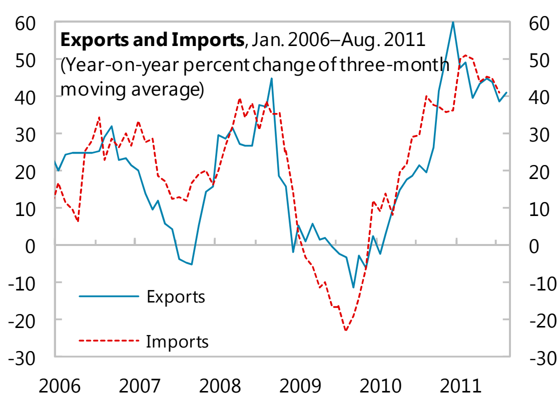
Headline inflation is at a three-year high due to food prices and, more recently, demand side pressures.



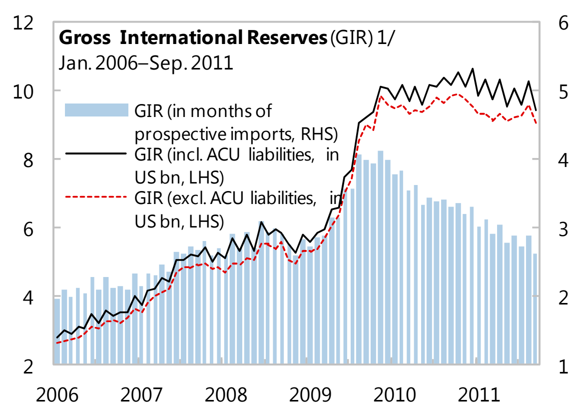
It has broadly followed a similar trend as in India.



Both export and import growth remains at an elevated pace, propelled by strong demand forces and high commodity prices, with imports increasing from a much larger base…



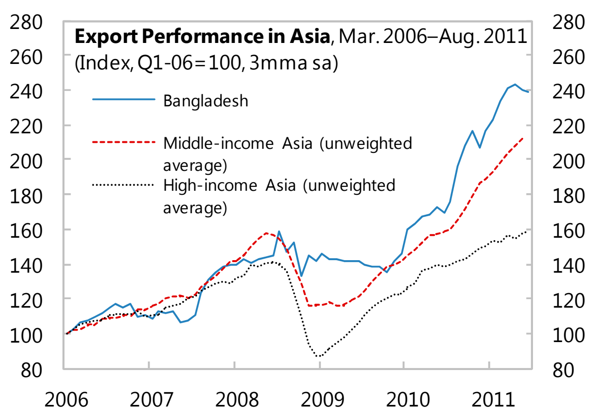
…which has contributed to reserve losses.



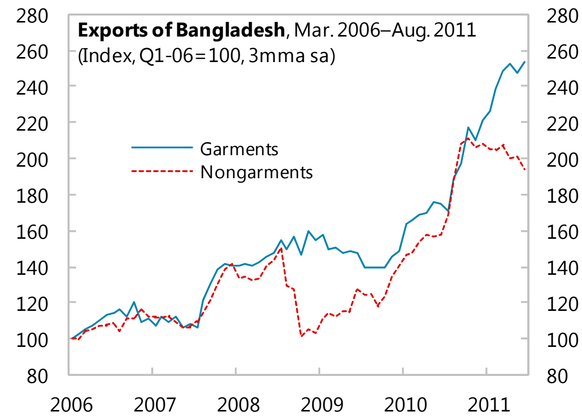
Sources: Bangladesh authorities; CEIC Data Company Ltd.; and IMF staff estimates.
1/ ACU: Asian Currency Union.

Figure 3. Bangladesh: Export, Import, and Remittances Performance

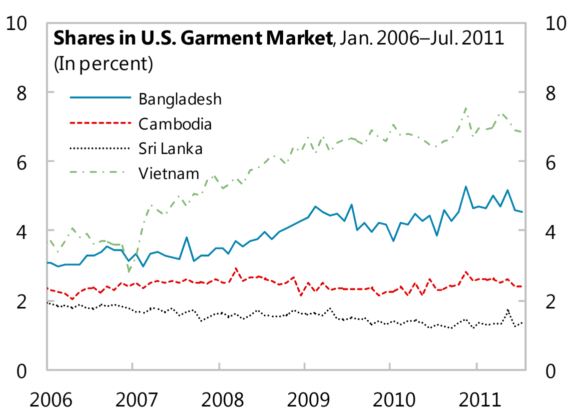
Bangladesh's exports have been performing better than in other Asian countries coming out of the global crisis...



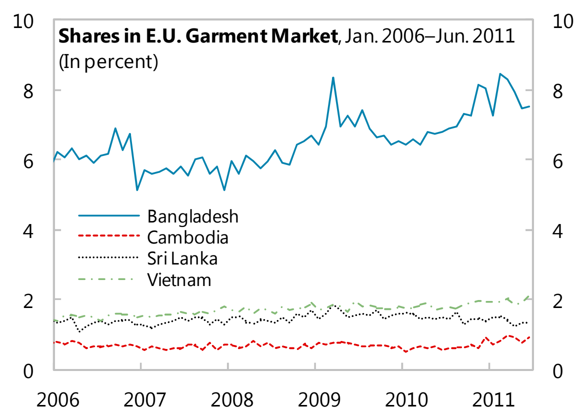
...led by garments, with other exports also performing well until recently.



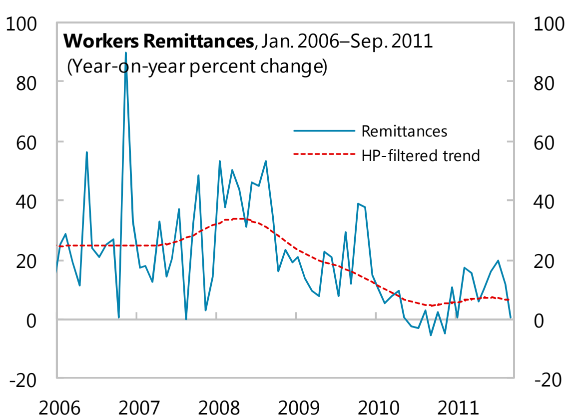
Bangladesh's market share of U.S. garment imports continues to rise slowly following some pullback in 2009.



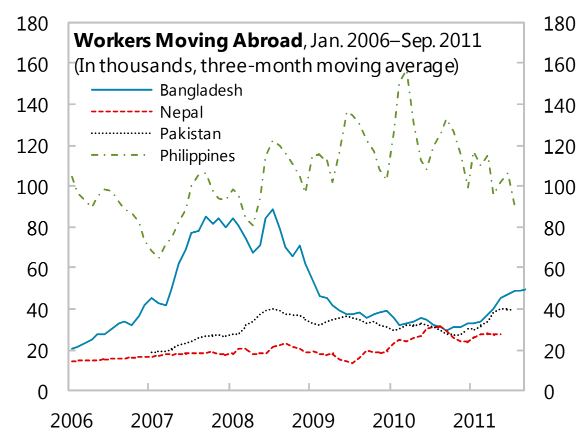
Its share in Europe also remains significantly larger than regional competitors and is rising, buoyed recently by a relaxation of rules of origin.



At the same time, growth in remittances slowed in 2010, although a modest uptick was observed in the first half of 2011..



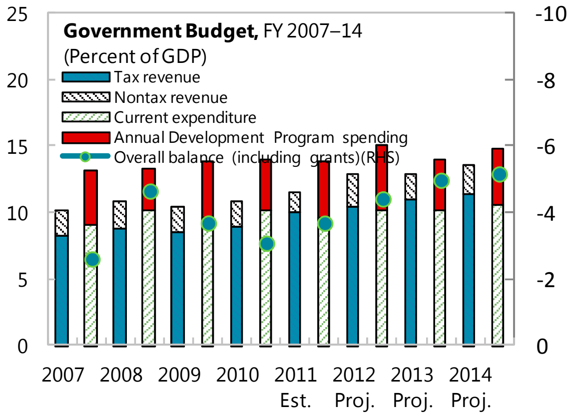
...given an earlier pick up in the pace of Bangladeshi workers moving abroad.



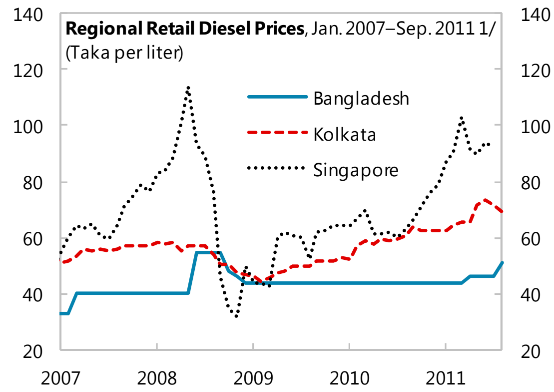
Sources: Bangladesh authorities; CEIC Data Company Ltd.; Eurostat; U.S. Department of Commerce; Office of Textiles and Apparel; and IMF staff estimates.

Figure 4. Bangladesh: Fiscal Developments

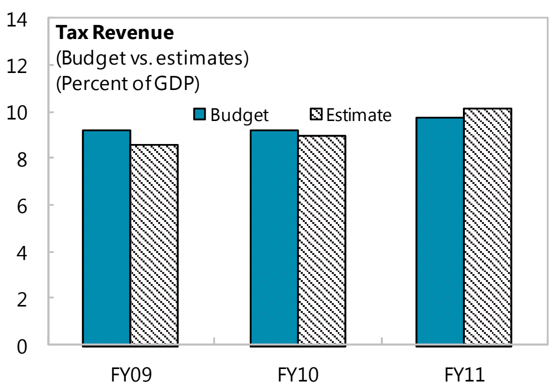
Fiscal deficits are projected to widen over the medium term, despite an increased tax take, with subsidy cost the main driver.



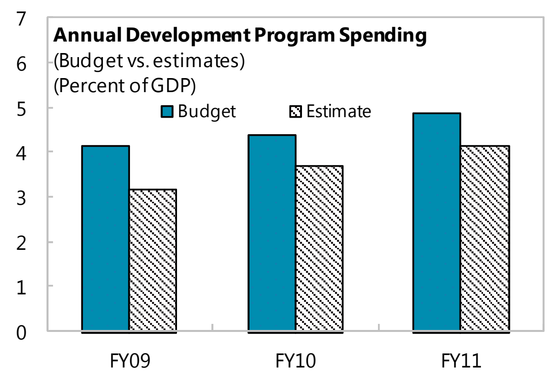
The growing gap between local and regional fuel prices remains a major factor in driving up subsidy costs.



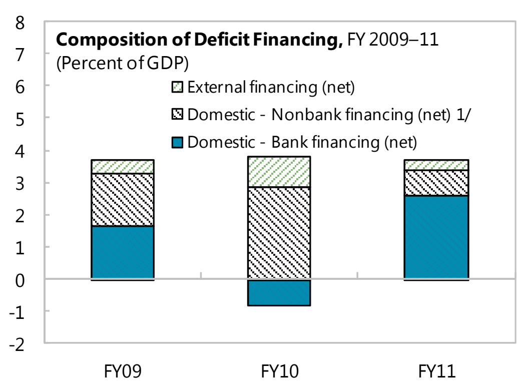
The National Board of Revenue's ongoing reforms to strengthen tax administration and broaden the tax base are beginning to pay off...



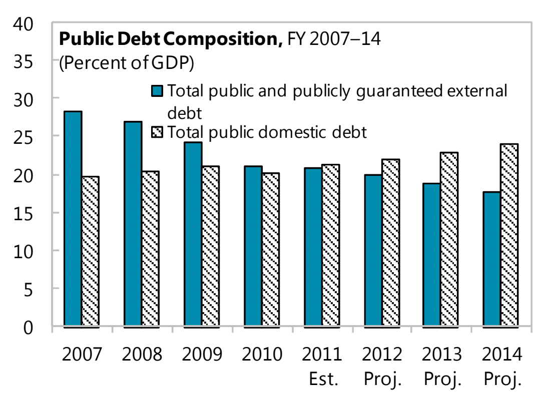
...with ADP spending also rising but still falling short of the budget.



Even so, domestic bank financing rose sharply in FY11, due in part to a slowing in external aid inflows.



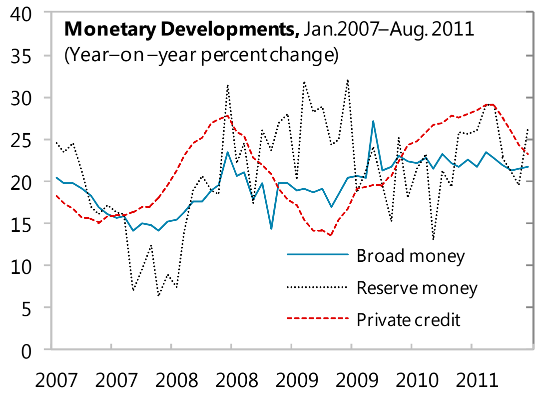
External debt is projected to remain on a declining trend, but domestic debt is forecasts to rise absent fiscal consolidation.



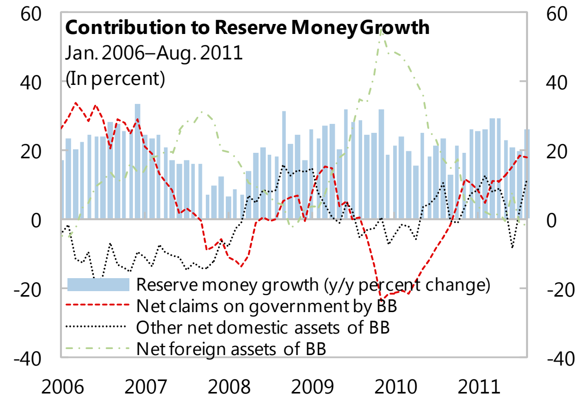
Sources: Bangladesh authorities; CEIC Data Company Ltd.; and IMF staff estimates.

Figure 5. Bangladesh: Monetary and Financial Market Developments

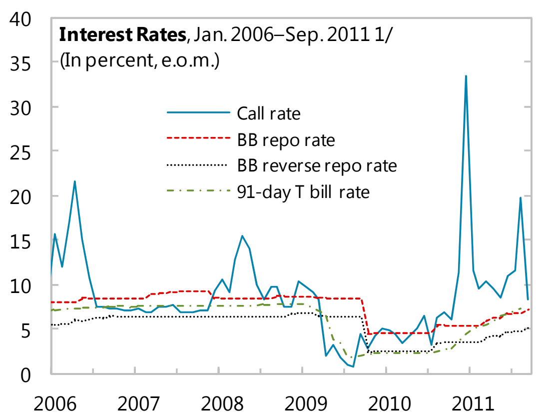
Private credit growth is moderating slowly from a record high in early 2011, but remains at an elevated level.



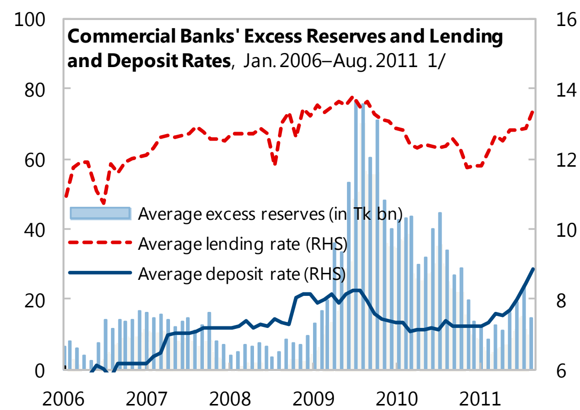
Reserve money growth is still high, due mainly to Bangladesh Bank's (BB) liquidity support to banks and surging credit to government.



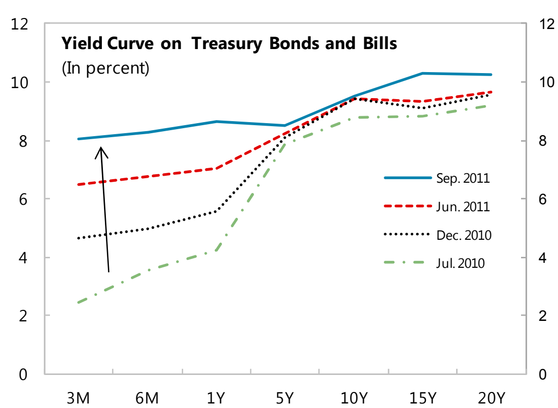
Call money rates reflect tightening liquidity conditions, with BB repo rates being increased gradually.



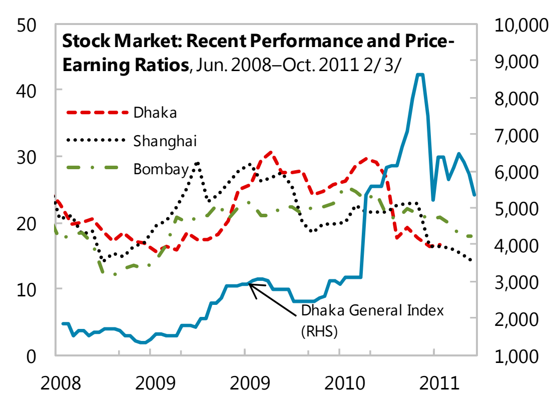
Along with declining net external inflows and rapid credit expansion, excess liquidity has fallen, notwithstanding recent central bank support.



Interest rates on treasury bills and bonds have increased only modestly despite rising inflation.



The Dhaka Stock Exchange index is well off its December peak, but remains volatile.



Sources: Bangladesh authorities; CEIC Data Company Ltd.; and IMF staff estimates.
1/ Interest rates are weighted average of commercial banks.
2/ Grameen Phone is not correctly reflected in the DSE index from November 2009.

Table 1. Bangladesh: Selected Economic Indicators, FY2009–14 1/

	FY09	FY10	FY11	FY12	FY13	FY14
			Est.		Projections	
National income and prices (percent change)						
Real GDP	5.7	6.1	6.7	6.3	6.4	6.6
GDP deflator	6.5	6.5	6.3	10.0	9.3	8.1
CPI inflation (annual average)	6.7	7.3	8.8	10.7	8.6	8.2
CPI inflation (end of period)	2.2	8.7	10.2	10.7	8.7	8.1
Nonfood CPI inflation (end of period)	5.9	5.2	5.7	10.8	7.8	6.3
Investment and savings (percent of GDP)						
Gross investment	24.4	24.4	24.7	25.7	26.2	27.0
Private	19.7	19.4	19.5	19.7	19.9	20.1
Public	4.7	5.0	5.3	6.0	6.3	6.9
National savings	27.2	28.1	25.6	24.9	25.3	26.2
Private	26.5	26.1	23.1	21.5	22.0	22.6
Public	0.7	2.0	2.5	3.5	3.4	3.6
Central government operations (percent of GDP)						
Total revenue and grants	10.8	11.5	12.2	13.5	13.6	14.1
Total revenue	10.5	10.9	11.6	12.9	13.0	13.6
Tax	8.6	9.0	10.1	10.5	10.9	11.5
Nontax	1.9	1.9	1.5	2.5	2.0	2.1
Grants	0.3	0.6	0.7	0.6	0.6	0.5
Total expenditure	14.5	14.6	15.9	17.9	18.5	19.2
Current expenditure	10.1	9.5	9.7	10.1	10.2	10.5
Annual Development Program (ADP)	3.2	3.7	4.2	4.5	4.9	5.3
Other expenditures 2/	1.2	1.4	2.1	3.3	3.4	3.4
Overall balance (including grants)	-3.7	-3.1	-3.7	-4.4	-4.9	-5.1
(Excluding grants)	-4.0	-3.7	-4.3	-5.0	-5.5	-5.6
Primary balance (excluding grants)	-1.5	-1.6	-2.4	-2.8	-3.3	-3.3
Financing (net)	3.7	3.1	3.7	4.4	4.9	5.1
Of which : External	0.4	0.9	0.3	0.7	1.0	1.0
Total central government debt (percent of GDP)	45.4	41.4	42.9	42.7	43.0	43.6
Money and credit (end of fiscal year; percent change)						
Net domestic assets of the banking system	17.6	19.6	24.6	26.0	...	...
Credit to private sector by the banking system	15.5	24.2	25.8	16.9	...	...
Reserve money	31.9	18.1	21.0	22.2	...	...
Broad money (M2)	19.2	22.4	21.4	20.7	...	...
Balance of payments (in billions of U.S. dollars)						
Exports, f.o.b.	15.6	16.2	23.0	26.3	30.6	35.5
(Annual percent change)	10.1	4.2	41.7	14.2	16.6	15.7
Imports, f.o.b.	-20.3	-21.4	-30.3	-35.8	-40.7	-45.8
(Annual percent change)	4.2	5.4	41.8	18.1	13.6	12.4
Current account balance	2.5	3.7	1.0	-0.8	-1.1	-1.1
(Percent of GDP)	2.8	3.7	0.9	-0.7	-0.9	-0.8
Capital and financial account balance	-0.4	-0.1	-1.0	0.1	0.6	0.6
Overall balance	2.1	2.9	-0.9	-0.7	-0.6	-0.6
Gross official reserves (in billions of U.S. dollars) 3/	7.4	10.1	10.0	9.1	8.3	7.7
In months of prospective imports of goods and services	3.6	3.4	2.9	2.3	1.9	1.6
Exchange rate (taka per U.S. dollar; period average)	68.8	69.2	71.2	...	...	...
Nominal effective rate (2000=100; period average)	89.5	87.0	82.9	...	...	...
Real effective rate (2000=100; period average)	105.4	108.3	108.8	...	...	...
Terms of trade (percent change)	1.6	-4.6	-6.7	...	...	...
Memorandum item:						
Nominal GDP (in billions of taka)	6,148	6,943	7,875	9,207	10,712	12,349

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

1/ Fiscal year begins July 1.
2/ Includes non-ADP capital spending and net lending.
3/ Excludes deposits held in offshore accounts of resident financial institutions, noninvestment grade sovereign bonds, and foreign exchange overdrafts provided by Bangladesh Bank to domestic banks.

Table 2. Bangladesh: Balance of Payments, FY2009–16 1/

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

	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16
			Est.	Projections				
Current account balance	2,536	3,737	999	-849	-1,139	-1,126	-814	-430
Trade balance	-4,708	-5,152	-7,323	-9,543	-10,055	-10,307	-10,338	-10,379
Exports (f.o.b.)	15,583	16,236	23,008	26,281	30,645	35,455	40,592	45,697
Of which: RMG sector	12,348	12,497	17,914	20,422	23,894	27,717	31,875	36,019
Imports (f.o.b.)	-20,291	-21,388	-30,332	-35,823	-40,700	-45,762	-50,930	-56,075
Of which: Crude oil and petroleum products	-2,581	-2,556	-4,109	-6,249	-7,336	-8,308	-9,045	-9,823
Services	-1,621	-1,240	-2,399	-3,079	-3,766	-4,487	-5,214	-5,930
Income	-1,361	-1,484	-1,354	-1,470	-1,595	-1,720	-1,872	-2,048
Transfers	10,226	11,613	12,075	13,243	14,277	15,388	16,609	17,927
Official current transfers 2/	72	125	127	117	110	98	106	114
Private transfers	10,154	11,488	11,948	13,126	14,167	15,290	16,503	17,813
Of which: Workers' remittances	9,689	10,987	11,650	12,815	13,840	14,947	16,143	17,435
Capital and financial account balance	-357	-134	-984	126	570	579	790	1,005
Capital account	451	488	600	598	646	633	684	735
Financial account	-808	-622	-1,584	-472	-76	-54	107	270
Foreign direct investment	941	913	768	950	1,129	1,342	1,597	1,901
Portfolio investment	-159	-117	-28	55	69	86	107	134
Medium- and long-term loans	563	933	312	828	1,319	1,372	1,323	1,229
Disbursements	1,204	1,604	1,051	1,598	2,240	2,451	2,308	2,204
Amortization	-641	-671	-739	-770	-921	-1,079	-984	-975
Other capital	-2,153	-2,351	-2,636	-2,305	-2,593	-2,855	-2,921	-2,994
Short-term oil import credit (net)	-169	67	531	750	250	200	150	100
Commercial banks (net)	26	-315	-160	0	0	0	0	0
Other items (net) 3/	-2,010	-2,103	-3,007	-3,055	-2,843	-3,055	-3,071	-3,094
Errors and omissions	-121	-738	-936	0	0	0	0	0
Overall balance	2,058	2,865	-922	-722	-569	-547	-24	575
Financing items	-2,058	-2,865	922	722	569	547	24	-575
Change in gross international reserves (GIR), net of valuation changes (increase -)	-2,043	-2,827	978	925	776	632	85	-532
Net use of IMF resources	-15	-38	-57	-202	-207	-85	-61	-43
Valuation changes (increase -)	521	267	-639	0	0	0	0	0
Change in GIR (increase -)	-1,522	-2,560	339	925	776	632	85	-532
Memorandum items:								
Current account balance (percent of GDP)	2.8	3.7	0.9	-0.7	-0.9	-0.8	-0.5	-0.3
Exports (annual percent change)	10.1	4.2	41.7	14.2	16.6	15.7	14.5	12.6
Import (annual percent change)	4.2	5.4	41.8	18.1	13.6	12.4	11.3	10.1
Medium- and long-term external public debt	21,487	20,907	22,256	22,453	22,836	23,245	23,776	24,268
(Percent of GDP)	24.0	20.8	20.1	18.7	17.5	16.4	15.4	14.4
Net aid flows (percent of GDP)	1.2	1.5	0.9	1.3	1.6	1.5	1.4	1.2
Gross official reserves 4/	7,444	10,140	10,034	9,110	8,334	7,701	7,616	8,148
(In months of imports of goods and services)	3.6	3.4	2.9	2.3	1.9	1.6	1.4	1.4
Gross official reserves (excluding ACU liabilities) 4/	6,976	9,536	9,197	8,272	7,496	6,864	6,779	7,311
(In months of imports of goods and services)	3.3	3.2	2.6	2.1	1.7	1.4	1.2	1.2
Net international reserves 4/	5,258	7,249	6,725	6,003	5,434	4,887	4,863	5,438

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

1/ Fiscal year begins July 1.
2/ Excludes official capital grants reported in the capital account.
3/ A large portion of this amount is the difference between exports reported on a customs basis and exports reported on a settlements basis.
4/ Excludes deposits held in offshore accounts of resident financial institutions, noninvestment grade sovereign bonds, and foreign exchange overdrafts provided by Bangladesh Bank to domestic banks.

Table 3. Bangladesh: Central Government Operations, FY2009–13 1/

	FY09	FY10	FY11		FY12		FY13
			Budget	Est.	Budget	Proj.	Proj.
	(In billions of taka)						
Total revenue and grants	667	799	977	964	1,233	1,247	1,453
Total revenue	646	757	928	912	1,184	1,192	1,391
Tax revenue	529	625	760	795	958	966	1,173
National Board of Revenue (NBR) taxes	502	598	726	763	919	929	1,129
Of which: VAT and supplementary duties	277	339	400	426	505	519	629
Taxes on income and profits	134	162	210	220	276	282	359
Customs and excise duties	87	89	112	112	131	122	135
Non-NBR taxes	27	27	35	32	39	38	44
Nontax revenue	117	132	168	117	226	226	218
Foreign grants	21	42	48	52	49	55	62
Total expenditure	893	1,013	1,322	1,253	1,636	1,650	1,980
Current expenditure	623	659	768	764	879	929	1,090
Pay and allowances	139	161	204	197	216	216	252
Goods and services	82	86	104	98	118	118	136
Interest payments	154	148	147	153	180	199	234
Subsidies and transfers	246	261	298	311	346	378	448
Block allocations	2	4	15	4	18	18	21
Annual Development Program (ADP)	194	256	385	328	460	416	524
Non-ADP capital spending	56	86	133	73	197	112	131
Net lending	18	9	32	75	94	189	232
Other expenditures 2/	1	2	4	14	6	4	4
Overall balance (including grants)	-226	-214	-345	-289	-403	-403	-527
(Excluding grants)	-248	-256	-393	-341	-452	-458	-589
Net financing	226	214	345	289	403	403	527
External	26	65	108	22	131	63	108
Disbursements	73	111	160	75	187	122	183
Amortization	-47	-46	-51	-53	-56	-59	-75
Domestic	159	87	237	248	272	339	419
Banks	103	-54	157	205	190	293	369
Of which: Bangladesh Bank	25	-77	80	114	…	…	…
Nonbanks	56	141	80	43	83	46	50
Cash float and discrepancy	41	62	0	19	0	0	0

Table 3. Bangladesh: Central Government Operations, FY2009–13 1/ (concluded)

	FY09	FY10	FY11		FY12		FY13
			Budget	Est.	Budget	Proj.	Proj.
	(In percent of GDP)						
Total revenue and grants	10.8	11.5	12.5	12.2	13.4	13.5	13.6
Total revenue	10.5	10.9	11.9	11.6	12.9	12.9	13.0
Tax revenue	8.6	9.0	9.7	10.1	10.4	10.5	10.9
NBR taxes	8.2	8.6	9.3	9.7	10.0	10.1	10.5
Of which: VAT and supplementary duties	4.5	4.9	5.1	5.4	5.5	5.6	5.9
Taxes on income and profits	2.2	2.3	2.7	2.8	3.0	3.1	3.4
Customs and excise duties	1.4	1.3	1.4	1.4	1.4	1.3	1.3
Non-NBR taxes	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Nontax revenue	1.9	1.9	2.2	1.5	2.5	2.5	2.0
Foreign grants	0.3	0.6	0.6	0.7	0.5	0.6	0.6
Total expenditure	14.5	14.6	16.9	15.9	17.8	17.9	18.5
Current expenditure	10.1	9.5	9.8	9.7	9.5	10.1	10.2
Pay and allowances	2.3	2.3	2.6	2.5	2.4	2.4	2.4
Goods and services	1.3	1.2	1.3	1.3	1.3	1.3	1.3
Interest payments	2.5	2.1	1.9	1.9	2.0	2.2	2.2
Subsidies and transfers	4.0	3.8	3.8	4.0	3.8	4.1	4.2
Block allocations	0.0	0.1	0.2	0.0	0.2	0.2	0.2
ADP	3.2	3.7	4.9	4.2	5.0	4.5	4.9
Non-ADP capital spending	0.9	1.2	1.7	0.9	2.1	1.2	1.2
Net lending	0.3	0.1	0.4	0.9	1.0	2.1	2.2
Other expenditures 2/	0.0	0.0	0.1	0.2	0.1	0.0	0.0
Overall balance (including grants)	-3.7	-3.1	-4.4	-3.7	-4.4	-4.4	-4.9
(Excluding grants)	-4.0	-3.7	-5.0	-4.3	-4.9	-5.0	-5.5
Primary balance (including grants)	-1.2	-0.9	-2.5	-1.7	-2.4	-2.2	-2.7
(Excluding grants)	-1.5	-1.6	-3.2	-2.4	-3.0	-2.8	-3.3
Net financing	3.7	3.1	4.4	3.7	4.4	4.4	4.9
External	0.4	0.9	1.4	0.3	1.4	0.7	1.0
Disbursements	1.2	1.6	2.0	0.9	2.0	1.3	1.7
Amortization	-0.8	-0.7	-0.7	-0.7	-0.6	-0.6	-0.7
Domestic	2.6	1.3	3.0	3.2	3.0	3.7	3.9
Banks	1.7	-0.8	2.0	2.6	2.1	3.2	3.4
Of which: Bangladesh Bank	0.4	-1.1	1.0	1.4	…	…	…
Nonbanks	0.9	2.0	1.0	0.6	0.9	0.5	0.5
Cash float and discrepancy	0.7	0.9	0.0	0.2	0.0	0.0	0.0
Memorandum items:							
Subsidy costs (percent of GDP) 3/	1.3	1.3	…	2.2	…	3.4	3.5
Nominal GDP (in billions of taka)	6,148	6,943	7,803	7,875	9,207	9,207	10,712

Sources: Bangladesh authorities; and IMF staff estimates and projections.
1/ Fiscal year begins July 1. Cash basis unless otherwise specified.
2/ Includes food account surplus (-)/deficit (+) and extraordinary expenditures.
3/ Comprises direct subsidies for food and fertilizer and subsidy-related lending to large energy-related state-owned enterprises.

Table 4. Bangladesh: Central Government Operations, GFSM 2001 Classification, FY2009–12 1/

(In billions of taka)

	FY09	FY10	FY11 Est.	FY12 Proj.
1. Central government accounts				
Revenue	667	799	964	1,247
Taxes	529	625	795	966
Grants	21	42	52	55
Other revenue	117	132	117	226
Expenditure	643	671	852	1,122
Compensation of employees	139	161	197	216
Purchases of goods and services	82	86	98	118
Interest	154	148	153	199
Subsidies 2/	88	81	163	303
Grants	140	142	167	198
Other payments	40	53	74	87
Gross operating balance	24	129	111	125
Net acquisition of nonfinancial assets	250	342	401	528
Fixed assets	194	256	328	416
Nonproduced assets	56	86	73	112
Net lending (+)/net borrowing (-) 3/	-226	-214	-289	-403
Net financial transactions	-185	-152	-270	-403
Net acquisition of financial assets (+ increase)	26	19	47	0
Domestic	26	19	47	0
Deposits	26	19	47	0
Net incurrence of liabilities (+ increase)	211	170	318	403
Domestic	185	106	296	339
Debt securities and loans and advances	185	106	282	339
Other accounts payable	0	0	14	0
Foreign	26	65	22	63
Statistical discrepancy (net borrowing less net financial transaction)	-41	-62	-19	0
2. Financial balance sheet				
Net financial worth				
Stock of financial assets	183	202	249	249
Domestic	183	202	249	249
Stock of liabilities	2,793	2,864	3,329	3,823
Domestic	1,305	1,410	1,677	2,016
Debt securities and loans and advances	1,305	1,410	1,677	2,016
Foreign	1,488	1,453	1,652	1,807

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

1/ Fiscal year begins July 1.
2/ Includes transfers to Bangladesh Petroleum Corporation and Bangladesh Power Development Board, previously included in net lending.
3/ Includes statistical discrepancy.

Table 5. Bangladesh: Monetary Accounts, June 2009–June 2012

	2009	2010		2011		2012
	June	June	Dec.	June	Aug.	June Proj. 1/
			(End of period; in billions of taka)			
Bangladesh Bank balance sheet						
Net foreign assets	366	528	569	523	530	470
Net domestic assets	261	213	251	374	434	626
Net credit to central government	271	193	183	307	311	486
Credit to other nonfinancial public sector	1	1	1	1	1	1
Credit to deposit money banks	61	59	65	96	84	74
Other items, net	-71	-39	3	-29	39	66
Of which: Repos with commercial banks	0	0	59	82	125	182
Reserve money	627	741	820	897	963	1,096
Currency	394	505	579	605	704	738
Reserves 2/	232	235	239	290	257	358
			(Contribution to reserve money growth)			
Net foreign assets	19.5	25.9	6.3	-0.7	-1.6	-6.0
Net domestic assets	12.5	-7.7	20.9	21.8	27.9	28.1
Of which: Net credit to central government	5.3	-12.3	11.3	15.4	17.8	20.0
Reserve money (year-on-year percentage change)	31.9	18.1	25.9	21.0	26.3	22.2
Monetary survey			(End of period; in billions of taka)			
Net foreign assets	475	651	685	693	716	639
Bangladesh Bank	366	528	569	523	530	470
Commercial banks	109	122	116	170	186	170
Net domestic assets	2,489	2,977	3,306	3,710	3,820	4,676
Domestic credit	2,854	3,355	3,774	4,236	4,344	5,199
Net credit to central government	551	496	475	701	729	995
Credit to other nonfinancial public sector	88	109	148	146	150	167
Credit to nonbank financial institutions	36	41	42	48	48	53
Credit to private sector	2,179	2,708	3,109	3,407	3,456	3,985
Other items, net	-365	-377	-468	-526	-524	-523
Broad money (M2)	2,964	3,628	3,991	4,403	4,536	5,316
Currency in circulation	360	462	529	548	643	658
Deposits	2,603	3,167	3,461	3,855	3,893	4,658
			(Year-on-year percent change)			
Net foreign assets	28.0	37.1	10.6	6.5	7.0	-7.7
Net domestic assets	17.6	19.6	24.2	24.6	24.8	26.0
Domestic credit	16.5	17.5	24.1	26.3	26.1	22.7
Net credit to central government	23.0	-9.9	4.7	41.3	50.0	41.8
Credit to other nonfinancial public sector	4.5	24.0	35.2	33.6	33.9	14.4
Credit to private sector	15.5	24.2	27.6	25.8	23.2	16.9
Broad money (M2)	19.2	22.4	21.7	21.4	21.6	20.7
Deposits	20.5	21.6	20.8	21.7	20.5	20.8
Memorandum items:			(In billions of taka, unless otherwise noted)			
Required domestic cash reserves (in billions of taka)	143	190	226	252	254	301
Excess domestic cash reserves (in billions of taka)	89	45	13	38	3	57
Loan-to-deposit ratio (in percent)	82.3	84.4	89.1	87.3	87.9	...
Broad money multiplier	4.7	4.9	4.9	4.9	...	4.9
Broad money velocity	2.1	1.9	1.9	1.8	...	1.7
Exchange rate, end of period (taka/U.S. dollar)	69.1	69.5	70.7	74.2	73.6	...

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

1/ At constant exchange rates.

2/ Liabilities arising from banks' foreign currency clearing accounts and nonbank deposits are excluded from reserves.

Table 6. Bangladesh: Financial Soundness Indicators, 2005–11

(In percent, end-of-period)

	2005	2006	2007	2008	2009	2010	2011 June
Capital adequacy							
Regulatory capital to risk-weighted assets (adjusted) 1/	8.9	5.6	4.1	6.5	8.8	7.6	8.2
State-owned commercial banks (adjusted) 1/	11.0	-2.1	-21.2	-14.8	-7.6	-0.1	1.5
Regulatory capital to risk-weighted assets (unadjusted)	8.9	5.6	9.3	10.4	11.7	9.3	9.7
State-owned commercial banks	11.0	-2.1	7.3	7.9	9.0	8.9	9.5
Specialized development banks	-5.2	-4.5	-5.0	-3.3	0.4	-7.3	-7.1
Private commercial banks	9.0	9.0	10.4	11.2	12.1	10.1	10.4
Foreign commercial banks	25.2	24.5	22.8	23.8	28.1	15.6	17.1
Regulatory capital to assets (adjusted) 1/	4.8	3.2	2.4	4.0	5.3	6.9	7.1
Regulatory capital to assets (unadjusted)	4.8	3.2	5.6	6.5	7.1	8.5	8.5
Nonperforming loans to regulatory capital (adjusted) 1/	188.5	280.1	404.6	191.6	109.9	69.0	64.2
Nonperforming loans to regulatory capital (unadjusted)	188.5	280.1	168.5	115.5	80.2	55.1	52.8
Asset quality							
Nonperforming loans to total loans	13.2	12.8	14.5	11.2	9.0	7.3	7.1
State-owned commercial banks	8.9	22.8	29.0	28.0	20.1	15.7	14.1
Specialized development banks	18.0	14.3	13.5	11.7	24.1	24.1	21.8
Private commercial banks	5.1	4.9	5.4	5.1	4.0	3.1	3.5
Foreign commercial banks	3.1	2.8	2.9	3.7	2.2	3.0	3.1
Loan provisions to total nonperforming loans	28.3	45.2	43.0	50.1	61.2	62.7	62.5
Loan provisions to total loans	3.7	5.8	6.2	5.6	5.5	4.6	4.5
Profitability							
Return on equity 2/	-11.6	-64.0	19.8	25.0	19.5	21.0	15.5
State-owned commercial banks	-99.5	1,262.5	-9.4	35.6	24.9	18.4	10.0
Specialized development banks	41.1	24.7	16.6	21.0	-199.0	-3.2	5.1
Private commercial banks	23.7	24.8	26.7	24.3	18.9	20.9	15.6
Foreign commercial banks	20.6	21.5	20.6	18.5	18.9	17.0	20.2
Return on assets 3/	-0.6	-2.1	1.1	1.6	1.4	1.8	1.3
State-owned commercial banks	-3.5	-9.2	-0.3	1.2	1.0	1.1	0.6
Specialized development banks	-1.6	-0.9	-0.6	-0.6	-0.6	0.2	-0.3
Private commercial banks	1.4	1.5	1.9	1.9	1.6	2.1	1.6
Foreign commercial banks	3.4	3.3	3.2	2.9	3.2	2.9	3.6
Sensitivity to market risk							
Net open position in foreign exchange to capital	4.4	16.6	4.2	6.0	3.3	…	…
Composition of credit (in percent of total) 4/							
Oil and gas	1.4	1.8	0.8	0.9	1.6	0.7	0.8
Industry (other)	31.3	32.2	34.5	36.0	36.4	35.5	35.8
Agriculture	9.0	8.2	7.7	6.8	6.9	5.7	6.0
Forestry	2.5	2.4	2.1	1.8	0.5	0.0	0.0
Trade	22.6	22.1	24.3	24.0	26.6	37.6	37.2
Construction	3.8	4.1	3.4	3.3	3.6	7.0	7.6
Households	3.4	3.3	4.7	4.8	4.7	6.8	5.6
Other	26.1	26.0	22.6	22.5	19.7	6.7	7.1
Memorandum items:							
Share of assets (as a percent of total banking system assets)							
State-owned commercial banks	38.1	33.3	33.5	29.8	28.8	28.5	28.8
Specialized development banks	8.5	7.9	7.0	6.6	6.5	6.1	5.8
Private commercial banks	45.8	50.5	51.1	55.2	57.2	58.8	59.0
Foreign commercial banks	7.6	8.3	8.4	8.3	7.4	6.6	6.3

Sources: Bangladesh Bank; and IMF staff estimates.

1/ From 2007, an adjustment is made to exclude special accounts set up in banks' balance sheets, which contain the accumulated losses arising from the difference in market and book value of assets. These amounts are deducted from banks' assets and from their regulatory capital.
2/ Bangladesh Bank defines return on equity as the ratio of net income after taxes to regulatory capital.
3/ Bangladesh Bank defines return on assets as the ratio of net income after taxes to total assets.
4/ Data for 2011 are as of end-March.

Table 7. Bangladesh: Medium-Term Outlook, FY2009–16

	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16
			Est.	Projections				
	(In percent of GDP)							
Gross national savings	27.2	28.1	25.6	24.9	25.3	26.2	27.0	27.7
Public national savings	0.7	2.0	2.5	3.5	3.4	3.6	3.9	4.3
Private national savings	26.5	26.1	23.1	21.5	22.0	22.6	23.1	23.4
Gross investment	24.4	24.4	24.7	25.7	26.2	27.0	27.5	28.0
Public investment	4.7	5.0	5.3	6.0	6.3	6.9	7.3	7.5
Private investment	19.7	19.4	19.5	19.7	19.9	20.1	20.3	20.5
Net exports of goods and services	-7.1	-6.4	-8.8	-10.5	-10.6	-10.5	-10.1	-9.7
Exports of goods and services	19.5	18.6	23.1	24.2	25.7	27.2	28.4	29.1
Of which: Exports of goods	17.4	16.2	20.8	21.9	23.4	25.1	26.3	27.2
Imports of goods and services	26.6	25.0	31.9	34.7	36.2	37.7	38.5	38.8
Of which: Imports of goods	22.7	21.3	27.4	29.8	31.1	32.4	33.0	33.3
Current account balance	2.8	3.7	0.9	-0.7	-0.9	-0.8	-0.5	-0.3
Gross domestic savings	20.1	20.3	19.3	15.1	15.6	16.6	17.4	18.3
Public domestic savings	0.7	2.0	2.5	3.5	3.4	3.6	3.9	4.3
Private domestic savings	19.4	18.3	16.8	11.7	12.3	12.9	13.5	14.0
Consumption	79.9	79.7	80.7	84.9	84.4	83.4	82.6	81.7
Public consumption 1/	5.3	5.4	5.5	5.5	5.5	5.5	5.5	5.5
Private consumption	74.6	74.3	75.2	79.3	78.9	78.0	77.1	76.2
	(Annual percentage change)							
Real GDP	5.7	6.1	6.7	6.3	6.4	6.6	7.0	7.1
Real GNI	5.3	6.5	5.6	7.3	6.3	6.6	6.9	7.0
Real public consumption	5.9	8.9	8.2	6.3	6.7	6.6	7.3	8.3
Real private consumption	7.4	5.9	3.9	10.3	4.6	3.7	4.6	4.8
Real public investment	0.9	15.1	13.8	17.6	16.3	17.1	13.5	12.2
Real private investment	7.6	6.2	8.8	5.6	10.2	8.0	9.6	9.5
ICOR (Investment to GDP ratio/real GDP growth)	4.2	4.0	3.7	4.1	4.1	4.1	3.9	3.9

Source: IMF staff estimates and projections.

1/ Current government expenditure, excluding interest payments.

Table 8. Bangladesh: Millennium Development Goals, 1990–2015 1/

	Base 1990–95	Current 2005–10	Target 2015	Status
Goal 1: Eradicate extreme poverty and hunger	**Goal will probably be met**			
Target 1.A: Halve by 2015 the proportion of people living below the poverty line				
Poverty headcount ratio	59	32	29	On Track
Poverty gap ratio	17	7	8	Goal Met
Income share held by lowest 20 percent	10	5	...	Needs Attention
Target 1.B: Halve by 2015 the proportion of people who suffer from hunger				
Prevalence of child malnutrition (percent of children under 5)	68	45	33	Off Track
Population below minimum level of dietary energy consumption (percent)	28	20	14	On Track
Goal 2: Achieve universal primary education	**Goal will probably be met**			
Target 2.A: Ensure that all boys and girls complete a full course of primary schooling				
Net enrollment ratio in primary education	61	91	100	On Track
Proportion of pupils starting grade 1 who reach grade 5, percent	43	55	100	Needs Attention
Adult literacy rate of 15–24 years old population (percent)	37	58	---	Needs Attention
Goal 3: Promote gender equality and empower women	**Goal will probably be met**			
Target 3.A: Eliminate gender disparity in primary and secondary education preferably by 2005 and at all levels by 2015				
Ratio of girls to boys in primary and secondary education (percent)	77	106	100	Achieved
Ratio of girls to boys in tertiary education (percent)	37	32	100	Needs Attention
Ratio of literate females to males (percent of ages 15–24)	65	85	100	Needs Attention
Share of women employed in the nonagricultural sector (percent)	19	25	50	Needs Attention
Proportion of seats held by women in national parliament (percent)	10	19	33	Needs Attention
Goal 4: Reduce child mortality	**Goal will probably be met**			
Target 4.A: Reduce by three quarters the maternal mortality ratio				
Under 5 mortality rate (per 1,000)	146	54	50	On Track
Infant mortality rate (per 1,000 live births)	92	41	31	On Track
Immunization, measles (percent of children under 12 months)	54	82	100	On Track
Goal 5: Improve maternal health	**Goal will probably be met**			
Target 5.A: Reduce by three quarters, by 2015, the maternal mortality ratio				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	574	194	143	On Track
Births attended by skilled health staff (percent of total)	5	12	50	Needs Attention
Target 5.B: Achieve universal access to reproductive health				
Contraceptive prevalence rate (percent of women ages 15–49)	40	60	72	Needs Attention
Goal 6: Combat HIV/AIDS, malaria, and other diseases	**Goal will potentially be met**			
Target 6.A: Have halted by 2015 and begin to reverse the spread of HIV/AIDS				
HIV prevalence among population (per 100,000 population)	0	0.3	Halting	On Track
Target 6.B: Have halted by 2015 and begun to reverse the incidence of malaria and other major diseases				
Prevalence of malaria (per 100,000 people)	43	59	Halting	On Track
Incidence of tuberculosis (per 100,000 people)	264	225	Halting	Needs Attention
Tuberculosis treatment success rate under DOTS (percent)	71	92	100	On Track
Goal 7: Ensure environmental sustainability	**Goal will potentially be met**			
Target 7.A: Integrate the principles of sustainable development into country policies and reverse the loss of environmental resources				
Forest area (percent of total land area)	6.8	11.0	20	Needs Attention
CO2 emissions (metric tons per capita)	0.1	0.3	...	Needs Attention
Terrestrial protected areas (percent of total surface area)	...	2.2	...	Insufficient Data
Target 7.B: Halve, by 2015, the proportion of people without sustainable access to safe drinking water and sanitation				
Improved water source (percent of population with access)	78	80	89	On Track
Improved sanitation facilities (percent of population with access)	39	53	70	Needs Attention
Target 7.C: By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers				
Slum population as percentage of urban (percent)	87.3	70.8	...	Insufficient Data
Goal 8: Develop a global partnership for development	**Goal will potentially be met**			
Target 12: Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system				
Net ODA received per capita (current U.S. dollars)	18	8	...	Needs Attention
Target 13: Make available the benefits of new technologies, especially information and communication				
Fixed line and mobile telephones (per 100 people)	0.2	13.6	50	On Track
Internet users (per 100 people)	0.0	3.4	...	Insufficient Data
General indicators				
Life expectancy at birth, total (years)	54	66	...	
Population (in millions)	115.6	162.2	...	
Gross national income (in billions of U.S. dollars)	39.1	95.4	...	
GNI per capita, Atlas method (current, in U.S. dollars)	310	590	...	
Total fertility rate (births per woman)	4.3	3.0	...	
Life expectancy at birth (years)	54.8	63.5	73	
Aid per capita (current US$)	20.1	10.1	...	

Sources: United Nations Development Program and World Development Indicators.
1/ In some cases, the data are for earlier or later years than those stated.
2/ Low contributions to the CO2 emission in a global context.

APPENDIX I. BANGLADESH: INFRASTRUCTURE DEVELOPMENT NEEDS[1]

Overview

1. **Infrastructure bottlenecks are a fundamental constraint to higher economic growth in Bangladesh.** According to the *Global Competitiveness Report 2010–11*,[2] inadequate infrastructure is the most problematic factor for doing business in Bangladesh. A comparison of infrastructure quality in Asia places Bangladesh as the second worst after Nepal, marked by a severely inadequate electricity supply. Accordingly, the government's Sixth Five-Year Plan (FY2011–15) (SFYP) prioritizes a scaling up of infrastructure-related investment in an effort to put Bangladesh on a growth trajectory on par with China, India, and Vietnam.

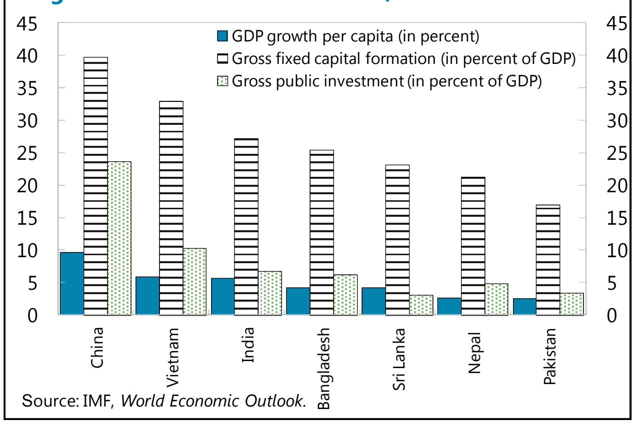
Comparison of Infrastructure Quality, 2009–10 1/

Region/Country	Country Ranking 2/	Overall Infrastructure	Electricity	Roads	Railroads	Port	Air Transport
World	66	4.3	4.5	4.0	3.2	4.3	4.7
Developing East Asia (average)	65	4.5	4.6	4.4	3.2	4.5	4.9
South Asia (average)	104	3.3	2.5	3.3	3.0	3.8	4.1
Bangladesh	130	2.7	1.6	3.0	2.5	3.4	3.5
China	72	4.1	5.3	4.3	4.3	4.3	4.4
India	91	3.6	3.1	3.3	4.6	3.9	4.6

Sources: 2010 World Economic Forum, *The Global Competitiveness Report 2010–11.*
1/ 1= extremely underdeveloped and 7= extensive and efficient by international standards.
2/ Ranking out of 139 countries.

2. **To close the infrastructure deficit and raise growth rates, regional experience shows that Bangladesh needs to ramp up investment rates—both public and private.** Real GDP growth during the last decade averaged 5.8 percent, while the overall investment rate was just below 25 percent of GDP. However, public investment averaged only 6 percent of GDP. Meanwhile, India achieved an average growth rate of 8 percent during 2003–10, supported by an investment rate of around 30 percent, while China achieved an average growth rate of 10 percent during the last decade, with an average investment rate of nearly 40 percent, of which more than half was public investment. In line with these trends, Bangladesh's SFYP targets a growth rate of 8 percent and investment rate of 32 percent of GDP by FY15, through a strategy of higher public investment catalyzing more private investment, including in infrastructure.

Regional Growth and Investment, 2001–10



Source: IMF, *World Economic Outlook.*

Power Infrastructure

3. **While Bangladesh faces a host of serious infrastructure challenges, an inadequate and unreliable power supply has by far been the most debilitating to growth**, increasing production costs, reducing external competitiveness, and constraining investment, including foreign direct inflows. Currently, Bangladesh has the second lowest per capita consumption of energy in the region, with less than half of population having access to electricity. The authorities still estimate electricity shortages average

[1] Prepared by Serpil Bouza (APD).

[2] *Global Competitiveness Report 2010–11*, World Economic Forum, 2010, (Geneva).

1,800 MW a day during peak hours, or more than a third of current generating capacity.[3, 4] Frequent load-shedding (averaging 1,000–1,200 MW a day) causes serious disruptions and also reduces productivity in both industrial and agricultural production. Back-up generators cost firms up to 50 percent more than base electricity costs.[5] Due either to poor electricity access or frequent power outages, many farmers have to depend on more costly diesel for running irrigation pumps.

4. **Power sector development has been held back for various reasons.** The most significant factor has been below-cost administered power tariffs, which have made power sector investment an unattractive business venture for private investors. Currently, the public sector in Bangladesh generates around 56 percent of total electricity production, with the Bangladesh Power Development Board (BPDB) alone producing 42 percent of the total. The private sector generates the rest, selling it to bulk and retail consumers at a government-determined fixed rate. However, this arrangement tends to perpetuate inefficiencies, including high transmission and distribution losses, low plant efficiencies, and inadequate plant maintenance. The overwhelming share of traditional power plants is still fueled by gas. However, crippling domestic gas shortages combined with ageing power plants has resulted in actual electricity generation falling well short of full production capacity, with only three-fourths of installed capacity considered available.

5. **Starting in early 2010, the government embarked on an ambitious plan to more than double electricity generation by 2016**, relying heavily on private sector participation. Under this plan, BPDB is entering into agreements with plant operators to purchase power at profitable rates. However, these agreements are putting pressure on fuel subsidy costs, as power generating capacity and related oil imports rise. Over the near to medium term, power sector plans envisage the following:

- In the near term, most new capacity is coming from "quick rental" and "rental" power stations, which can be set up quickly and are typically capable of producing 50–100 MW of electricity per plant, mainly using imported diesel or furnace oil.[6] As a

Bangladesh: Electricity Production Plan
(In MW)

Year	Public	Private	Total
2010	255	520	775
2011	851	1,343	2,194
2012	838	1,319	2,157
2013 1/	1,540	1,134	2,674
2014	1,270	1,053	2,323
2015	450	1,900	2,350
2016	1,500	1,300	2,800
Total	6,704	8,569	15,273

Source: *Power and Energy Sector Road Map: An Update*, 2011.

1/ Includes 500 MW of imported electricity from India.

[3] See the *Power and Energy Sector Road Map: An Update*, Government of People's Republic of the Bangladesh, Ministry of Finance, Finance Division, 2011.

[4] Shortages are estimated by taking the difference between peak electricity demand and highest generating capacity.

[5] *Bangladesh: Strategy for Sustained Growth*, The World Bank, 2007, Bangladesh Development Series Paper No. 18 (Dhaka).

[6] A rental unit refers to the length of the contract to operate a plant (generally three to five years). They are typically commissioned in four to six months to meet short-term and emergency power requirements of a country. On the other hand, independent power producer plants (IPPs) are usually contracted for at least 20 years (either as build-own-operate or build-operate-transfer). They generally take three to five years to bring online. Rental units are mainly simple cycle plants (i.e., have no capacity for waste heat recovery) and consume marginally more fuel than combined cycle power plants, which are normally set up as IPPs.

result, electricity generation capacity has picked up noticeably. By end 2011, the government expects to add around 2,200 MW in electricity generating capacity to the national grid, representing more than a 50 percent increase in capacity over the past two years.

- Over the medium term (2012–16), new power plants with more than 12,000 MW in total generating capacity will be set up. Under this plan, Bangladesh could generate surplus electricity from 2012 onward if projects are commissioned on time.

- Bangladesh also has a Regional Grid Interconnection Plan, which aims to install a 400 KV transmission line and high voltage direct current power sub-station in order to import 500 MW a day from India by end-2013. The Asian Development Bank (AsDB) approved funding for this project in 2010, but disbursement has been delayed due to the absence of a signed Power Purchase Agreement between Bangladesh and India.

Transportation Network

6. The transportation network has also long been neglected and needs significant investment to support growth. In Bangladesh, only 10 percent of roads are paved, compared to India's 47 percent.[7] The availability of land is the most serious constraint in expanding the road network in Bangladesh, as one of the most densely populated countries in the world. The existing road network in Bangladesh is also of poor quality, increasing transport costs and restricting market access. As a result, production and employment opportunities are constrained, especially in rural areas. As such, developing the transportation infrastructure is critical to helping achieve poverty reduction goals and reduce rural migration pressures. Better transportation infrastructure could also improve regional integration, mainly with India.

7. The government is currently embarking on several large transportation projects. While these projects look to relieve major transport bottlenecks, they will need to be supported by more ambitious plans to develop secondary and tertiary road networks to bring greater rural-urban connectivity. With waterways also a major source of internal transport, water management and dredging activities (and associated environmental concerns) will need to be part of an integrated transportation plan. In the meantime, major transport-related projects focus on the following:

- Roads and bridges: The government envisages the construction of the Padma River multibridge project, as a top transportation priority in the SFYP. When scheduled to open in 2015, the US$2.9 billion combined road-rail bridge will connect some 30 million people (nearly one-fifth of Bangladesh's total population) in the more underdeveloped southwestern part of the country to the northern and eastern parts.[8] Already,

[7] Source: World Bank, *World Development Indicators*.

[8] Project financing will be provided by the government of Bangladesh (US$0.5 billion) and a consortium of development partners (US$2.4 billion), led by the World Bank, whose executive board approved the project in February 2011. Since then, final agreements have been signed with the World Bank's International Development Association (IDA) (US$1.2 billion), AsDB (US$615 million), Japan International Cooperation Agency (JICA) (US$420 million), and Islamic

(continued)

resettlement efforts have begun in order to facilitate bridge construction. The government also approved the construction of the Dhaka Elevated Expressway in March 2011, in an effort to reduce traffic congestion and improve urban road connectivity by linking major commercial centers. The project is expected to be undertaken on a PPP basis at a total estimated cost of US$2 billion. The government has called for proposals from interested investors.

- Rail links: The government plans to use a portion of the US$1 billion credit line from India's Eximbank, approved in October 2010, to upgrade rail lines and improve railway integration between India and Bangladesh. In addition, it is looking at the feasibility of a metro rail in Dhaka, with possible external support.

Port Infrastructure

8. Improving port infrastructure is also key to reducing transport-related costs, expanding foreign trade, and fostering greater regional integration. Bangladesh ranks second lowest to Nepal in its quality of port infrastructure among South Asian countries and 107 out of 139 countries, according to the *Global Competitiveness Report 2010–2011*. Chittagong port, the principal seaport of Bangladesh, handles about 92 percent of total external trade. The port is under increasing strain, with cargo handling growing by 8 percent in 2009 compared to only 2 percent in 2008. Current facilities lack sufficient space and equipment, which prolongs wait times for incoming and outgoing cargo and contributes to high shipping and port charges. To reduce congestion, major envisaged projects center on:

- Developing a master plan for Chittagong port, with technical support from the AsDB, in order to improve port operating efficiency and intermodal transport logistics, so as to bring the port up to international standards.

- Reviving Mongla port in southwestern Bangladesh, as part of the SFYP, by providing transit access to neighboring countries, such as India, Nepal, and Bhutan. The Ministry of Shipping has already embarked on developing an ambitious development plan for the port, which encompasses increasing handling capacity and automating port operations.

Resource Mobilization Challenges and Initiatives

9. The resources needed for a scaling up of infrastructure in Bangladesh are significant. Carrying out large infrastructure projects will also require substantial long-term technical and financial assistance and better coordination between the government, private sector, and development partners. To meet these needs, Bangladesh will continue to depend on government and donor resources. At the same time, given huge investment requirements, it will need to find more effective means of channeling domestic savings into infrastructure investment by developing new funding vehicles, including those needed for newly envisaged public-private partnerships (PPPs) and surrounding formulation of a domestic bond market. While the bulk of Bangladesh's sizeable savings rate of almost 30 percent of GDP is concentrated in

Development Bank (US$140 million). The IDA, AsDB, and JICA credits have yet to be made effective.

the banking system, maturity mismatches mean that domestic banks would find it difficult to fund long-term projects.

10. The government is developing the institutional framework to use PPPs to undertake infrastructure projects, in view of the funding requirements, specialized management, and technical capacity needed to address the country's large and complex infrastructure needs. Guidelines to frame the formation, appraisal, and approval of projects have already been issued. In addition, the government is in various stages of setting up a PPP Advisory Council; a PPP Office under the Prime Minister's Office; a PPP Unit in Ministry of Finance to assess budget implications; and PPP focal points in line ministries. The AsDB is providing TA to make operational the different steps in the PPP cycle.

11. Specific guidelines are also being formulated for financial participation in PPP projects in three forms: (i) technical assistance (TA) financing (i.e., access to government-sponsored TA funds), (ii) viability gap financing (bridging financial gaps for economically viable projects), and (iii) infrastructural financing for extending financing facilities for the PPP projects in the form of debt or equity. The government has already established Bangladesh Infrastructure Finance Fund (BIFF), which is expected to serve as a financing vehicle for private investment in large infrastructure projects.[9]

12. In this regard, lessons may be learned from India's experience with PPP, which has been mixed, but overall highlight the need for a detailed PPP policy that ensures proper planning and risk allocation, adequate protections for private investors, and capacity development in the public sector.

13. Another source of financing that the government may access for infrastructure development is nonconcessional external borrowing. In the event, this type of financing should be limited to high priority, high-return projects and managed carefully within well-integrated medium-term fiscal framework and a national debt management strategy.

[9] The BIFF is expected to operate similar to the India Infrastructure Finance Company Limited (IIFCL). The IIFCL, which was established in India in 2006, raises long-term debt domestically and externally from bilateral and multilateral institutions, backed by a sovereign guarantee.

APPENDIX II. FOOD SECURITY IN BANGLADESH[1]

1. **The recent surge in global commodity prices has complicated Bangladesh's efforts to achieve food security, as a net food, fuel, and fertilizer importer.** In response, the government of Bangladesh, supported by development partners and nongovernmental agencies, has taken steps over the past year to mitigate the effects of rising food prices. Food inflation peaked at 14.4 percent (y/y) in April 2011—just below the previous peak in late 2007.[2] Since then, it has moderated slightly, running at 12.7 percent in August (the latest available data). When Bangladesh went through its last bout of high food price inflation in 2007–08, the country experienced social unrest, which the current government has been keen to avoid.

2. **Broadly defined, food security aims to ensure all people have access to sufficient, nutritious, and affordable food.** It is an integral part of the Millennium Development Goals for Bangladesh (see Table 8), where about two-thirds of the consumption basket comprises food and 31.5 percent of the population lived below the national poverty line in FY10 (July 2009 to June 2010). As a result, Bangladesh is highly vulnerable to food price increases. The Asian Development Bank (AsDB) reported earlier this year that a 10 percent rise in food prices in Bangladesh could drag an additional 4 million people into poverty.[3]

3. **Achieving food security remains a major challenge in Bangladesh and the South Asian region.** More than one-fifth of the region's population still lives in hunger. Despite strong economic performance over the past decade, hunger levels remain high, although lower-income countries in the region perform well compared to global low-income country benchmarks. Food imports have also pushed up import growth in some countries in the region, adding to balance of payments pressures.

4. **Recently, the government of Bangladesh has taken several measures to better ensure food security, which are in line with regional efforts to achieve the same.** Efforts have focused on the following:

- **First, official subsidies on various inputs have helped cushion against rising costs.** Over the past year, for example, the increasing cost of urea fertilizer has posed a significant challenge to farmers. In response, the government expanded the resources available for fertilizer subsidies (around 0.7 percent of GDP in FY11). It also continued to subsidize diesel (used to run the irrigation pumps) and to encourage banks to expand farm loans (agricultural loans are about 6 percent of total loans). Bangladesh Bank also continues to make lending to agriculture a priority sector for banks, as reiterated in the latest Monetary Policy Statement.

- **Second, a variety of food-related social safety net programs exist, with several recently expanded.** These programs focus on meeting food needs of vulnerable groups, providing food for work, and undertaking open market sales of strategic

[1] Prepared by Hye Sun Kim (APD).

[2] In the year preceding April 2011, rice and wheat prices in Bangladesh increased by 13 and 12 percent, respectively.

[3] See *Global Food Price Inflation and Developing Asia*, AsDB, March 2011 (Manila).

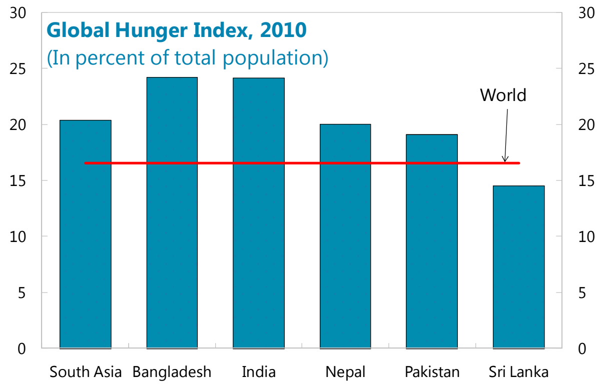
food reserves at subsidized prices. Through its food distribution system, the government released 2.3 million metric tons of food grains in FY11 (mostly rice and wheat)—a 17 percent increase from the previous fiscal year.

- **Third, food imports increased sharply in FY11, mainly through government purchases used for open market sales and strategic reserves.** In total, food grain imports rose by 128 percent in FY11 to US$1.9 billion. Previously, most reserve stocks were built up through local purchases. The government scaled back these programs in FY11 to manage its own procurement costs. Some food grain imports have been sold in the local market and the rest retained as part of official food reserves, which rose to 0.89 million metric tons at end-June 2011 from 0.52 million metric tons at end-June 2010.

- **Finally, the sources of food imports have become more diversified, which has helped hold down their cost.** Bangladesh has moved away from traditional source markets such as India, where past export bans on rice created supply disruptions. Over the past year, food grains have been increasingly imported from Pakistan, Thailand, and Vietnam.

5. A key policy challenge is to balance stabilizing food prices and assuring a fair return for the farmers. The price of rice in Bangladesh, the main staple, was down by about 15 percent from its recent peak (as of end-August 2011). In part, this is due to earlier increases in imported procurement and the emergency release of grain reserves, as well as a strong *boro* rice crop harvest in mid-2011. At current price levels, local farmers appear to be able to recoup their production costs and obtain a fair price, thus mitigating some of the effects of higher food grain prices on rural households.

Bangladesh: Food Security Indicators

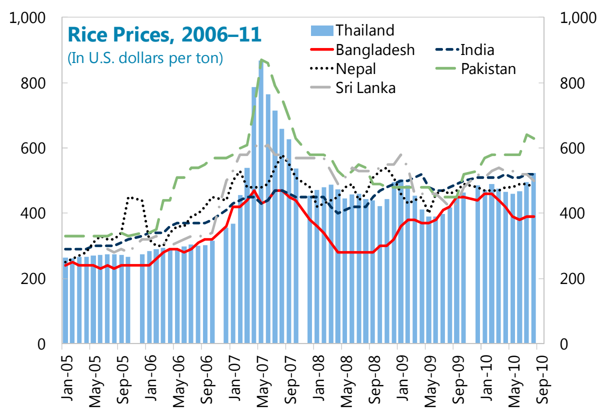


Source: International Food Policy Research Institute, *2010 Global Hunger Index*.

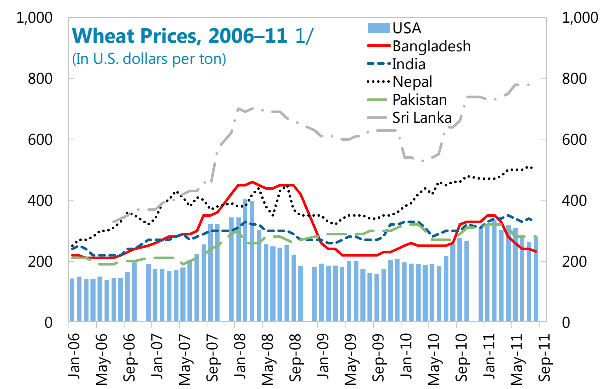
Food Security Indicators

	Bangladesh	India	Nepal	Pakistan	Sri Lanka	South Asia	Low-Income Countries 1/	World
Real GDP growth, 2010 (In percent)	6.1	9.7	4.6	4.4	8.0	8.8	5.9	4.2
Poverty headcount ratio ratio at $1.25 a (PPP basis), 2005 (Percent of population) 1/	49.6	41.6	55.1	22.6	7.0	40.3	25.2	...
Proportion of under-nourishment (Percent of population), 2007	27.0	21.0	16.0	26.0	19.0	22.1	32.0	13.9

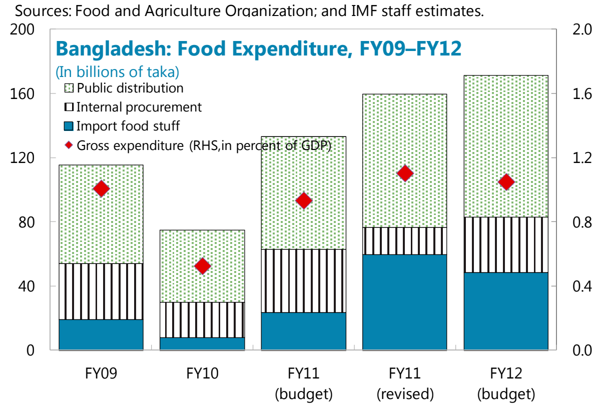
Sources: World Bank, *World Development Indicators*.
1/ For Nepal, 2004 data; for Sri Lanka, 2007 data.



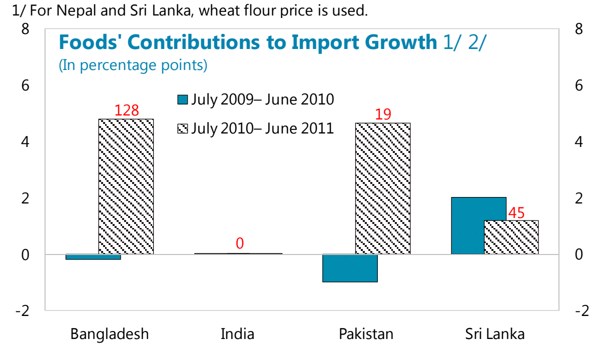
Sources: Food and Agriculture Organization; and IMF staff estimates.



Sources: Food and Agriculture Organization; and IMF staff estimates.
1/ For Nepal and Sri Lanka, wheat flour price is used.



Sources: Bangladesh authorities; and IMF staff estimates.



Sources: CEIC Data Company Ltd.; and IMF staff estimates.
1/ Numbers above bars denote the year-on-year growth of food imports in 2010/11.
2/ Data for India accounts for the first 9 months and for Sri Lanka is for the first 11 months of the reference period for food imports.

Bangladesh: Food Security-Related Programs

Vulnerable group feeding	Provides rice to selected women to support basic needs.
Vulnerable group development	Develops skills and provides food as return, generally to women.
Gratuitous relief	Provides immediate food grants to households after a disaster.
Food for work	Offers food as payment to rural women working on infrastructure projects.
Open market sales	Allows subsidized cash sales of rice.

Source: World Bank, *Bangladesh Economic Update*, April 2011.

Summary of Regional Measures to Address Rising Food Prices

	Bangladesh	India	Nepal	Pakistan	Sri Lanka
Reduce taxes	√			√	√
Increase supply	√	√	√	√	√
Restrict exports	√	√		√	
Control prices/ subsidize consumers	√	√	√	√	√
Food for work	√				
Food aid	√	√			√
Development of agriculture	√	√	√	√	√
Feeding programs		√			
Input subsidy	√	√			√

Sources: Asian Development Bank, *Global Food Price Inflation and Developing Asia*, 2011; and IMF staff estimates.

INTERNATIONAL MONETARY FUND

BANGLADESH

STAFF REPORT FOR THE 2011 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS[1]

October 14, 2011

Approved By
Masahiko Takeda and Thomas Dorsey (IMF)
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Prepared by
International Monetary Fund
International Development Association

The results of the debt sustainability analysis (DSA) are similar to those of the previous DSA. Bangladesh's risk of debt distress on external debt remains low. The level of public and publicly guaranteed external debt as a share of GDP in FY11 is in line with that anticipated in the previous DSA, but has improved as a share of exports and revenues given their recent strong growth.[2] *Under the baseline scenario, Bangladesh's external debt burden indicators remain below the relevant policy-dependent indicative thresholds. They also do not breach the thresholds under the stress tests.*[3] *Debt burden indicators are less favorable when domestic debt is included.*

[1] This DSA has been prepared jointly by IMF and World Bank 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.

[2] See IMF Country Report No. 10/55.

[3] 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.

INTRODUCTION

1. **This DSA incorporates a new baseline macroeconomic outlook, including revised assumptions on the public sector's external and domestic borrowing plans.** The outlook, summarized in Box 1, follows the broad trend of the government's Sixth Five-Year Plan (FY11–15) (SFYP)[4] and medium-term budget framework. Compared to the previous DSA, the baseline assumptions for economic growth in this DSA are moderately higher. At the same time, rising demand for oil and capital goods imports, in part associated with a ramping up of infrastructure investment, is accompanied by moderate current account deficits over the medium to long run, in part financed by larger external borrowing. As a result, the projected rate of external debt accumulation over the medium term is higher than in the previous DSA.

2. **Debt dynamics are positively affected by the higher growth assumptions, but negatively affected by the higher projected rate of debt accumulation.** On balance, the present value (PV) of external debt now declines by about 3 percentage points of GDP over the immediate six-year projection period (FY12–17), similar to the decline over the immediate six-year projection period in the previous DSA. Under the baseline scenario, this DSA has a less favorable external debt path than the historical scenario, the opposite of the previous DSA.[5]

3. **Bangladesh's current debt stock comprises the following:**

- **Public and publicly guaranteed external debt had a face value equivalent to 21.6 percent of GDP at end-FY11.** The debt is owed mostly to multilateral creditors, including the World Bank and the Asian Development Bank. Japan is the main bilateral creditor (see table below).

- **Domestic debt amounted to 21.3 percent of GDP at end-FY11, up from 20.3 percent in the previous year.** It mainly comprises treasury bills and bonds (42 percent), held mostly by domestic commercial banks, and National Savings Certificates (NSCs) (38 percent), held mainly by the nonbank private sector (see table below).[6]

[4] FY11 refers to the period July 2010–June 2011.

[5] The large noninterest current account surplus recorded in FY10 (4 percent of GDP) and more moderate surplus in FY11 (1.1 percent of GDP) raise the 10-year average noninterest current account balance, which is used in the historical scenario to generate the relevant path for external debt. At the same time, compared to the baseline scenario in the previous DSA, the current account balance in this DSA weakens more over the near to medium term. This translates into a higher external borrowing requirement in the baseline scenario.

[6] Net domestic government debt (i.e., including government deposits) was 18.1 percent of GDP at end-FY11. Deposits are mostly held by autonomous and semi-autonomous government bodies that are largely outside the control of the central government. Hence the public DSA focuses on gross public debt.

(continued)

Bangladesh: Public and Publicly Guaranteed External Debt
(At end-June 2011)

	In Millions of U.S. Dollars	In Percent of Total External Debt
Multilateral debt	**19,609**	**85.5**
World Bank	11,129	48.6
Asian Development Bank	7,330	32.0
International Monetary Fund	590	2.6
International Fund for Agricultural Development	298	1.3
Islamic Development Bank	181	0.8
Other	80	0.3
Bilateral debt	**2,647**	**11.5**
Japan	2,039	8.9
Kuwait	166	0.7
Korea, Republic of	152	0.7
United States	116	0.5
Other	173	0.8
Short-term debt	**666**	**2.9**
Total	**22,922**	**100.0**
(Percent of GDP)	**21.6**	

Source: IMF staff estimates.

Bangladesh: Public Domestic Debt by Creditor
(At end-June 2011)

	In Billions of Taka	In Percent of Total Domestic Debt
Bangladesh Bank	**320**	**19.1**
Advances and overdrafts	284	16.9
Treasury instruments	30	1.8
Other obligations	6	0.4
Commercial banks	**663**	**39.5**
Treasury instruments	615	36.7
Other obligations	48	2.9
Other	**694**	**41.4**
National savings certificates	634	37.8
Treasury instruments	60	3.6
Total	**1,677**	**100.0**
(Percent of GDP)	**21.3**	

Source: IMF staff estimates.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

4. **All external debt indicators remain well below the policy-dependent debt burden thresholds under the baseline scenario, and no thresholds are breached under the standardized stress tests.** The main results of the external DSA are as follows:

- **All debt indicators in the baseline scenario are expected to decline over the 20-year projection period** (Table 1). During the projection period, the PV of the debt-to-GDP ratio decreases from 17½ percent in FY11 to about 8½ percent in FY32 (compared to an indicative threshold of 40 percent), while the PV of the debt-to-exports ratio decreases from 75 percent in FY11 to 26 percent in FY32 (compared to an indicative threshold of 150 percent).

- **The standard stress tests do not reveal any serious vulnerability** (Table 2 and Figure 1). The strong increase in remittances in Bangladesh in recent years, from about 8 percent of GDP in FY06 to 11 percent of GDP in FY11, has further raised Bangladesh's capacity to repay.[7] While remittances growth slowed significantly in FY11 relative to earlier years and remittances as a percent of GDP are projected to gradually fall over the long term, they will remain substantial and will continue to contribute toward reducing Bangladesh's vulnerability to shocks. Strong growth of exports and revenues in FY11 also contributed to lower the debt-to-exports and debt-to-revenue ratios, respectively.

[7] A recent review of some aspects of the LIC DSF 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).

Box 1. Bangladesh: Macroeconomic Assumptions Underlying the DSA

Real GDP growth is projected to average 6¾ percent a year over the immediate projection period (FY12–17), broadly in line with the government's medium-term growth targets. This is above the ten-year average (5¾ percent), reflecting stepped-up investment and reforms. Over the longer run, growth is projected to average around 6½ percent a year. The near-term outlook factors in more robust growth in garments exports than envisaged in the previous DSA, which was prepared in late 2009 when there was substantial uncertainty about the pace of recovery from a severe global downturn. In addition, the baseline assumptions for growth presume a pickup in structural reforms, concentrated on strengthening fiscal management, deepening the financial sector, and improving the trade and investment climate. Finally, they take account of ongoing efforts to relieve energy shortages and infrastructure bottlenecks, most notably through higher public investment, as envisaged in the government's Annual Development Program (ADP), also with greater private sector participation in power and transportation sector development.

Inflation, as measured by the GDP deflator in domestic currency, decelerates from 10.0 percent in FY12 to 6.8 percent in FY17 and slightly more thereafter, reflecting an easing of upward pressures from import prices, moderate policy tightening, and a reduction in domestic supply constraints.

The growth of **exports** and **imports** of goods and services is moderately strong over the immediate projection period (around 13¼ and 12½ percent, on average, respectively, compared to about 10 percent for both in the previous DSA). Exports would continue to be driven by ready-made garments, as Bangladesh's low-cost advantage allows it to capture greater market share. As noted earlier, imports would be driven by stronger investment demand, including that associated with infrastructure development. Improvements in the trade and investment climate would also contribute to higher export and import growth.

The **current account** is projected to slip into a moderate deficit starting in FY12 and remain as such over the medium to long run. Main drivers during FY12–17 are strong envisaged growth in oil and capital goods imports, in part to address electricity shortages and infrastructure bottlenecks, and more moderate growth in remittances compared to recent years, because of lower net migration. Macroeconomic and structural reforms would also trigger larger foreign direct investment inflows, including in infrastructure, which would finance at least part of the higher imports.

Net aid inflows (disbursements of grants and loans, net of amortization payments) are projected to average 1.4 percent of GDP a year in the long term—around the current level. However, in FY12–15, official disbursements are projected to rise substantially, with net aid inflows averaging about 1.8 percent of GDP, owing to the construction of the Padma Bridge (with gross disbursements equivalent to around 2.5 percent of GDP) and stepped-up implementation of existing donor-supported projects.

The **grant element of new external borrowing** is assumed to average about 31 percent in FY12–17, despite some expected recourse to nonconcessional borrowing to fund infrastructure projects. Real domestic interest rates on government debt are currently suppressed and negative in real terms. With greater interest rate flexibility and financial markets development, real domestic interest rates are assumed to increase steadily over the medium term.

The **primary fiscal deficit** (including grants) is expected to average 2.3 percent of GDP during FY12–17, about 1 percent of GDP higher than the average of the past 10 years. The higher deficits factor in substantial expected improvement in revenue collection over the long run driven by the introduction of new VAT and income tax laws and implementation of the tax modernization plan, which will improve revenue collection processes. Offsetting these gains are steady increases in public investment which peak in FY20 before falling slightly as a percent of GDP to a long-run equilibrium consistent with continuing large investment needs. They also encapsulate rising subsidy costs associated with expected incurred losses by energy and fertilizer-related state-owned enterprises. In the electricity sector, the greater reliance on high-cost rental power plants to address the power deficit is expected to add to these losses over the near to medium term. The current baseline assumes gradual movement to full cost recovery for electricity by mid-decade.

On balance, the current outlook carries some downside risks, which, if realized, could result in a slightly lower growth trajectory, that is, a scenario more in line with the IMF's 2009 Article IV Consultation staff report and World Bank's July 2010 *Country Assistance Strategy*. These risks stem mainly from weak implementation capacity, persistent governance issues, and political opposition to reforms. In addition, the global economic recovery remains fragile, with Bangladesh's heavy dependence on garment exports to the U.S. and E.U. and on workers' remittances, mainly from the Middle East, exposing it to potential setbacks.

PUBLIC DEBT SUSTAINABILITY ANALYSIS[8]

5. **In the baseline scenario, the PV of public debt-to-GDP ratio remains steady initially, but then falls gradually over the long run to 38½ percent of GDP in FY32** (Table 3). The decline in the PV of external public debt-to-GDP ratio is partially offset by a rising domestic debt-to-GDP ratio. Reflecting reform plans to boost domestic revenue collection and a slight tapering off of public investment in the outer years, the PV of public debt-to-domestic revenue ratio declines steadily 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 some risks** (Table 4 and Figure 2). A case in point is the low-case scenario, in which limited progress on fiscal and financial as well as trade and investment reforms causes real GDP growth and the primary fiscal balance to remain at their historical averages (Alternative Scenario 1). In this scenario, key debt and debt service ratios rise over the long term. Greater-than-envisaged dependence on high-cost power from rental power plants, slower-than-envisaged adjustments to electricity prices, and a larger-than-anticipated rise in world oil prices would add to prospective operating losses of energy-related state-owned enterprises (SOEs), which could exacerbate contingent liabilities of the government and necessitate budgetary absorption through larger fiscal imbalances.[9] Recapitalization needs of state-owned commercial banks (SOCBs), including those brought on by absorbing SOE losses, could put further pressure on contingent liabilities. One of the standardized shocks in the DSA framework assesses the impact of a one-time 30 percent real depreciation in FY13. As a result of this shock, the debt service-to-revenue ratio would reach 39 percent in FY14, compared with the baseline ratio of 31 percent.

DEBT MANAGEMENT

7. **In response to a request from the authorities, a joint World Bank/IMF mission visited Bangladesh in September 2010 to provide follow-up technical assistance to help build capacity to improve debt management.** The mission's main recommendations focused on operationalizing the debt management strategy, including the preferred choice of strategy and the need to develop annual borrowing plans. The authorities are making progress on devising a comprehensive debt management strategy that is built on estimates of the long-term public investment requirements and the associated financing needs. This strategy will also need to take into account the direct and contingent liabilities arising from infrastructure projects, including those being developed under the new public-private partnership framework, given the envisaged use of viability gap funding for some projects. Finally, work is also under way to establish a single, comprehensive, and wholly accurate database on domestic and external debt, which covers the wider public sector, as well as loan guarantees.[10] These reforms are being

[8] Public debt includes central government domestic debt and external public and publicly guaranteed debt.

[9] Legacy loans of these and several other large SOEs to the SOCBs currently amount to about 2 percent of GDP. The DSA explicitly accounts for short-term external nonconcessional borrowing by the Bangladesh Petroleum Corporation, which is guaranteed by the government. The total stock was US$0.7 billion at end-FY11 and is projected to rise.

[10] The authorities are also working to improve their database on private sector external debt, which was estimated at US$1.2 billion at end-FY11. Capital controls generally impede borrowing from abroad. Industrial projects in Bangladesh can access medium- and long-term external borrowing with prior approval by the government's Board of Investment. Until recently, the absence of a sovereign credit rating inflated the country risk premium, making such borrowing relatively expensive. In April 2010, S&P gave Bangladesh its first sovereign credit rating (BB-).

implemented in alignment with the objectives of the Strengthening Public Expenditure Management Project to develop capacities for debt policy and management.

VIEWS OF THE AUTHORITIES

8. **The authorities were in broad agreement with the DSA.** They underscored that the government would continue to assess the budgetary, debt, and growth implications of individual projects and ensure that the terms of new external borrowing are consistent with a debt management strategy currently being formulated. However, the authorities also indicated that should concessional resources fall short of financing development spending needs, the government might access non-concessional medium to long-term borrowing. They also recognized that progress on developing domestic bond markets would create a deeper and more stable source of financing for domestic debt.

CONCLUSION

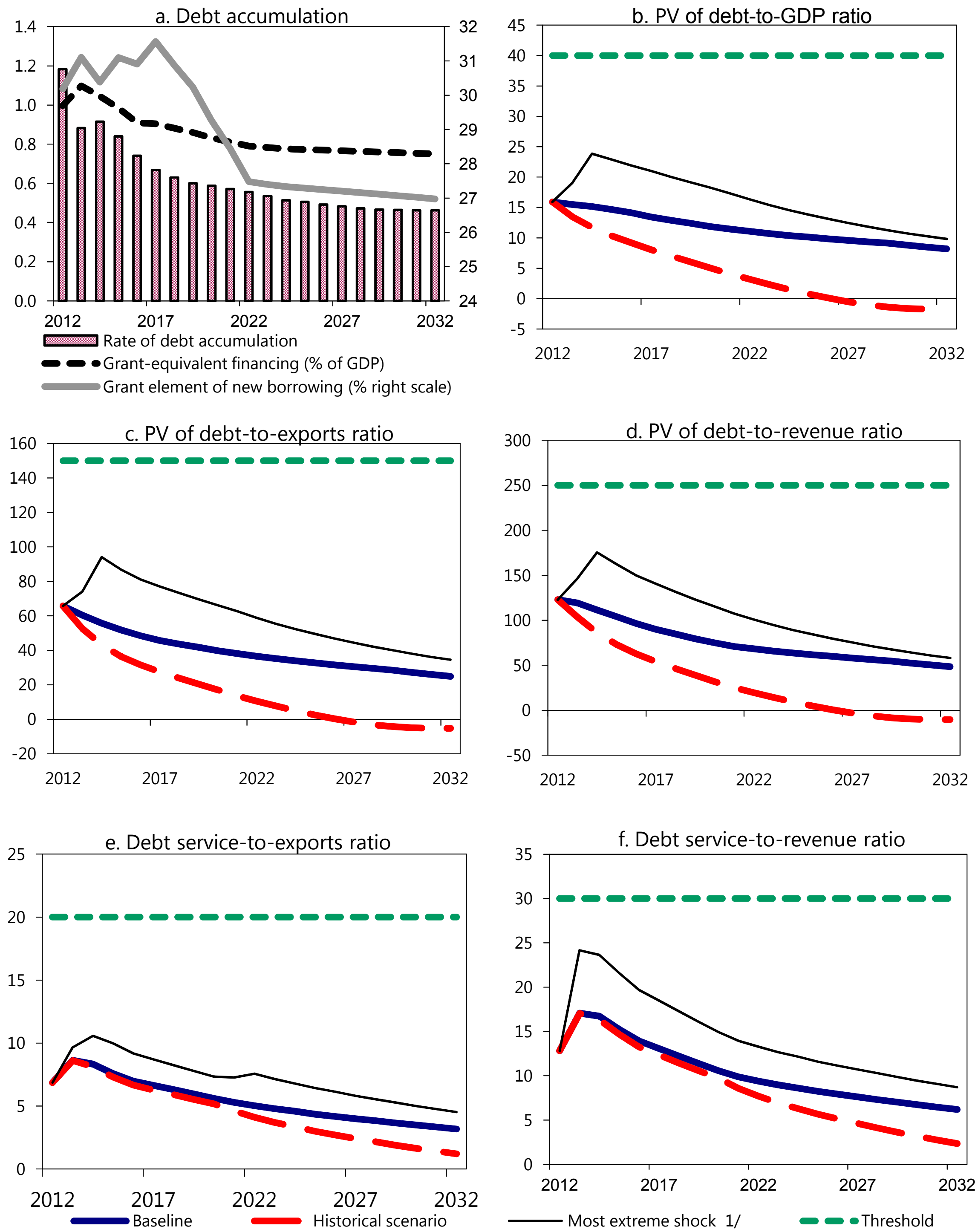
9. **In the staffs' view, Bangladesh is at low risk of debt distress based on external indicators, but the analysis reveals less favorable debt indicators on public debt.** The baseline projections and the associated standard stress tests show little risk related to external debt given that none of the indicators breach the indicative debt burden thresholds. However, in view of Bangladesh's continued low domestic revenue base, risk to total debt and debt service, including domestic debt, remains a concern.

10. **The substantial increase in debt ratios when domestic debt is included calls for a prudent fiscal policy.** While the PV of the 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 rise over the long term in some of the alternative scenarios and bound tests. Public debt and debt service ratios also remain high over the long term when some of the key variables are fixed at historical levels. This underscores the importance of undertaking structural fiscal reforms aimed at expanding domestic resources, containing subsidy costs, and raising public investment, ultimately with an aim of boosting growth.

11. **Efforts to mobilize domestic revenues, to manage expenditures prudently while protecting priority outlays, and to contain contingent liabilities are key to improving debt indicators.** Higher pass-through of changes in world energy prices would help reduce SOE losses and associated subsidy costs, protecting the fiscal space needed to raise social and development spending and put Bangladesh on a higher growth trajectory, as targeted in its SFYP. This exercise also underscores the importance of effective management of the existing debt and new debt accumulation, including relying primarily on concessional external debt over the medium term to finance infrastructure needs.

12. **The staffs encourage 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 under way to develop a comprehensive debt management strategy and public debt data base, covering both domestic and external debt and integrating it with centralized reporting of all external aid flows.

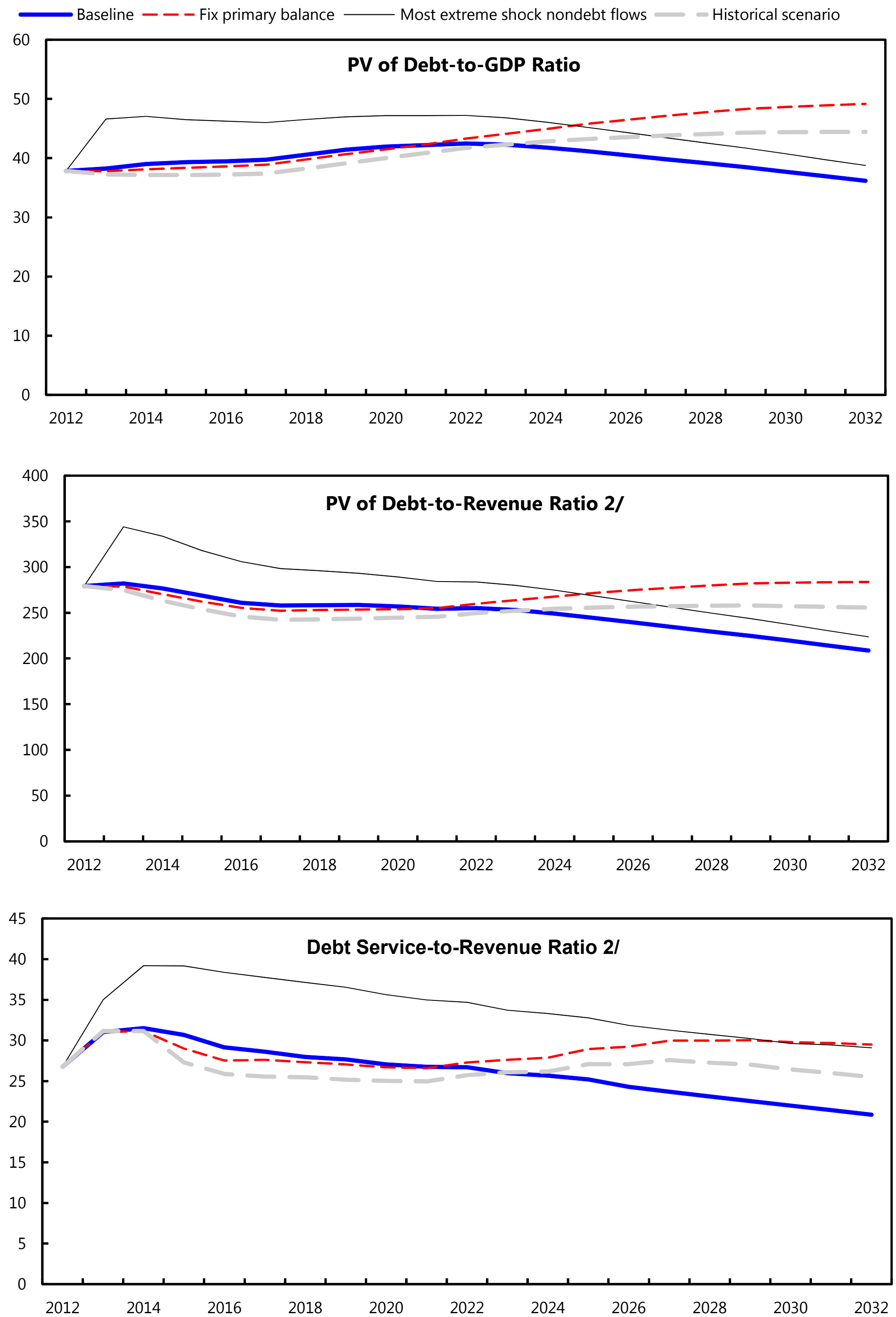
Figure 1. Bangladesh: Indicators of Public and Publicly Guaranteed External Debt under Alternative Scenarios, 2012–32 1/



Sources: Bangladesh authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in 2021. In figure b. it corresponds to a One-time depreciation shock; in c. to a Combination shock; in d. to a One-time depreciation shock; in e. to a Combination shock and in figure f. to a Combination shock.

Figure 2. Bangladesh: Indicators of Public Debt Under Alternative Scenarios, 2012–32 1/



Sources: Bangladesh authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2022.
2/ Revenues are defined inclusive of grants.

Table 1. Bangladesh: External Debt Sustainability Framework, Baseline Scenario, 2009–32 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 2/	Standard Deviation	Projections									
	2009	2010	2011			2012	2013	2014	2015	2016	2017	2012–17 Average	2022	2032	2018–32 Average
External debt (nominal) 1/	**25.7**	**22.3**	**22.7**			**21.9**	**21.2**	**20.7**	**19.9**	**19.1**	**18.1**		**14.7**	**10.9**	
Of which: Public and publicly guaranteed (PPG)	24.2	21.1	21.6			20.8	20.2	19.7	19.0	18.2	17.3		14.1	10.4	
Change in external debt	-2.6	-3.4	0.4			-0.8	-0.7	-0.5	-0.7	-0.9	-1.0		-0.6	-0.4	
Identified net debt-creating flows	-7.0	-7.4	-3.7			-1.4	-1.3	-1.4	-1.8	-2.1	-2.2		-1.7	-1.9	
Noninterest current account deficit	**-3.1**	**-4.0**	**-1.1**	**-1.4**	**1.3**	**0.4**	**0.6**	**0.5**	**0.2**	**0.0**	**0.0**		**0.6**	**-0.2**	0.4
Deficit in balance of goods and services	7.1	6.4	8.8			10.5	10.6	10.5	10.1	9.7	9.6		9.4	7.0	
Exports	19.5	18.6	23.1			24.2	25.7	27.2	28.4	29.1	29.4		30.2	32.9	
Imports	26.6	25.0	31.9			34.7	36.2	37.7	38.5	38.8	39.0		39.6	39.9	
Net current transfers (negative = inflow)	-11.4	-11.6	-10.9	-8.9	2.2	-11.0	-10.9	-10.9	-10.8	-10.7	-10.6		-9.8	-8.3	-9.3
Of which: Official	-0.1	-0.1	-0.1			-0.1	-0.1	-0.1	-0.1	-0.1	-0.1		-0.1	-0.1	
Other current account flows (negative = net inflow)	1.3	1.2	1.0			0.9	0.9	0.9	0.9	0.9	0.9		1.0	1.0	
Net FDI (negative = inflow)	**-1.1**	**-0.9**	**-0.7**	**-0.9**	**0.2**	**-0.8**	**-0.9**	**-0.9**	**-1.0**	**-1.1**	**-1.2**		**-1.6**	**-1.3**	-1.5
Endogenous debt dynamics 3/	**-2.9**	**-2.6**	**-1.9**			**-1.0**	**-1.0**	**-1.0**	**-1.0**	**-1.0**	**-1.0**		**-0.7**	**-0.4**	
Contribution from nominal interest rate	0.2	0.2	0.2			0.3	0.3	0.3	0.3	0.3	0.3		0.3	0.2	
Contribution from real GDP growth	-1.4	-1.4	-1.3			-1.3	-1.3	-1.3	-1.3	-1.3	-1.3		-1.0	-0.6	
Contribution from price and exchange rate changes	-1.7	-1.4	-0.7			...	...	...	...	...	...		...	...	
Residual (3–4) 4/	**4.4**	**4.1**	**4.1**			**0.6**	**0.6**	**0.9**	**1.1**	**1.3**	**1.2**		**1.2**	**1.5**	
Of which: Exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 5/	...	...	17.4			17.0	16.5	16.1	15.6	15.0	14.3		11.7	8.6	
In percent of exports	...	...	75.1			70.2	64.3	59.2	54.9	51.5	48.5		38.7	26.2	
PV of PPG external debt	**...**	**...**	**16.3**			**15.9**	**15.5**	**15.2**	**14.7**	**14.1**	**13.4**		**11.1**	**8.2**	
In percent of exports	**...**	**...**	**70.3**			**65.8**	**60.4**	**55.7**	**51.7**	**48.5**	**45.8**		**36.6**	**24.9**	
In percent of government revenues	**...**	**...**	**140.4**			**123.0**	**119.4**	**111.6**	**104.0**	**96.6**	**90.1**		**68.3**	**48.5**	
Debt service-to-exports ratio (in percent) 6/	**4.5**	**5.5**	**4.0**			**7.1**	**8.9**	**8.6**	**7.8**	**7.3**	**6.9**		**5.4**	**3.5**	
PPG debt service-to-exports ratio (in percent) 6/	**4.2**	**5.2**	**3.8**			**6.9**	**8.6**	**8.3**	**7.6**	**7.0**	**6.6**		**5.0**	**3.2**	
PPG debt service-to-revenue ratio (in percent) 6/	**7.9**	**8.8**	**7.5**			**12.8**	**17.1**	**16.7**	**15.3**	**13.9**	**13.1**		**9.4**	**6.2**	
Total gross financing need (in billions of U.S. dollars)	-2.6	-3.8	-0.8			2.3	4.1	4.4	4.1	3.7	3.7		4.0	0.3	
Noninterest current account deficit that stabilizes debt ratio	-0.4	-0.6	-1.5			1.2	1.3	1.1	1.0	0.8	1.0		1.1	0.2	
Key macroeconomic assumptions															
Real GDP growth (in percent)	5.7	6.1	6.7	6.0	0.7	6.3	6.4	6.6	7.0	7.1	7.2	6.8	6.8	6.0	6.5
GDP deflator in U.S. dollar terms (change in percent)	6.2	5.9	3.3	2.9	4.1	2.2	2.3	1.4	1.9	1.9	1.6	1.9	1.6	1.6	1.6
Effective interest rate (percent) 7/	0.9	1.1	0.9	1.0	0.1	1.6	1.6	1.6	1.7	1.7	1.8	1.7	1.9	2.0	2.0
Growth of exports of G&S (U.S. dollar terms, in percent)	8.6	7.4	36.7	14.0	10.9	13.7	15.4	14.7	13.7	12.0	9.9	13.2	9.3	8.7	9.0
Growth of imports of G&S (U.S. dollar terms, in percent)	3.7	5.7	40.6	14.1	13.5	18.1	13.6	12.4	11.3	10.1	9.4	12.5	8.7	7.7	8.4
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	30.2	31.1	30.4	31.1	30.9	31.6	30.9	27.5	27.0	27.9
Government revenues (excluding grants, in percent of GDP)	10.5	10.9	11.6			12.9	13.0	13.6	14.1	14.6	14.9		16.2	16.9	16.3
Aid flows (in billions of U.S. dollars) 8/	0.6	0.8	1.0			1.1	1.4	1.5	1.6	1.7	1.9		2.2	4.5	
Of which: Grants	0.3	0.6	0.7			0.7	0.8	0.7	0.8	0.8	0.9		1.3	2.7	
Of which: Concessional loans	0.3	0.2	0.2			0.4	0.6	0.7	0.8	0.8	1.0		0.9	1.8	
Grant-equivalent financing (in percent of GDP) 9/	...	...	...			1.0	1.1	1.0	1.0	0.9	0.9		0.8	0.8	0.8
Grant-equivalent financing (in percent of external financing) 9/	...	...	...			51.8	48.8	46.4	48.5	50.1	50.7		48.1	48.6	48.6
Memorandum items:															
Nominal GDP (in billions of U.S. dollars)	89.4	100.4	110.6			120.2	130.8	141.4	154.1	168.2	183.2		281.4	597.4	
Nominal dollar GDP growth	12.3	12.3	10.2			8.6	8.8	8.1	9.0	9.1	8.9	8.8	8.5	7.7	8.2
PV of PPG external debt (in billions of U.S. dollars)	...	...	17.3			18.6	19.6	20.8	22.0	23.1	24.3		30.7	50.2	
(PVt-PVt-1)/GDPt-1 (in percent)	...	...	...			1.2	0.9	0.9	0.8	0.7	0.7	0.9	0.6	0.5	0.5
Gross workers' remittances (in billions of U.S. dollars)	9.7	11.0	11.7			12.8	13.8	14.9	16.1	17.4	18.8		26.9	48.2	
PV of PPG external debt (in percent of GDP + remittances)	...	...	14.7			14.4	14.0	13.7	13.3	12.8	12.2		10.1	7.6	
PV of PPG external debt (in percent of exports + remittances)	...	...	48.3			45.7	42.8	40.1	37.8	35.8	33.9		27.8	20.0	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	2.6			4.8	6.1	6.0	5.5	5.2	4.9		3.8	2.6	

Sources: Bangladesh authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

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

4/ 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.

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

6/ The increase in debt service in FY12 is, in part, due to projected interest for AsDB loans that is not paid during the loan's grace period.

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

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

9/ 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, 2012–32

(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	**2022**	2032
PV of debt-to GDP ratio								
Baseline	16	16	15	15	14	13	**11**	8
A. Alternative scenarios								
A1. Key variables at their historical averages in 2011–31 1/	16	13	12	10	9	8	**3**	-2
A2. New public sector loans on less favorable terms in 2011–31 2/	16	15	16	15	15	15	**14**	13
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012–13	16	15	15	15	14	13	**11**	8
B2. Export value growth at historical average minus one standard deviation in 2012–13 3/	16	17	21	20	19	18	**14**	9
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2012–13	16	16	16	15	15	14	**11**	9
B4. Net nondebt creating flows at historical average minus one standard deviation in 2012–13 4/	16	18	21	20	19	19	**15**	9
B5. Combination of B1–B4 using one-half standard deviation shocks	16	19	24	23	22	21	**16**	10
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	16	21	21	20	19	19	**15**	12
PV of debt-to-exports ratio								
Baseline	66	60	56	52	48	46	**37**	25
A. Alternative scenarios								
A1. Key variables at their historical averages in 2011–31 1/	66	53	43	36	32	28	**11**	-5
A2. New public sector loans on less favorable terms in 2011–31 2/	66	60	57	55	52	51	**45**	39
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012–13	66	58	54	50	47	45	**36**	25
B2. Export value growth at historical average minus one standard deviation in 2012–13 3/	66	74	94	87	81	77	**59**	35
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2012–13	66	58	54	50	47	45	**36**	25
B4. Net nondebt creating flows at historical average minus one standard deviation in 2012–13 4/	66	71	78	72	67	64	**48**	28
B5. Combination of B1–B4 using one-half standard deviation shocks	66	77	95	87	82	77	**58**	32
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	66	58	54	50	47	45	**36**	25
PV of debt-to-revenue ratio								
Baseline	123	119	112	104	97	90	**68**	49
A. Alternative scenarios								
A1. Key variables at their historical averages in 2011–31 1/	123	104	87	73	63	54	**20**	-10
A2. New public sector loans on less favorable terms in 2011–31 2/	123	119	115	110	104	101	**85**	76
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012–13	123	117	111	103	96	90	**68**	50
B2. Export value growth at historical average minus one standard deviation in 2012–13 3/	123	131	152	140	130	122	**88**	54
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2012–13	123	119	115	107	99	94	**71**	52
B4. Net nondebt creating flows at historical average minus one standard deviation in 2012–13 4/	123	141	156	144	133	125	**90**	54
B5. Combination of B1–B4 using one-half standard deviation shocks	123	146	176	162	150	141	**101**	58
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	123	163	153	143	132	125	**94**	69

Table 2. Bangladesh: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2012–32 (concluded)

(In percent)

	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
Debt service-to-exports ratio								
Baseline	7	9	8	8	7	7	**5**	3
A. Alternative scenarios								
A1. Key variables at their historical averages in 2011–31 1/	7	9	8	7	7	6	**4**	1
A2. New public sector loans on less favorable terms in 2011–31 2/	7	9	8	8	7	7	**5**	4
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012–13	7	9	8	8	7	7	**5**	3
B2. Export value growth at historical average minus one standard deviation in 2012–13 3/	7	10	11	10	9	9	**8**	5
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2012–13	7	9	8	8	7	7	**5**	3
B4. Net nondebt creating flows at historical average minus one standard deviation in 2012–13 4/	7	9	9	8	7	7	**6**	4
B5. Combination of B1–B4 using one-half standard deviation shocks	7	9	10	9	8	8	**7**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	7	9	8	8	7	7	**5**	3
Debt service-to-revenue ratio								
Baseline	13	17	17	15	14	13	**9**	6
A. Alternative scenarios								
A1. Key variables at their historical averages in 2011–31 1/	13	17	16	15	13	12	**8**	2
A2. New public sector loans on less favorable terms in 2011–31 2/	13	17	17	16	14	13	**10**	8
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012–13	13	17	17	16	14	13	**10**	6
B2. Export value growth at historical average minus one standard deviation in 2012–13 3/	13	17	17	16	15	14	**11**	7
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2012–13	13	18	18	16	15	14	**10**	7
B4. Net nondebt creating flows at historical average minus one standard deviation in 2012–13 4/	13	17	17	16	15	14	**12**	7
B5. Combination of B1–B4 using one-half standard deviation shocks	13	17	18	17	16	15	**13**	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2013 5/	13	24	24	22	20	19	**13**	9
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	26	26	26	26	26	26	**26**	26

Sources: Bangladesh authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), noninterest 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, 2009–32

(In percent of GDP, unless otherwise indicated)

	Actual					Projections									
	2009	2010	2011	Average	Standard Deviation	2012	2013	2014	2015	2016	2017	2012–17 Average	2022	2032	2018–32 Average
Public sector debt 1/	45.4	41.4	42.9			42.7	43.0	43.6	43.7	43.6	43.6		45.5	38.4	
Of which: Foreign-currency denominated	24.2	21.1	21.6			20.8	20.2	19.7	19.0	18.2	17.3		14.1	10.4	
Change in public sector debt	-1.6	-4.1	1.5			-0.2	0.2	0.6	0.1	-0.1	0.0		0.2	-0.8	
Identified debt-creating flows	-1.4	-2.0	0.1			-0.6	0.2	0.5	0.0	-0.2	0.0		0.1	-0.9	
Primary deficit	1.2	0.9	1.7	1.3	0.5	2.1	2.7	2.7	2.2	2.1	2.2	2.3	1.3	0.1	0.7
Revenue and grants	10.8	11.5	12.2			13.5	13.6	14.1	14.6	15.1	15.4		16.7	17.3	
Of which: Grants	0.3	0.6	0.7			0.6	0.6	0.5	0.5	0.5	0.5		0.5	0.5	
Primary (noninterest) expenditure	12.0	12.4	14.0			15.7	16.2	16.8	16.8	17.2	17.6		18.0	17.4	
Automatic debt dynamics	-2.6	-2.9	-1.7			-2.7	-2.4	-2.1	-2.2	-2.2	-2.2		-1.2	-0.9	
Contribution from interest rate/growth differential	-1.7	-1.8	-2.1			-2.4	-2.1	-1.7	-2.2	-2.2	-2.0		-1.2	-0.8	
Of which: Contribution from average real interest rate	0.8	0.8	0.5			0.1	0.4	0.9	0.7	0.7	0.9		1.7	1.4	
Of which: Contribution from real GDP growth	-2.6	-2.6	-2.6			-2.5	-2.6	-2.7	-2.9	-2.9	-2.9		-2.9	-2.2	
Contribution from real exchange rate depreciation	-0.9	-1.1	0.4			-0.3	-0.3	-0.4	0.0	0.0	-0.2		...	...	
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	-0.2	-2.1	1.5			0.5	0.0	0.1	0.1	0.1	0.0		0.0	0.0	
Other sustainability indicators															
PV of public sector debt	...	...	37.6			37.8	38.2	39.0	39.3	39.5	39.7		42.5	36.2	
Of which: Foreign-currency denominated	...	...	16.3			15.9	15.5	15.2	14.7	14.1	13.4		11.1	8.2	
Of which: External	...	...	16.3			15.9	15.5	15.2	14.7	14.1	13.4		11.1	8.2	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	4.6	3.9	4.5			6.3	8.0	8.3	7.9	7.7	7.7		6.5	4.0	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	306.9			279.3	282.0	276.8	268.9	261.0	257.9		255.2	208.7	
PV of public sector debt-to-revenue ratio (in percent)	...	...	324.3			292.1	294.6	287.3	278.6	270.0	266.5		262.6	214.3	
Of which: External 3/	...	...	140.4			123.0	119.4	111.6	104.0	96.6	90.1		68.3	48.5	
Debt service-to-revenue and grants ratio (in percent) 4/	28.6	25.2	21.5			26.8	31.0	31.5	30.7	29.2	28.6		26.7	20.9	
Debt service-to-revenue ratio (in percent) 4/	29.6	26.6	22.8			28.0	32.4	32.7	31.8	30.2	29.6		27.5	21.4	
Primary deficit that stabilizes the debt-to-GDP ratio	2.8	5.0	0.2			2.3	2.4	2.1	2.1	2.2	2.1		1.1	0.9	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	5.7	6.1	6.7	6.0	0.7	6.3	6.4	6.6	7.0	7.1	7.2	6.8	6.8	6.0	6.5
Average nominal interest rate on forex debt (in percent)	0.8	1.1	0.9	1.0	0.1	1.6	1.5	1.6	1.6	1.7	1.7	1.6	1.7	5.1	2.1
Average real interest rate on domestic debt (in percent)	5.7	3.6	3.3	3.9	1.2	0.7	1.1	2.6	3.2	3.2	4.0	2.5	5.8	4.0	5.4
Real exchange rate depreciation (in percent, + indicates depreciation)	-3.5	-4.8	2.2	-0.6	4.5	-1.5	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	6.5	6.5	6.3	5.7	1.6	10.0	9.3	8.1	7.8	7.6	6.8	8.3	4.5	4.5	4.5
Growth of real primary spending (deflated by GDP deflator, in percent)	-0.1	0.1	0.2	0.1	0.1	0.2	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)	...	...	...	...	...	30.2	31.1	30.4	31.1	30.9	31.6	30.9	27.5	27.0	...

Sources: Bangladesh authorities; and staff estimates and projections.

1/ Central government gross debt. The years in the table refer to fiscal years. Therefore, 2010 refers to July 2009–June 2010.

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. The increase in debt service in FY12 is, in part, due to projected interest for AsDB loans that is not paid during the loan's grace period.

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

6/ The increase in debt service in FY12 is, in part, due to projected interest for AsDB loans which is not paid during the loan's grace period.

Table 4. Bangladesh: Sensitivity Analysis for Key Indicators of Public Debt 2012–32

	Projections							
	2012	2013	2014	2015	2016	2017	2022	2032
PV of Debt-to-GDP Ratio								
Baseline	38	38	39	39	39	40	42	36
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	38	37	37	37	37	37	42	44
A2. Primary balance is unchanged from 2012	38	38	38	38	39	39	43	49
A3. Permanently lower GDP growth 1/	38	38	39	40	40	40	44	40
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2012–13	38	39	40	41	41	42	46	41
B2. Primary balance is at historical average minus one standard deviations in 2012–13	38	38	38	38	38	39	42	36
B3. Combination of B1–B2 using one half standard deviation shocks	38	38	38	38	39	39	43	39
B4. One-time 30 percent real depreciation in 2013	38	45	45	45	45	45	46	40
B5. 10 percent of GDP increase in other debt-creating flows in 2013	38	47	47	47	46	46	47	39
PV of Debt-to-Revenue Ratio 2/								
Baseline	279	282	277	269	261	258	255	209
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	279	275	263	254	246	242	250	256
A2. Primary balance is unchanged from 2012	279	279	270	262	255	252	260	284
A3. Permanently lower GDP growth 1/	279	282	278	270	263	261	263	231
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2012–13	279	286	286	279	272	270	273	235
B2. Primary balance is at historical average minus one standard deviations in 2012–13	279	277	266	260	253	250	249	205
B3. Combination of B1–B2 using one half standard deviation shocks	279	277	268	262	257	256	260	223
B4. One-time 30 percent real depreciation in 2013	279	333	322	309	297	290	278	229
B5. 10 percent of GDP increase in other debt-creating flows in 2013	279	344	334	318	306	298	284	224
Debt Service-to-Revenue Ratio 2/								
Baseline	27	31	31	31	29	29	27	21
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	27	31	31	27	26	26	26	25
A2. Primary balance is unchanged from 2012	27	31	31	29	28	28	27	29
A3. Permanently lower GDP growth 1/	27	31	31	31	29	29	28	23
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2012–13	27	31	32	32	31	30	29	24
B2. Primary balance is at historical average minus one standard deviations in 2012–13	27	31	31	28	27	27	26	20
B3. Combination of B1–B2 using one half standard deviation shocks	27	31	31	28	27	28	28	22
B4. One-time 30 percent real depreciation in 2013	27	35	39	39	38	38	35	29
B5. 10 percent of GDP increase in other debt-creating flows in 2013	27	31	35	55	32	37	28	24

Sources: Bangladesh 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 2011 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

October 14, 2011

Prepared By

Asia and Pacific Department
(In consultation with other departments)

CONTENTS

ANNEX I. BANGLADESH: FUND RELATIONS

(As of September 30, 2011)

Membership Status

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

General Resources Account

	SDR Million	Percent Quota
Quota	533.30	100.00
Fund holdings of currency	649.57	121.80
Reserve tranche position	0.41	0.08

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	510.40	100.00
Holdings	423.03	82.88

Outstanding Purchases and Loans

	SDR Million	Percent Quota
Emergency assistance	116.66	21.88
ECF[1] arrangements	222.30	41.68

Financial Arrangements

In millions of SDRs (mm/dd/yyyy)

Type	Arrangement	Date	Amount Approved	Amount Drawn
ECF[1]	6/20/03	6/19/07	400.33	316.73
ECF[1]	8/10/90	9/13/93	345.00	330.00
SAF[1]	2/06/87	2/05/90	201.25	201.25

[1] Extended Credit Facility (ECF), formerly PRGF; Structural Adjustment Facility (SAF).

Projected Payments to the Fund

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

	2011	2012	2013	2014	2015
Principal	21.62	130.01	91.73	48.50	33.65
Charges/Interest	0.47	1.59	0.67	0.40	0.31
Total	22.09	131.60	92.39	48.90	33.96

Article IV Consultation

The previous Article IV consultation was concluded on February 25, 2010 (IMF Country Report No. 10/55).

Safeguards Assessment

A safeguards assessment of the Bangladesh Bank (BB) was concluded in July 2011. Bangladesh Bank's governance structure and legal underpinning need to be updated to strengthen autonomy and thus better safeguard resources. Important areas of BB operations such as management of foreign reserves and extension of overdraft facilities in foreign exchange are not monitored by BB's board. Audit committee oversight is ineffective, as evidenced by current external and internal audit mechanisms, which are inadequate to provide necessary accountability. These safeguards are much needed in an environment where BB is seeking to modernize its accounting and auditing systems and controls.

Exchange Arrangement

- **Exchange regime.** The *de jure* exchange rate regime is a managed float. Effective October 4, 2010, the *de facto* regime was reclassified from stabilized to crawl-like.
- **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.

Resident Representative

The resident representative office was established in 1972. Ms. Eteri Kvintradze has been the Resident Representative since February 2010.

Bangladesh: Technical Assistance, 2010–11

Department	Topic	Timing
LEG	VAT and income tax laws	***2010:*** December ***2011:*** February, April, and October
MCM	Central bank accounting/internal audit	***2008–11:*** Multiple visits
	Reserve management	***2010:*** September
	Medium-term debt management strategy (joint with World Bank)	***2010:*** September
	Bank supervision and risk exposure	***2011:*** April
	Banking supervision	***2011:*** May–present (resident advisor)
FAD	Revenue administration (RA)	***2010–11:*** Multiple visits by regional RA advisor
	VAT administration	***2010–11:*** Multiple visits
	Macro fiscal framework	***2010–11:*** Multiple visits
	Tax administration and VAT reform	***2010:*** August
	PEFA assessment (joint with World Bank)	***2010:*** October
	VAT implementation framework	***2011:*** April
	Public financial management (PFM)	***2011:*** September (regional PFM advisor)
STA	National accounts statistics	***2011:*** January and September
	External sector statistics	***2011:*** July

ANNEX II. BANGLADESH: IMF-WORLD BANK COLLABORATION

(October 2011)

The IMF and World Bank Group (both International Development Association (IDA) and International Finance Corporation (IFC) teams) work together to promote critical reforms that are essential for maintaining macroeconomic stability and improving growth conditions in Bangladesh. Collaboration on the ground is strong through the IMF resident representative's office and the World Bank's Country Office. The teams also discuss regularly the division of labor between the two institutions.

The teams note that collaboration between the IMF and the Bank is good—both in the field and at headquarters—with informal and frequent exchange of information on each other's activities and through shared analysis of key policy issues.

Based on this assessment, the teams agreed that the two institutions should remain focused on the following reform areas:

- **Tax policy and administration.** Higher public investment is needed for Bangladesh to accelerate economic growth. To achieve this, improved revenue generation is important for creating the necessary fiscal space to raise public investment to 7–8 percent of GDP by mid-decade. Developing a modern tax regime, establishing a supportive legal framework, and strengthening tax administration are essential, requiring concerted efforts to deal address legal, institutional, and other capacity constraints. *Division of labor:* The World Bank Group, IMF (including through its regional revenue administration advisor), and Asian Development Bank will collaborate in this area, in alignment with the National Board of Revenue's plan for tax modernization.
- **Public financial management.** Sound public financial management (PFM) is important for improving the quality of public expenditure as well as increasing public investment through better implementation of the government's Annual Development Program. *Division of labor:* IDA will take the lead in this area through its administration of the Strengthening Public Expenditure Management Program (SPEMP), supported by a multi-donor trust fund. The SPEMP focuses on core PFM issues in the executive branch of the government of Bangladesh, as well as strengthening public expenditure oversight functions in Parliament and supreme audit institutions. The IDA is also taking the lead on public procurement reform and capacity building. The IMF will coordinate in this area through its regional PFM advisor.
- **Debt management.** Debt burden indicators do not signal debt servicing difficulties. However, there is no integrated debt management strategy and no single entity responsible for managing total public sector debt. *Division of labor:* The IMF and IDA will continue working jointly in this area, including on the joint IDA-IMF Debt Sustainability Analysis, with the IMF

coordinating views on main macroeconomic assumptions and outlook and IDA providing technical support on debt management capacity through the SPEMP.

- **Monetary and exchange rate policies.** The IMF will take the lead in this area. The IDA will play a complementary role through operations to strengthen policy formulation and payments systems at Bangladesh Bank (BB).
- **Financial sector reform.** A sound and viable financial sector will remain critical for creating an improved environment for private sector investment. Ensuring steady sector growth and institutional development and sound prudential oversight and risk management will require considerable technical resources in the coming years. Strengthening the central bank's regulatory and supervisory framework and internal accounting and controls underpins this work. *Division of labor:* both the IDA/IFC and IMF are engaged in this area, with the former taking the lead on financial market development and governance and the latter on bank supervision and oversight, supported by a resident advisor in BB.
- **Energy sector reform.** Severe power shortages constrain growth in Bangladesh. Proper incentives are needed for stepped-up private investment in the sector. Foremost, the government needs to implement a well-designed strategy to raise retail and bulk tariffs in a phased manner to reduce overall subsidies and create fiscal space for more pressing spending needs. Complementary actions are under way to develop a monitoring framework and use of performance audits to contain losses of energy-related state-owned enterprises. Given the likelihood of higher fuel and electricity prices, properly designed and targeted safety nets will also need to be put in place. *Division of labor:* IDA will lead on policy dialogue and investment in this area, with the IMF focused on fiscal implications.
- **Statistical policy.** Improvements in statistics are critical to formulating sound policies and monitoring their outcomes. Both IDA and the IMF have sustained engagement in this area and will ramp it up further in the future. *Division of labor:* IDA on poverty, social, and development statistics and the IMF on macroeconomic statistics.
- **Other structural policies.** The World Bank keeps the IMF informed about its work on governance and anti-corruption, local government and decentralization, social protection, trade policy and private sector development. Upstream sharing allows the IMF to comment on such work before it is finalized.

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

ANNEX III. BANGLADESH: RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

(September 2011)

Lending and Technical Assistance Operations

Bangladesh had cumulative public sector borrowing from the Asian Development Bank (AsDB) of almost US$12.1 billion (212 loans) as of December 31, 2010, and technical assistance (TA) grants of US$202.7 million (363 projects). The country is one of the largest borrowers of concessional Asian Development Fund (ADF) resources. The loans and TA have supported all key sectors, including energy and transport, social infrastructure, and agriculture and natural resources. The AsDB has also supported eight private sector projects worth US$242.2 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 2010, the AsDB approved a total amount of US$1.3 billion in loans. This included loans to (i) construct the Padma River multipurpose bridge (US$615 million, of which US$76 million is from the ADF);[2] (ii) expand capacity and improve efficiency in natural gas production, transmission, and distribution systems (US$266 million); (iii) facilitate the exchange of electric power between India and Bangladesh under the Bangladesh-India Electrical Grid Interconnection Project (US$100 million); (iv) improve urban environment and infrastructure services based on effective regional urban planning under the City Region Development Project (US$120 million); and (v) enhance rural people's access to social services, such as health and education, and enhance economic opportunities under the Sustainable Rural Infrastructure Improvement Project (US$60 million).

In FY2012 (July 2011–June 2012), planned AsDB disbursements are about US$564 million, up from US$407 million in FY2011 (see table below).

AsDB Loan Disbursement to Bangladesh, FY09–11
(In millions of U.S. dollars)

	FY10	FY11	FY12 Proj.
Project loans	424	281	518
Power sector	72	92	70
Gas transmission and development	91	10	105
Emergency assistance	18	5	0
Other	243	174	343
Program loans	649	126	46
Good governance program	0	0	46
Countercyclical support	500	0	0
Public expenditure support	149	97	0
Other	0	29	0
Total loans	**1,073**	**407**	**564**

Source: AsDB.

Country Partnership Strategy

The Country Partnership Strategy (CPS) 2006–10 lapsed in December 2010. The AsDB is currently preparing the CPS for 2011–15, which is expected to be considered by the AsDB's board in October 2011. The new CPS is aligned to the government's Sixth Five-Year Plan (SFYP) and the AsDB's Long-Term Strategic Framework (*Strategy 2020*). It will support the government's SFYP objectives of

[1] Bangladesh joined the Asian Development Bank (AsDB) in 1973.

[2] The Padma Bridge loan, which was approved in November 2010, is the largest project assistance that the AsDB has provided to Bangladesh.

higher growth and accelerated poverty reduction. Under the CPS, the AsDB will seek to mainstream climate change and environmental sustainability considerations into its project operations. In addition, more emphasis will be given to promote public-private partnerships, especially in infrastructure. The CPS will also seek to foster regional cooperation and integration.

The Bangladesh country operations business plan for 2011–13, approved in July 2010, comprises 24 projects totaling about US$3.2 billion, including assistance for primary education and the energy and transport sectors. The TA program for 2011–13 consists of 41 projects, with an annual allocation of about of US$7.9 million.

Co-financing operations enable the AsDB's financing partners—government or their agencies, multilateral financial institutions, and commercial organizations—to participate in the financing of AsDB projects. The additional funds are provided in the form of grants, official or commercial loans, and syndications. In 2010, three projects received loan cofinancing: from the Korea Export-Import Bank for the Natural Gas Access Improvement Project (US$45 million); from the International Fund for Agricultural Development for the Participatory Small-Scale Water Resources Sector (US$10 million); and from the Islamic Development Bank (US$140 million), Japan Agency for International Cooperation (US$300 million), and the World Bank (US$1.2 billion) for the Padma Multipurpose Bridge Project. A grant was provided by KfW, Germany for the Sustainable Rural Infrastructure Improvement Project (US$16 million). As of end-2010, cumulative direct value-added cofinancing for Bangladesh amounted to US$2.87 billion for 30 investment projects and US$60.4 million for 74 TA projects.

Economic and Sector Work Program

Each year, the AsDB publishes its *Asian Development Outlook* and *Asian Development Outlook Update*, in which it assesses macroeconomic performance. The AsDB's Bangladesh resident mission also publishes the *Bangladesh Quarterly Economic Update*. A bimonthly *Economic Indicators Update* is also prepared. In support of the AsDB's CPS (2011–15) exercise, several thematic assessments and sector studies were completed. These include: thematic assessments for poverty; private sector development; governance, gender, and environment issues; and various sector studies.

ANNEX IV. BANGLADESH: STATISTICAL ISSUES

(September 2011)

Assessment of Data Adequacy for Surveillance

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

National accounts. The paucity of source data remains the main impediment to improving national accounts statistics. It 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. Source data are primarily from benchmark surveys and a biennial census of manufacturing establishments and household expenditure survey. Many of the benchmark surveys were conducted over five years ago and are based on outdated sample frames. The shortcomings in the data also affect compilation practices. In addition, a system of price indices for estimating national accounts at constant prices needs to be developed. Technical assistance missions conducted in September 2009 and January 2011 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. The work program envisages the release of a new base year series by early 2012.

Price statistics. The CPI and PPI weights are outdated, which introduces uncertainty, but these are already being addressed by BBS, which is working on rebasing the base years to 2005/06 and accordingly updating the weights by incorporating recent household survey data.

Government finance statistics. A 2008 STA multisector mission recommended additional actions to strengthen the analytical usefulness of fiscal data, including to: (i) improve the integration of debt stocks and related financial flows; (ii) sensitize donors to the need to promptly provide complete data on direct project assistance; and (iii) establish an interagency committee to prepare a migration plan to the GFSM 2001. In addition, the authorities need to map the monthly budget data to GFSM 2001 presentation, disseminate stock data on financial assets and liabilities, and broaden the coverage to general government.

Monetary and financial statistics. 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.

External sector statistics. Pressing issues need to be addressed in balance of payments and international investment position statistics, mainly in trade in goods, trade credits, and related financing. In the area of goods transactions, data are collected from different data sources; exports are based on information from customs declarations and imports are based on foreign exchange settlements. Efforts are under way by the authorities 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. Bangladesh Bank, the institution in change of external sector statistics, also needs to employ additional data sources, apart from the settlement data, for the financial account, including for trade credits, and should discontinue some adjustments to the financial account that are deemed to be unsound. International investment position data remains weak.

Data Standards and Quality

Bangladesh has participated 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

(As of October 13, 2011)

	Date of latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	10/13/11	10/13/11	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	10/12/11	10/13/11	D	D	D
Reserve/Base Money	10/12/11	10/13/11	D	D	M
Broad Money	Aug. 2011	10/13/11	M	M	M
Central Bank Balance Sheet	Aug. 2011	10/13/11	W/M	W/M	M
Consolidated Balance Sheet of the Banking System	Aug. 2011	10/13/11	M	M	M
Interest Rates[3]	10/12/11	10/13/11	W	W	D
Consumer Price Index	Aug. 2011	9/18/11	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]—General Government[5]	n/a	n/a	n/a	n/a	n/a
Revenue, Expenditure, Balance and Composition of Financing[4]—Central Government	June 2011	Aug. 2011	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[6]	June 2011	8/23/11	M	M	M
External Current Account Balance	June 2011	Aug. 2011	M	M	M
Exports and Imports of Goods and Services	Aug. 2011	Sep. 2011	M	M	M
GDP/GNP	FY2011	Jun. 2011	A	A	A
Gross External Debt	FY2011	Sep. 2011	A	A/M	A
International Investment Position[7]	Q4 2009	May 2011	A	A	A

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

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 11/132
FOR IMMEDIATE RELEASE
November 1, 2011

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

IMF Executive Board Concludes 2011 Article IV Consultation with Bangladesh

On October 28, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bangladesh.[1]

Background

Growth performance in Bangladesh has been strong the past few years, bolstered by efforts to reduce longstanding infrastructure bottlenecks and aided by accommodative policies. Export growth also reached a record high in fiscal year 2011 (July 2010–June 2011), driven up by a bustling ready-made garments sector. Official estimates place real GDP growth at 6¾ percent in FY11, up from around 6 percent in FY10. At the same time, macroeconomic pressures are intensifying, with the current account balance deteriorating by around 3 percentage points of GDP to slightly below 1 percent in FY11 and the overall balance of payments (BoP) running a deficit in FY11 for the first time in a decade. Despite strong export growth and supportive remittance inflows, BoP pressures are emanating from rising oil and capital goods imports, volatile commodity prices, and weak aid inflows. Fiscal pressures have also emerged due to increasing subsidy costs, mainly on account of fuel consumption, despite tax revenues having exceeded 10 percent of GDP in FY11—a milestone for Bangladesh. Finally, inflation reached a multi-year high in August 2011, with aggregate demand and food prices the major drivers.

In response, the authorities have allowed greater exchange rate flexibility over the past year to relieve external pressures; undertaken moderate fuel price and electricity tariff adjustments to contain subsidy costs; and attempted to tighten monetary policy, mainly through policy rate hikes and credit-related ceilings. Certain lending rate caps have also been removed. However,

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[1] 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.

Bangladesh Bank has also increasingly been called to provide credit to the government. As a result, fiscal pressures are undermining monetary policy, reducing its effectiveness. Measured reforms have taken place in the financial sector, but rapid growth of the banking system and equity markets is straining supervisory capacity. Despite recently adopted Basel II standards, risks have emerged from liquidity pressures, stock market exposures, and weakened governance, especially at the state-owned commercial banks, in an environment of strong credit expansion.

Notwithstanding global uncertainties, real GDP growth is projected to reach 6.3 percent in FY12 on still supportive domestic demand. Inflation is expected to remain at around 10 percent, given relatively accommodative macroeconomic policies and possible upside pressures from higher food and energy prices and a weaker taka. The current account will likely slip into a deficit in FY12 of around ¾ percent of GDP and remain near this level over the next few years, notwithstanding a favorable exports and remittances outlook, as fuel imports grow and infrastructure investment intensifies. Concomitantly, foreign reserves are expected to decline to 2.3 months of import cover at end-FY12 from 2.9 months at end-FY11, and decrease further over the medium term, absent stronger policy adjustment and timely structural reforms.

Executive Board Assessment

Executive Directors commended the authorities' economic performance and poverty reduction efforts in a fragile global environment. While the near-term growth outlook is favorable, high commodity prices and accommodative policies are contributing to a deterioration in the current account and inflation pressures. To preserve macroeconomic stability and to boost medium-term growth prospects, Directors stressed the need for prudent macroeconomic policies and advancing the reform process.

Directors emphasized that reducing vulnerabilities while maintaining space for social and development spending will require concerted policy actions. In the fiscal area, they called for well-designed measures to reduce subsidy costs. This will require further adjustments to domestic energy prices, with targeted safeguards to protect the poor. Welcoming the recent efforts to increase tax revenues, Directors encouraged the authorities to press ahead with tax reforms, including modernizing the tax regime and timely approval of the new VAT and income tax laws. They also highlighted the need to strengthen public financial management and to continue to improve Annual Development Program implementation, including more effective use of development partner resources. Directors observed that Bangladesh is at low risk of external debt distress. It will nevertheless remain important to pursue a sound debt management strategy with continued reliance on concessional external financing, careful control over the domestic debt burden, and proper accounting for contingent liabilities.

Directors supported further monetary tightening and continued exchange rate flexibility. They urged Bangladesh Bank to reduce its financing of the budget deficit in line with achieving its FY12 monetary targets, accompanied by higher policy and treasury rates and limited liquidity support. Increased interest rate flexibility will help strengthen the monetary transmission mechanism, and greater central bank independence will improve overall policy effectiveness. In view of external pressures, Directors stressed the importance of limiting foreign exchange market intervention to smoothing short-term volatility and maintaining adequate reserves. They welcomed the new reserve management guidelines, and recommended that they also govern the use of foreign exchange overdrafts.

Directors emphasized that ensuring the soundness of the financial sector is essential to maintain macroeconomic stability and reduce fiscal risks. Key priorities are to strengthen bank supervision and oversight, and improve governance and performance, in particular of state-owned commercial banks. Directors also stressed the need for strong equity market oversight, including to contain systemic risks that could arise from market volatility.

Directors agreed that further progress on key structural reforms will be critical to achieve the ambitious growth and poverty reduction objectives. The focus should be on reforms aimed at relieving infrastructure bottlenecks, enhancing the trade and investment regime, and improving the business environment, including for labor-intensive activities.

Many Directors favorably noted the authorities' interest in a possible Extended Credit Facility-supported program to help stabilize the reserve position and foster the reform efforts, to be underpinned by strengthened macroeconomic policies.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Bangladesh: Selected Economic Indicators, FY2009–12 1/

	FY09	FY10	FY11 Est.	FY12 Proj.
National income and prices (percent change)				
Real GDP	5.7	6.1	6.7	6.3
GDP deflator	6.5	6.5	6.3	10.0
CPI inflation (annual average)	6.7	7.3	8.8	10.7
CPI inflation (end of period)	2.2	8.7	10.2	10.7
Nonfood CPI inflation (end of period)	5.9	5.2	5.7	10.8
Investment and savings (percent of GDP)				
Gross investment	24.4	24.4	24.7	25.7
Private	19.7	19.4	19.5	19.7
Public	4.7	5.0	5.3	6.0
National savings	27.2	28.1	25.6	24.9
Private	26.5	26.1	23.1	21.5
Public	0.7	2.0	2.5	3.5
Central government operations (percent of GDP)				
Total revenue and grants	10.8	11.5	12.2	13.5
Total revenue	10.5	10.9	11.6	12.9
Tax	8.6	9.0	10.1	10.5
Nontax	1.9	1.9	1.5	2.5
Grants	0.3	0.6	0.7	0.6
Total expenditure	14.5	14.6	15.9	17.9
Current expenditure	10.1	9.5	9.7	10.1
Annual Development Program (ADP)	3.2	3.7	4.2	4.5
Other expenditures 2/	1.2	1.4	2.1	3.3
Overall balance (including grants)	-3.7	-3.1	-3.7	-4.4
(Excluding grants)	-4.0	-3.7	-4.3	-5.0
Primary balance (excluding grants)	-1.5	-1.6	-2.4	-2.8
Financing (net)	3.7	3.1	3.7	4.4
Of which: External	0.4	0.9	0.3	0.7
Total central government debt (percent of GDP)	45.4	41.4	42.9	42.7
Money and credit (end of fiscal year; percent change)				
Net domestic assets of the banking system	17.6	19.6	24.6	26.0
Credit to private sector by the banking system	15.5	24.2	25.8	16.9
Reserve money	31.9	18.1	21.0	22.2
Broad money (M2)	19.2	22.4	21.4	20.7
Balance of payments (in billions of U.S. dollars)				
Exports, f.o.b.	15.6	16.2	23.0	26.3
(Annual percent change)	10.1	4.2	41.7	14.2
Imports, f.o.b.	-20.3	-21.4	-30.3	-35.8
(Annual percent change)	4.2	5.4	41.8	18.1
Current account balance	2.5	3.7	1.0	-0.8
(Percent of GDP)	2.8	3.7	0.9	-0.7
Capital and financial account balance	-0.4	-0.1	-1.0	0.1
Overall balance	2.1	2.9	-0.9	-0.7
Gross official reserves (in billions of U.S. dollars) 3/	7.4	10.1	10.0	9.1
In months of prospective imports of goods and services	3.6	3.4	2.9	2.3
Exchange rate (taka per U.S. dollar; period average)	68.8	69.2	71.2	...
Nominal effective rate (2000=100; period average)	89.5	87.0	82.9	...
Real effective rate (2000=100; period average)	105.4	108.3	108.8	...
Terms of trade (percent change)	1.6	-4.6	-6.7	...
Memorandum item:				
Nominal GDP (in billions of taka)	6,148	6,943	7,875	9,207

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

1/ Fiscal year begins July 1.

2/ Includes non-ADP capital spending and net lending.

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

Statement by Arvind Virmani, Executive Director for Bangladesh and Koodathumuriyil Eapen, Senior Advisor to Executive Director
October 25, 2011

1. The Bangladesh authorities would like to put on record their appreciation to the Fund staff for their constructive engagement which has led to an effective and productive 2011 Article IV Consultation. They have found the discussions on various aspects of the Bangladesh economy and the evolving outlook open-minded and useful. They have also found the reports presenting a balanced view of the economy and broadly reflecting the discussions held between them and the staff. The authorities are in general agreement in principle with the assessments and policy messages of the reports.

Macroeconomic Developments and General Outlook

2. The authorities point out that Bangladesh is steadily moving towards a high growth trajectory, which is evidenced by the fact that, over the last 5 years, the country has achieved an average annual growth rate of 6.2 percent. Real GDP growth in FY'11 (Bangladesh follows a July to June fiscal) has increased to 6.7 percent from 6.1 percent in FY'10. This development has been primarily attributed to the good performance of the industrial and agricultural sectors along with improved growth in the service sector. Industrial production has risen by 9.5 percent mainly due to external demand for garment products. Further, the authorities' steps to overcome infrastructural bottlenecks in the power, energy and communication sectors have had a positive impact on all sectors of the economy. An additional 2022 MW of electricity has been added to the national grid between January, 2009 and June, 2011and this is likely to go up to 2969 MW by December 2011.

3. Given brighter prospects for increasing agricultural and manufacturing output, as well as due to strong remittance inflows, the authorities estimate that the economy will grow by 7.0 percent in FY'12. There has been a substantial increase in remittance inflows in July-September 2011 and they feel that remittances are likely to further register higher inflows in the current fiscal year. Besides, they note that prudent fiscal policy measures and effective public investment coupled with public-private partnership (PPP) initiatives will support achieving this planned growth by crowding in private investment. Continued reforms in the financial sector and in the capital markets together with appropriate monetary and other growth supportive policies will further contribute to the process of realizing growth targets.

4. Bangladesh has increased its real per capita income by more than 130 percent and cut the poverty rate by 60 percent over the past 40 years. This development is due to a range of improvements in the socioeconomic structure of the country, including enhanced economic growth, expansion of primary and secondary education, reduction in infant and child mortality rate, control of the spread and fatality of malaria and tuberculosis, reforestation and

access to safe drinking water and sanitation. The percentage of population living below the poverty line has gone down from 48.9 percent in 2000 to 31.5 percent in 2010.

5. Regarding inflationary pressures, the authorities point out that inflation in Bangladesh is mainly driven by external supply-side factors, triggered by international price hikes in food, fuel and fertilizer. In addition, there has been enhanced internal demand for food and energy, which has also caused upward inflationary pressures. The 12-month average CPI has risen by 7.3 percent in FY'10 and further increased to 8.8 percent in FY'11. Accommodative monetary policies in FY'11 to support higher credit demand for public and private sector investment could also have contributed to this rise. Inflationary pressures have remained on the rise in the current fiscal, with a rise in the average CPI by 9.4 percent till August 2011. However, with the likely positive supply responses of the real sector to the policy measures of the Government and the Bangladesh Bank (BB), the impact of the price rise is expected to moderate in due course. The authorities feel that recent steps taken to contract monetary expansion as well as domestic supply-side interventions to ensure uninterrupted flow of essential commodities in the market are likely to further restrain inflationary pressures. They will keep a constant watch on the current inflationary trends and are ready to take necessary steps in case the inflationary scenario poses a threat to macroeconomic stability.

Fiscal Sector Developments

6. On the fiscal front the authorities state that total revenue, as estimated in the FY'12 budget, is likely to reach a level of 12.1 percent of GDP. The increase in revenue mobilization has been encouraging with a 20 percent growth in FY'11. There has been a 27.8 percent growth in the National Board of Revenue (NBR) collected taxes, exceeding the budget estimate by nearly 1½ percentage points and the scaled up revised tax revenue estimates by 0.8 percentage points. For the first time, the Tax-GDP ratio has crossed 10 percent by reaching a level of 10.1 percent in FY'11 compared to 9.0 percent in FY'10. Following the recent drive to step up tax revenue collection, the estimated tax revenue growth in FY'12 is likely to be 20.4 percent. The authorities have indicated that the improvement in revenue performance can be attributed to the effectiveness of various reforms initiated by the government in tax policy and administration including modernization and automation of tax administration, expansion of tax net and coverage, reduction of tax exemptions and the creation of awareness among citizens for paying taxes. The draft new *VAT Act is* now under stakeholders' consultation prior to being placed before the Parliament by FY'12. A *Direct (Income) Tax Act* has also been drafted and stakeholder's consultation will be started soon. Nevertheless, a number of legal provisions included in these two laws have already been given effect through the Finance Act passed by the Parliament, along with the budgets of FY'11 and FY'12. These measures are expected to give a further impetus to enhanced revenue collection.

7. On the expenditure front, the implementation of the Annual Development Program (ADP) has remained satisfactory (92 percent of revised allocation) in FY'11. In order to further enhance the effectiveness of public expenditure and investment, emphasis is being placed on reforms in the areas of project implementation, procurement, and monitoring. To make public spending more effective, the Medium-Term Budgetary Framework has been rolled out across all ministries/divisions in the government. Initiatives are also underway to create a Budget Management Wing/Branch in all line ministries/divisions to strengthen the process of budget formulation. The Ministry of Planning has taken up steps to amend the existing procedure for project planning, approval and implementation to speed up project processing and implementation. Private sector investment is also being actively sought through PPP initiatives.

8. The expenditure on subsidies was 2.2 percent of GDP in FY'11. To reduce the pressure on public resources, the authorities have recently raised the administered prices of fuel oil, compressed natural gas (CNG) and electricity even though they feel that it might have some impact on inflation. They have plans to further rationalize prices of fuel and electricity by aligning them with international prices. This is likely to reduce the fiscal burden and also create greater space for expenditure on physical and social infrastructure. Under the power tariff rationalization plan (FY 2009-2014), the Bangladesh Power Development Board (BPDB) will reach a breakeven level by FY 2014. Similarly, fuel prices in local markets will also be gradually aligned with prices in the neighboring countries.

9. The authorities have indicated that prudent fiscal management has enabled the government to keep the overall budget deficit at an acceptable level of 3.9 percent of GDPin FY'11. However, the budget deficit has been estimated at 5.0 percent of GDP in FY'12 with an expected financing mix of 3.0 percent from domestic sources and 2.0 percent from external sources. The debt situation remains within acceptable limits. There has been a continuous focus on reforms in domestic debt instruments, for exploring cost-effective external financing sources and for keeping contingent liabilities within sustainable limits. The Debt Sustainability Analysis of Bangladesh indicates that the economy's risk of debt distress is low. The External Debt to GDP ratio has decreased from 24.3 percent in FY'09 to 20.4 percent in FY'11. A draft Medium Term Debt Strategy (MTDS) is under preparation and will be finalized by December 2011.

Monetary and Financial Sector Developments

10. The expansion in broad money (M2) at 21.3 percent during FY'11 was marginally lower than that of 22.4 percent experienced during FY'10. Domestic credit has also increased by 27.4 percent in the FY'11 compared with 17.9 percent in the previous year. Reserve money (RM) recorded an increase of 21.1 percent during FY'11 compared with 16.0 percent during FY'10 mainly driven by increase in net domestic assets of BB by 87.0 percent. To

reign in monetary expansion and credit growth, the BB has raised repo and reverse repo rates four times in FY'11 and once in September during the current fiscal year. As a consequence, growth in broad money, reserve money and domestic credit are all now moving along the BB's programmed levels. Meanwhile lending rate caps have also been removed to provide interest rate flexibility in the market and this is expected to reduce credit flow to unproductive sectors.

11. The authorities have indicated that the broad targets set forth in the government's FY'12 budget and the BB's Monetary Policy Statements (MPS) for July-December 2011 are aimed to keep money supply growth within acceptable levels in order to target inflation without affecting macroeconomic stability, growth and poverty reduction efforts. They have stated that the monetary policy stance during the first half of the FY'12 aims at ensuring reasonable price stability and providing support to the sustainable and high output growth targets as adopted in the macro framework of the current fiscal. In order to provide for growth supportive policies, the policy stance would give priority to unhindered flow of private sector credit to the economy's productive sectors, with agriculture, SMEs and the rural economy being the prime targets. While the policy stance would be to lessen the pressures on inflation by increasing supply of output and keeping demand pressures within control, the target rate of average inflation has been kept at around 8.0 percent for FY'12.

12. The authorities have also indicated that reforms are also being actively pursued with a view to modernizing and strengthening the financial sector. The draft amendments to Bank Companies Act 1991 have already been posted on the Bangladesh Bank's website seeking the views of the public. Audits of the State Owned Commercial Banks (SOCBs) for FY'10 have been carried out by internationally-affiliated audit firms in order to improve their financial performance. In order to comply with Basel II requirements, the BB has raised the risk-weighted capital adequacy ratio for banks to 9 percent from July 1st 2011 and this will be further raised to 10 percent from July 1st 2012.

13. The government has also undertaken various reform initiatives to develop the capital market and restore confidence of small investors. The authorities have indicated that these reforms include, *inter alia,* demutualization of two stock exchanges; the Dhaka and Chittagong Stock Exchanges have been asked to submit comprehensive concept papers detailing the steps and legal requirements needed to be followed in the demutualization process. Other reform initiatives include revising the book building method, intensifying market surveillance, framing a Financial Reporting Act and establishing a Financial Reporting Council to oversee the audit and accounting standards. The authorities expect that these initiatives are likely to bring back confidence in the capital markets as well as help it grow further.

External Sector Developments

14. The authorities have pointed out that export receipts have increased by 41.7 percent as against an import growth of 41.8 percent in FY'11. Garment products, especially knitwear and woven garments, raw jute and jute products dominate the export sector in Bangladesh. There has been an exponential growth in imports, mainly of capital machinery and industrial raw materials. Despite significant export growth, increased import bills have led to a widening trade deficit of US$ 7.3 billion in FY'11. Further, sluggish growth in private transfers including remittance has altogether contributed to the deterioration of current account balance (US$ 995 million in FY'11 as against US$ 3737 million in FY'10). In addition, stagnant foreign direct investment (FDI) and a decline in foreign assistance have resulted in deficits in the capital and financial accounts of Balance of Payment (BoP) in FY'11. With a small surplus in the current account balance and a higher deficit in capital and financial accounts, the resulting deficit in the overall balance has led to a drawdown from the foreign exchange reserve. In addition, the nominal exchange rate also depreciated due to higher import demand and slower growth in foreign remittances, FDI inflows and external assistance.

15. Export receipts have registered a 22.5 percent growth in July-September, 2011 while imports grew only by 19.6 percent during July-August, 2011. In addition, remittance growth in the first quarter of FY12 was 9.3 percent as compared to 6.0 percent in FY 2011. Despite a small easing of the situation in the current account balance in the recent months with reduction in import growth, the higher deficits in the financial and capital account, mainly due to net outflows of foreign resources and stagnancy in FDI inflows, are posing a threat to foreign exchange reserves and the BoP. The authorities have indicated that the foreign exchange reserves are around US$ 10.0 billion at present- sufficient only to meet import bills for 2.9 months. In this context, the authorities have mentioned that access to IMF resources under a three-year Extended Credit Facility, would be crucial for stabilizing the reserve position and strengthening reform efforts that have already been initiated.

16. In conclusion, the authorities have indicated that Bangladesh aspires to reach the status of a middle income country by FY'21. The current pressures on BoP are mainly due to rising petroleum and food prices and also, to some extent, due to increased public and private sector investment demand which is needed to take the country to a desired higher growth trajectory. However, the pressure on BoP is expected to be eased through efficient and effective macroeconomic management. The authorities need appropriate assistance from development partners as they seek to strike a balance between enhanced demand for infrastructure, continued efforts for poverty reduction and keeping reform initiatives on track. They feel that this will help achieve the sustainable higher growth that the country is striving for.