



Managing stability challenges in growth promoting utilization of capital flows: the Bangladesh experience

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Outline

- Growth support focused eclectic stance in managing capital flows
- Cautious, limited openness for outflows of resident owned capital
- Growth and stability outcomes of Bangladesh's stance on openness to capital flows
- Outlook for the path ahead

**Growth support focused eclectic
stance in managing capital flows**

Capital inflows: opportunities & risks

- Foreign private capital inflows are needed for investment and growth acceleration in developing economies like Bangladesh;
- But volatility of the capital flows entail risks for macroeconomic and financial stability;
- QE and other monetary loosening measures of advanced economies have amplified the opportunities and risks.

Bangladesh's growth support focused eclectic stance:

- Seeks to channel inflows into growth promoting uses underpinning stability with:
 - liberal permissibility of inflows into real sector productive undertakings
 - cautiously regulating access into the volatility prone financial sector.

Bangladesh's growth support focused eclectic stance:.....(cont'd)

- Access to external financing inflows widened and facilitated for private sector productive undertakings
 - not hurrying into sovereign bonds issuance for budget financing, presumably from concerns about public sector's fund utilization efficiency;
- Domestic currency is freely convertible for all trade related and other current external transactions;
- Local and foreign productive undertakings can freely access and extend short term trade credits;
- They can also raise project related longer term external financing, subject to prior viability scrutiny by a BOI Committee chaired by Bangladesh Bank Governor.

Bangladesh's growth support focused eclectic stance:.....(cont'd)

- Public sector's external financing needs are met:
 - mainly with concessional assistance from development partners
 - partly with non-concessional project related borrowings subject to prior clearance of a high level committee, chaired by Finance Minister.

Bangladesh's growth support focused eclectic stance:.....(cont'd)

- FDI equity inflows are freely permissible in wholly foreign owned and joint venture real sector industrial undertakings;
 - Post tax profits/dividends/disinvestment proceeds of foreign equity including capital gains are freely repatriable.
- FDI equity inflows into banks and other financial sector entities require prior regulatory approval;
 - Post tax profits/dividends and disinvestment proceeds thereon are also freely repatriable.

Bangladesh's growth support focused eclectic stance:.....(cont'd)

- Banks in Bangladesh can borrow or lend abroad for short tenors only for trade related transaction settlements in correspondent banking arrangements with counterparts abroad;
- Term borrowings abroad by banks and financial institutions require regulatory approval, accorded sparingly only for longer term local lending.

Bangladesh's growth support focused eclectic stance:.....(cont'd)

- FPI inflows can freely move into listed stocks and bonds, including in Treasury bonds,
 - Post-tax profits/dividends/yields and disinvestment/redemption proceeds thereon including capital gains are freely repatriable.
- FPI inflows are not allowed into short term (one year and lower) money and Treasury bills markets, to avoid destabilization risks from volatile surges.

**Cautious, limited openness for
outflows of resident owned capital**

Openness for resident owned capital outflows

- Limited domestic savings vis-a-vis high domestic investment demand preclude free permissibility of capital outflows for resident-owned investments abroad.
- Repatriation remains mandatory for export proceeds and foreign earnings of residents.
- Exporters can freely use ‘retention quota’ portion of their repatriated export proceeds in setting up offices abroad to facilitate marketing and inputs sourcing.
- Non-exporter businesses can also spend funds up to specified amounts without prior approval for similar purposes.

Openness for resident owned capital outflows..(cont'd)

- Banks and financial institutions are not free to invest abroad or to extend loans to non-resident clients.
- With prior approval, banks may incur modest capital outflows for setting up branches or subsidiaries abroad.
- Expatriates working in Bangladesh with valid permits are free to:
 - remit abroad up to 3/4th of monthly earnings,
 - to take back all savings with post tax profits while returning.

Growth and stability outcomes of Bangladesh's stance on openness to capital flows

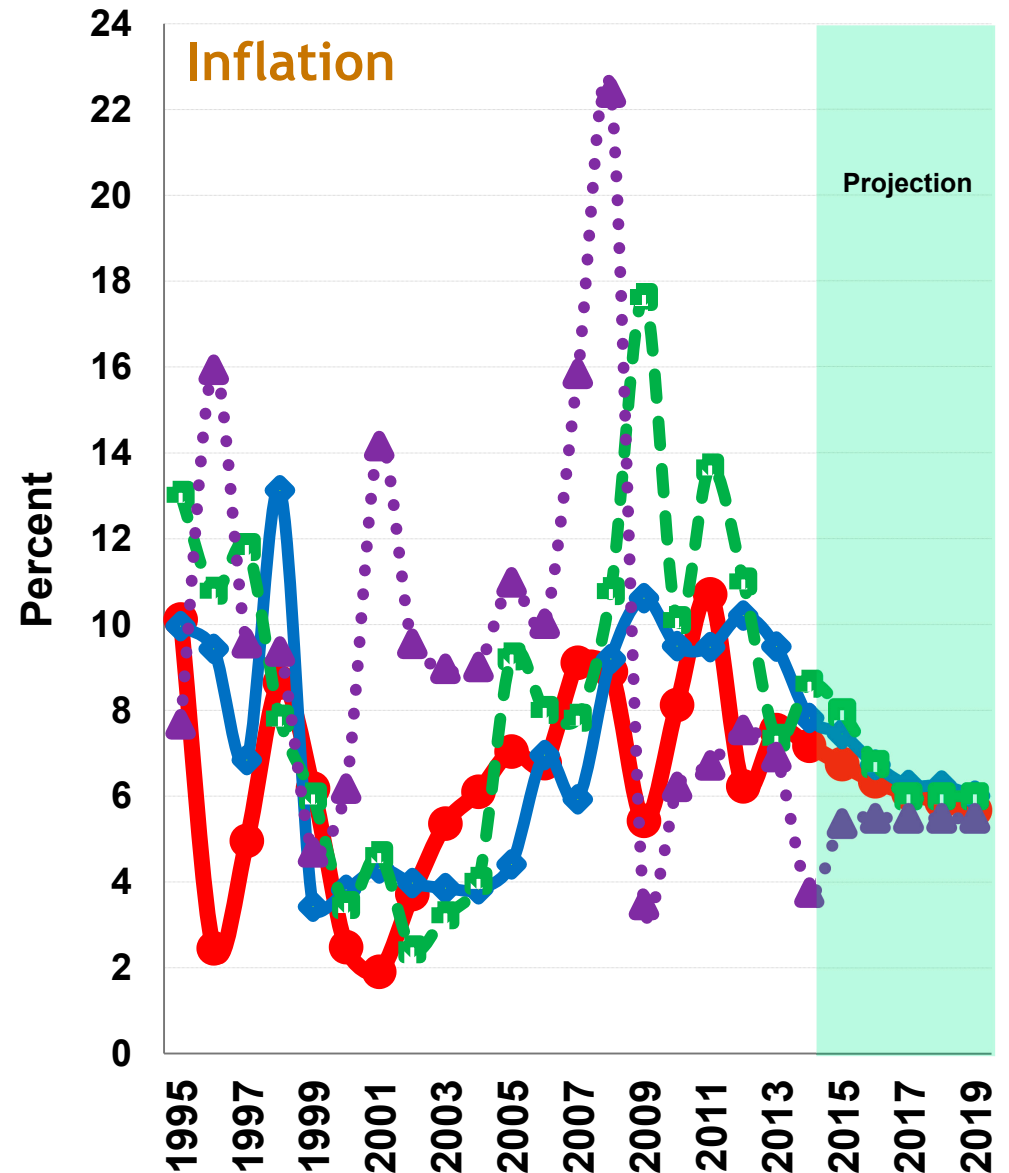
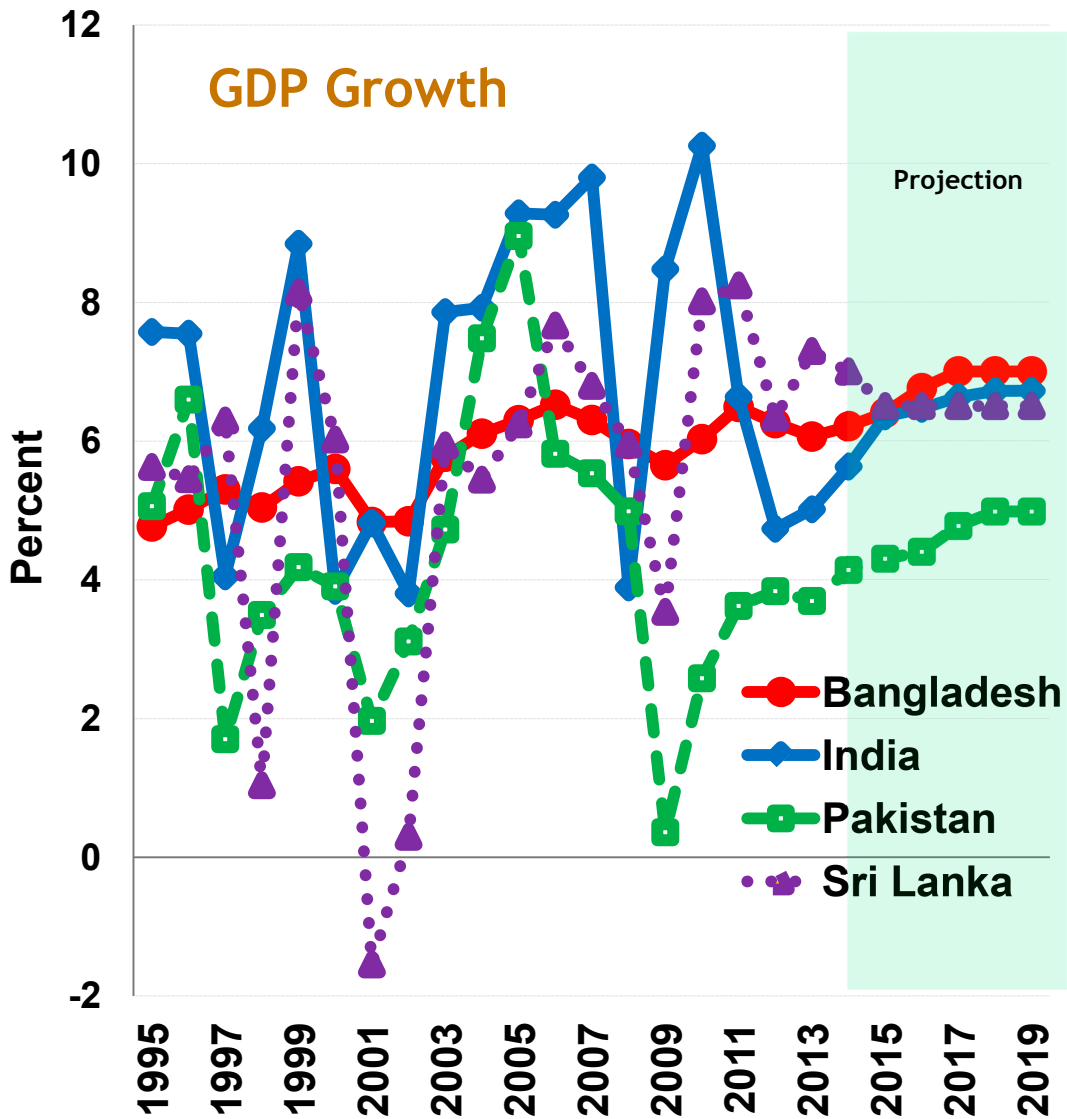
Growth and stability outcomes of Bangladesh's stance

- Liberal access to lower cost external financing for real sector undertakings has helped uphold output competitiveness, underpinning growth and stability.
- Restrictive stance on footloose short term external inflows into domestic financial sector has helped maintain Taka exchange rate stability,
 - avoiding abrupt swings from transient inflow and outflow surges,
 - aiding price and financial stability.

Growth and stability outcomes of Bangladesh's stance....(cont'd.)

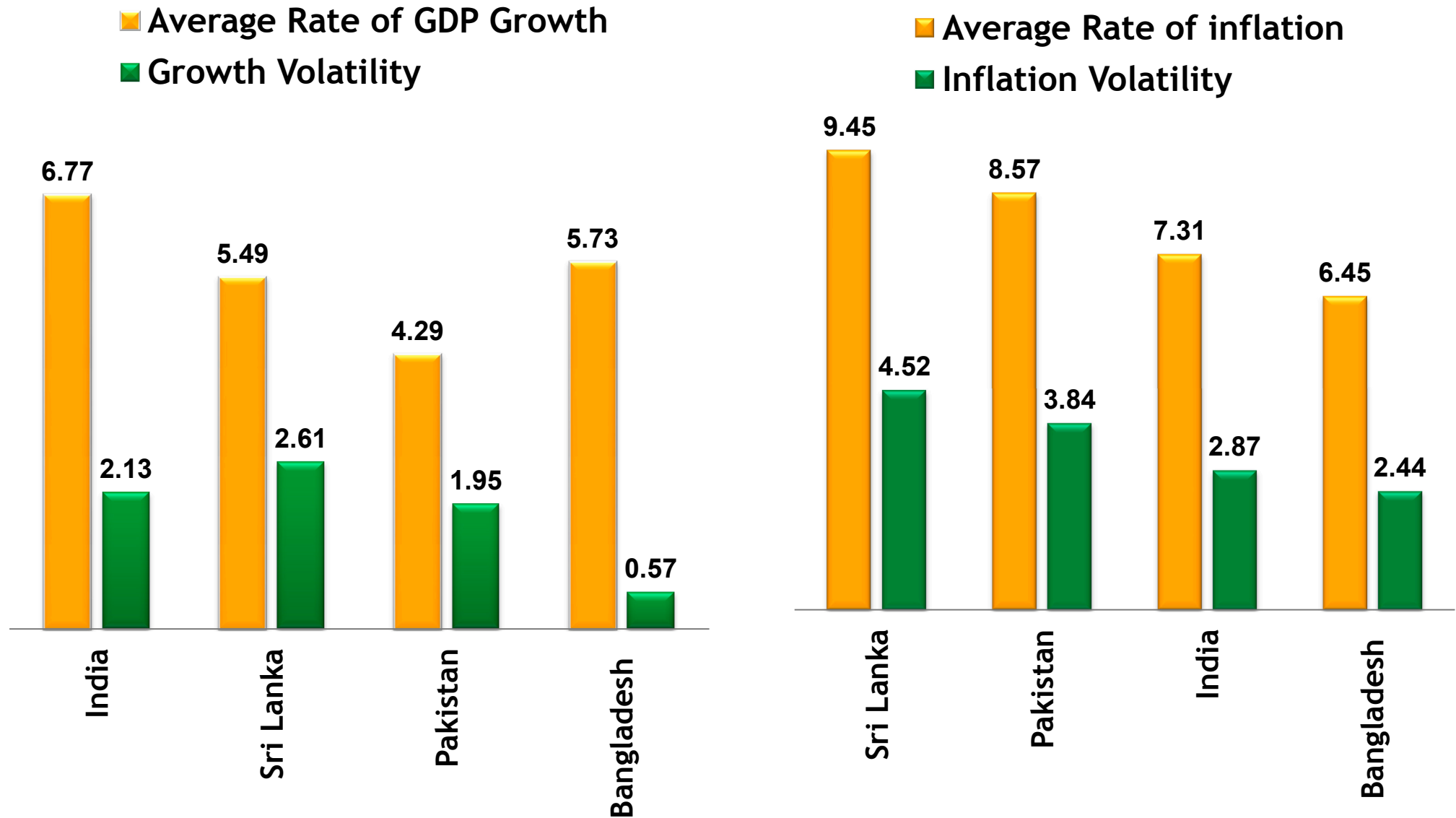
- With no speculative exposure to QE generated liquidity inflows, unwinding thereof should pose no significant stability concern for Bangladesh.
- Careful simultaneous attention to growth and stability concerns in capital flows management is paying off well in terms of:
 - sustained spell of 6+ percent annual average real GDP growth for well over a decade amid prolonged global growth slowdown,
 - single digit inflation on steadily declining path.

Bangladesh's growth projection (7% by 2019) highest in South Asia, with inflation convergent around 5%



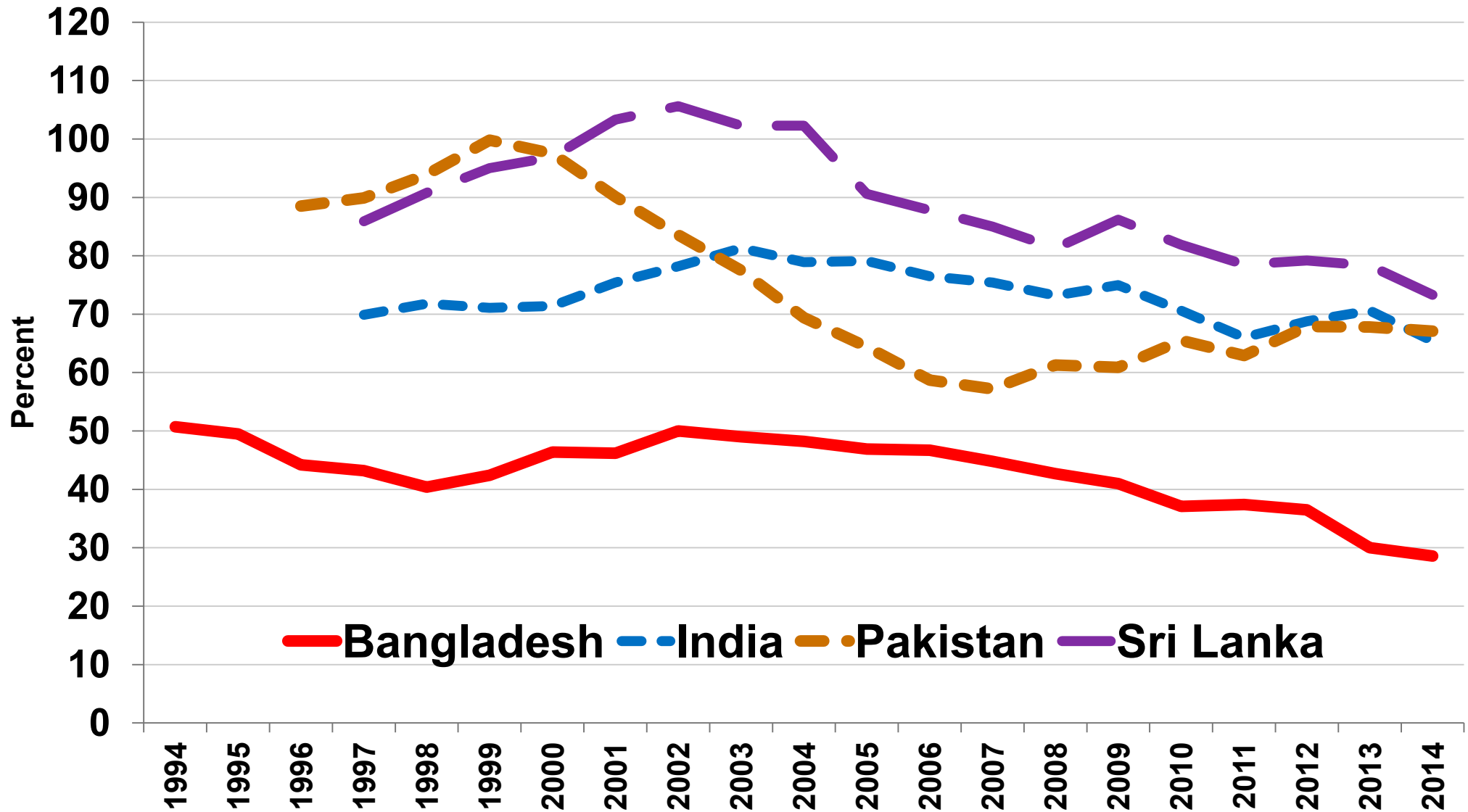
Source: World Economic Outlook (Sept. 2014), IMF

Bangladesh's growth and inflation least volatile in South Asia: 1995-2014



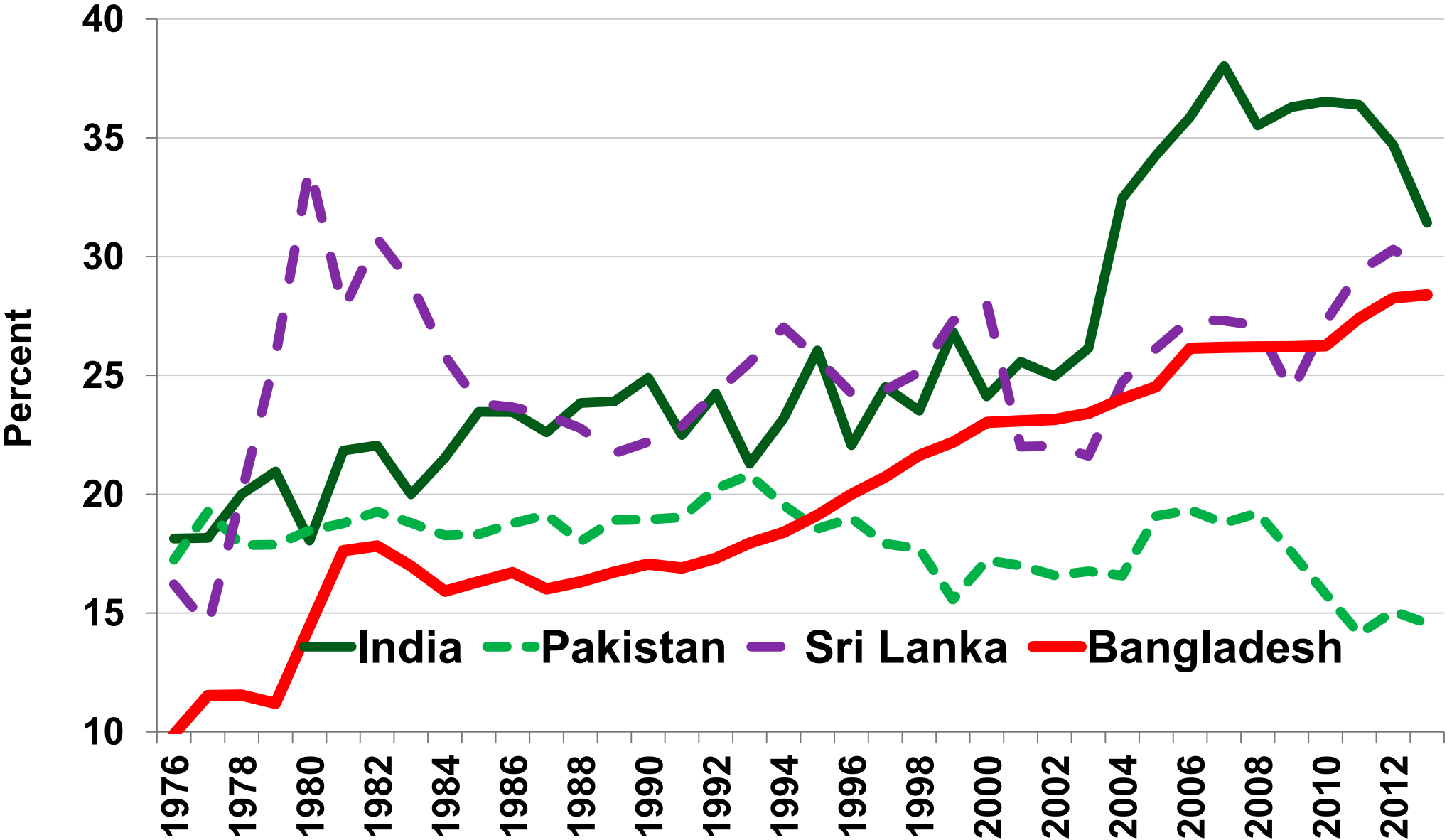
Source: World Economic Outlook (Sept. 2014), IMF

External debt to GDP ratio declining, yielding continuing gains in external sector viability



Source: World Economic Outlook (Sept. 2014), IMF

Steadily rising investment to GDP ratio

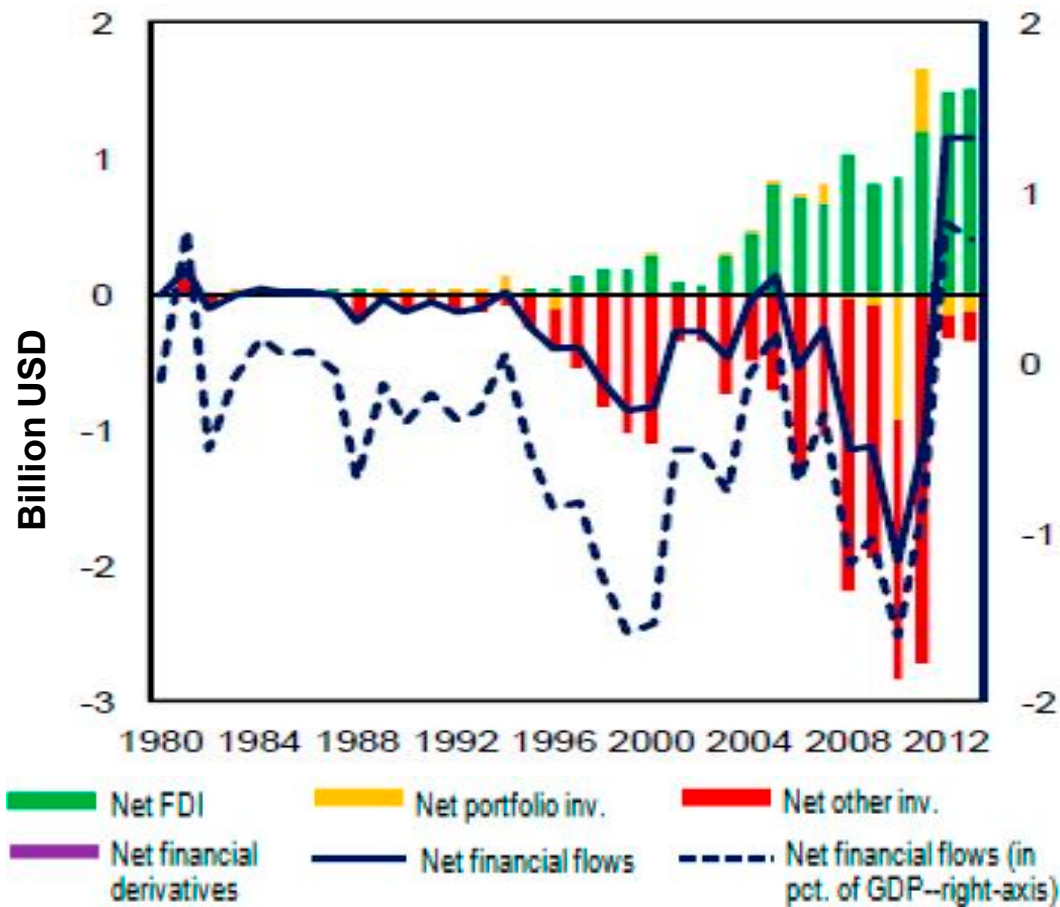


Source: World Economic Outlook (Sept. 2014), IMF

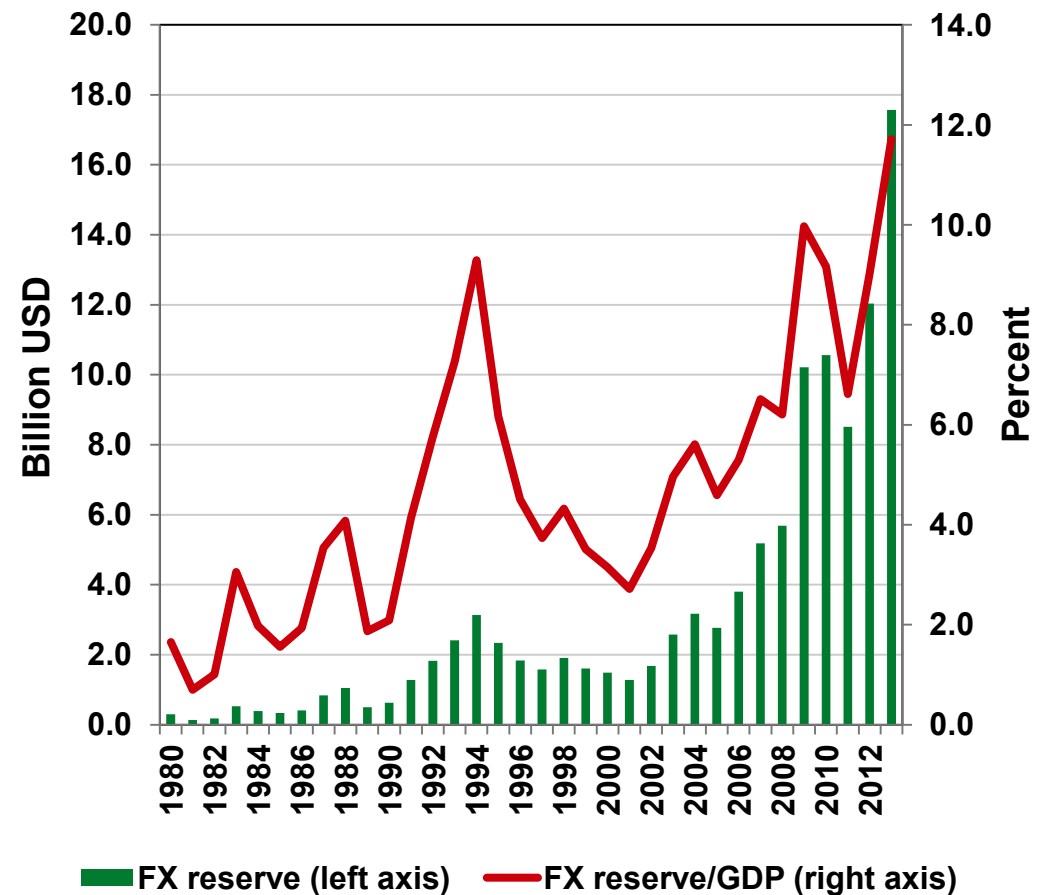
Strong FX reserves growth enhancing confidence for foreign investments in Bangladesh

- Rising foreign exchange reserves already comprising 6 month's import cover and 23% backing for broad money base.

Net financial flows



Total Reserves excluding Gold



Source: IMF 2014

Growth and stability outcomes..(cont'd)

- Bangladesh's financial sector suffered no stability impairment in the GFC and its aftermath, productive economic segments suffered no liquidity crunch.
- Sustained stability and viability gains are cumulating into a robust confidence base for foreign investors.
- Steadily rising FDI inflows are still relatively modest however, due to acute physical infrastructure deficiencies.
- Scarcity of serviced industrial zones now receiving priority attention of the authorities.

Outlook for the path ahead

Outlook for the path ahead

- Beginning in the late 1980s, widening of Bangladesh economy's external openness has proceeded in gradual, measured steps in line with:
 - gains in macroeconomic and financial sector stability
 - external sector viability, and
 - capabilities in external sector data collection, capital flow measurement and management.
- With the cautious gradualist approach, none of Bangladesh's liberalization steps needed reversal in regional and global crises.

Outlook for the path ahead..(cont'd)

- Bangladesh is on course for coming out of low income and least developed country categorizations in the near future.
- Already dwindling concessional financing from development partners will then dry up altogether, needing substantial recourse to non concessional financing from international markets.
- Authorities are positioning Bangladesh economy in readiness for this eventuality, with:
 - continued strengthening and consolidation of the stability and viability gains
 - regulatory, supervisory and resource utilization capacities.

Outlook for the path ahead..(cont'd)

- Progress on this path is anchoring confidence of external investors and will enable full phase out of the remaining regulatory controls on capital flows.
- IMF and other global forums minding global balance and stability will have important supportive role to play in preventing severe jolts from new regional or global crises.

Thank you