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BANGLADESH DEVELOPMENT UPDATE

April 2016

THE WORLD BANK
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Moving forward with fading tailwinds

April 2016

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Preface

The objective of this report is to update the Government of Bangladesh, think tanks and researchers, the general public as well as the Bank's senior management on the state of the economy, outlook, risks, progress on structural policy reforms and key challenges the economy is currently facing. The coverage includes developments in the real sector focusing on growth, inflation, and poverty; external sector developments focusing on the balance of payments, foreign exchange reserves and the exchange rate; fiscal developments focusing on revenue mobilization, public expenditures, and deficit financing; financial sector developments focusing on credit and interest rates; and monetary developments focusing on reserve money and broad money growth trends. The update also covers an assessment of Bangladesh's prospect of graduating out of the LDC status and eligibility for concessional financing from the World Bank and the Asian Development Bank.

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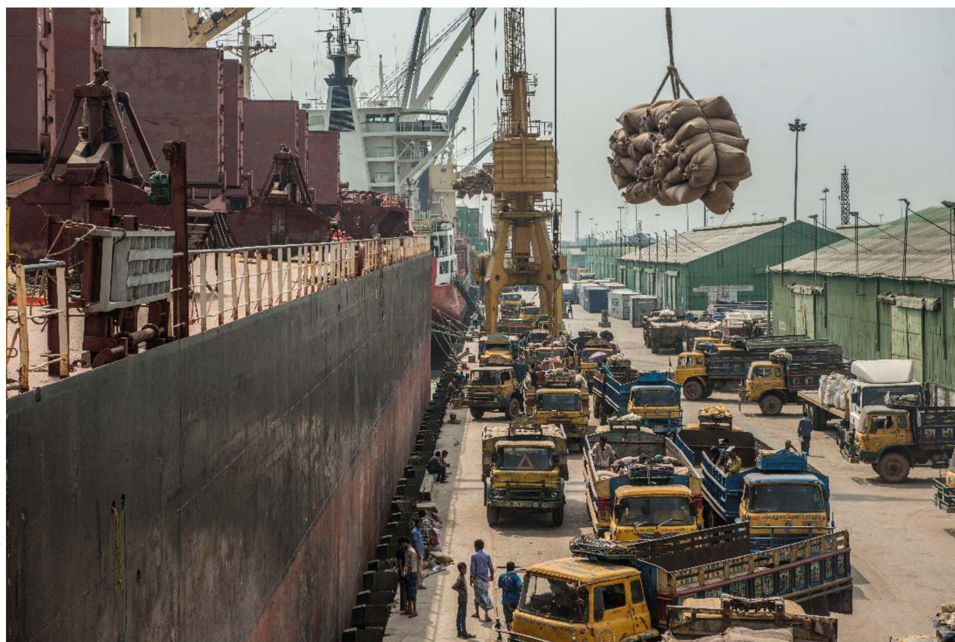
Executive Summary



Bangladesh economy has maintained its progress on a 6 plus percent growth path, notwithstanding many external and internal challenges. Headline inflation has decelerated, largely reflecting international commodity price declines; lending rate declined modestly despite large excess liquidity; and the nominal exchange rate has remained stable while reserves have reached new heights. Revenue and development budget implementation shortfall continue to haunt fiscal policy while overall monetary management has remained cautious. The financial sector woes showed no sign of waning.

GDP growth surpassed 7 percent in FY16, according to preliminary official estimates.

For the second time in last three decades, GDP growth is estimated to have exceeded 7 percent, driven on the supply side by services and on the demand side by rise in public investment and consumption expenditures. Services and public consumption growth largely reflected the impact of the public sector pay increase. Private investment rate has continued to stagnate. The contribution of private investment to GDP growth declined from 1.5 percentage point to 1.3 percentage point.

The 7 percent official growth estimate is not easy to reconcile with growth related indicators such as remittance, exports, industrial production, import of industrial raw materials and capital machinery, tax revenue collection, and ADP implementation, among others. The question is not about whether the Bangladesh economy has done well. It has demonstrated resilience to internal and external headwinds time and again. The question is about whether the official estimate is consistent with other growth related indicators and whether the resilience of growth can be sustained without getting the private investment rate out of the recent 21-22 percent of GDP trap.

Macroeconomic stability has been sustained.

Headline inflation has moderated considerably. The external position remains comfortable. Sterilized foreign exchange interventions by Bangladesh Bank (BB) kept the taka/US$ rate stable and restrained reserve money growth. Monetary targets undershot due to restrained growth in domestic credit. Banking sector still limping. The challenges confronting the state-owned commercial banks (SCBs) and the specialized banks (SBs) are particularly daunting.

Budget deficit is rising.

Revenue collection in FY16 is most likely to fall short of the target for the fourth consecutive year. Public expenditure is expected to be lower than the planned budget size. However, the budget deficit in FY16 is likely to rise with revenue shortfall exceeding the usual expenditure shortfall. While the deficit will remain within sustainable thresholds, the composition of domestic financing of deficit has continued to shift from low interest to high interest sources.

Structural reforms yet to gain momentum.

The 7th Five Year Plan, the government's medium-term development strategy document, has gone into action. Some important legal amendments pertaining to special economic zones, EPZ labor rights, bus rapid transit and so on were approved by the government. The nontransparent practice of changes import tariffs through SROs has continued as did additions of several new projects in the already stretched ADP portfolio.

Global outlook from Bangladesh perspective is mixed. Income growth prospects in Bangladesh's main export markets are uneven, but sustained low oil prices bode well on balance for external and internal balance. With modest fiscal expansion and some easing of the infrastructure bottleneck, GDP growth is projected to rise towards 7 plus percent, albeit gradually.

Global growth continues to disappoint.

Weak growth among major emerging markets will weigh on global growth in 2016. Monetary accommodation in response to deteriorating global growth prospects and financial market turmoil is expected to continue. Excess supply keeps downward pressure on oil prices. While oil exporters are feeling the pressure, oil importers are seeing vulnerabilities narrow as the lagged benefits to growth emerge.

Growth in Bangladesh is projected at 6.8 percent in FY17.

On the back of further increase in government consumption as the increased benefit package for government employees is implemented, increase in public investment, and a recovery in private investment, as regulatory and infrastructure constraints are eased and creditor confidence returns with improvements in governance in the financial sector.

Inflation is expected to edge up to 6.6 percent.

In FY16–18 on account of higher public sector wages, a one-off effect from the introduction of the new VAT, and overheating with actual growth exceeding the potential growth rate.

The overall monetary policy stance announced in the January 2016 MPS maintains policy continuity.

Nominal GDP growth is unlikely to exceed 13.3 percent in FY16. Perhaps BB could have been a bit more ambitious in lowering the inflation target below 6 percent.The revised stance on policy rates provides a signal to bankers to expand private credit by reducing lending rates. These reductions signal to the banks to be more proactive in finding bankable projects to lend in the private sector. There is uncertainty about the impact of the considerable Real Effective Exchange Rate (REER) appreciation of recent years on export competitiveness. Given this uncertainty, continued sterilized foreign exchange market intervention is

warranted in the near term to prevent further erosion in competitiveness which could eventually impact growth, tax revenue, and bank asset quality.

The overall fiscal deficit is projected to widen to 4.6 percent of GDP in FY16 with the implementation of the first phase of public sector pay hike.

Over the medium term, the increase in pay and allowances and public investment is likely to be partly offset by lower energy-related subsidies and higher revenue from the new VAT. The debt-to-GDP ratio is projected to increase slightly and then stabilize as concessional external financing declines and interest costs rise, and as pension liabilities increase with aging. The need to use NSCs as a financing vehicle should be reconsidered.

Financial and political shocks constitute the main risk to the outlook. Growth has remained constrained by infrastructure bottlenecks, shortage of power and primary energy, absence of investment friendly climate and lack of reform continuity. Structural reforms and public investment effort need to be intensified to overcome these impediments in order to enhance the country's growth opportunities.

Bottlenecks in critical infrastructure, particularly in energy and transport, may have become more binding in recent years as the economy becomes more market-oriented.

To meet the country's infrastructure development needs, the 7th Five Year Plan envisages a total financing requirement of about US$ 410 billion. This is about twice the size of Bangladesh's GDP. Private sector participation can help address part of the infrastructure gap. A sound Public Private Partnership (PPP) framework can assist in improved risk allocation between the private and public sectors. However, private participation alone will be insufficient to address Bangladesh's wide infrastructure gap. A majority of investments in transport, or in river management, will require public funding. To address this constraint it is necessary to focus on both indirect and direct taxation. On the implementation side, major infrastructure projects have a history of problems in Bangladesh. Cost overruns, delays, failed procurement, or unavailability of private financing are common.Most overruns are foreseeable and avoidable.

Competitiveness needs strengthening.

Apart from infrastructure, there are also regulatory constraints, highlighted by the non-enviable ratings the country gets in international benchmarking exercises. While the government has made progress in easing several regulatory constraints, additional steps would help. They include: i) the enactment of rules under the Civil Procedures Code (CPC) regarding mandatory mediation of civil and commercial cases; ii) the approval of the new Customs Act; iii) the approval of the new Companies Act (and the associated rules and regulations); and iv) the approval of the Bangladesh Standards and Testing Institution Act. Note that some of the key obstacles to greater private sector efficiency are related to access to land. Efforts to remove this bottleneck through the creation of industrial zones are helpful, but the multiplicity of zones and oversight agencies with overlapping roles at times undermine such efforts.

Financial sector weaknesses further drag investment.

Weak bank balance sheets and governance failures limit lending capacity, divert credit away from productive investment, and, in the case of SBs, impose large fiscal recapitalization costs. High levels of non-performing loans and the high rates on national savings certificates (NSCs), increase banks' operating and funding costs, putting upward pressure on interest rates. Priorities in the financial sector include:

- Strengthening theindependence and accountability of SB boards; shoring up SB balance sheets through recapitalization conditional on improved loan recovery and temporary credit growth limits; and speedy completion of branch automation to strengthen financial reporting and efficiency.
- Enhancing financial sector regulation and supervision, by strictly enforcing existing rules and avoiding regulatory forbearance; and completing implementation of risk-based supervision, contingency planning, and lender of last resort policies.
- Improving the legal and financial framework for loan recovery. Difficulties in realizing collateral and lengthy dispute resolution processes have weakened banks' ability to bring down non-performing loans. It is critical to institute simpler court procedures, alternative dispute resolution mechanisms, and asset management companies.
- Addressing risks from concentration and macro-fiscal linkages. It is important to reduce banks' exposure to: (i) the sovereign (and reform the NSCs) (ii) the capital market, in line with the limit set in the law by the July 2016 deadline and (iii) large single borrowers.

Preparing for tougher competition. Bangladesh moved into lower-middle income (LMIC) status in 2015, when the FY14 GNI per capita reached $1,080. If fast and shared economic growth continues, Bangladesh can hope to step up the 'development ladder' further if its recent economic performance is sustained, but this will increase prospect of graduating from IDA, the Asian Development Fund and Least Developed Country (LDC) status. Bangladesh will need to maintain its economic momentum as it slowly loses the benefits from its LMIC and LDC status. These include access to concessional finance, access to technical assistance and preferential market access for its exports.

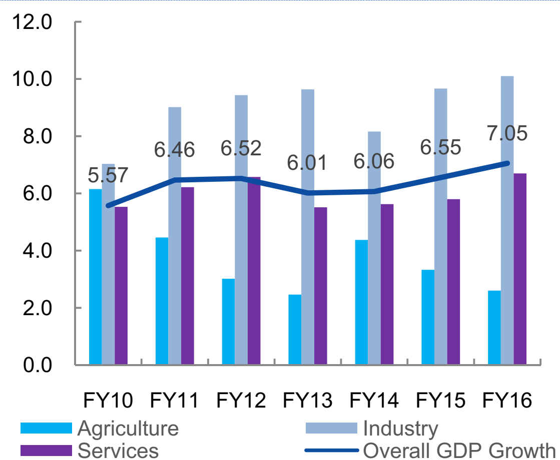
A. Recent Development

The Bangladesh economy has maintained its progress on a 6 plus percent growth path, notwithstanding many external and internal challenges. Headline inflation has decelerated, largely reflecting international commodity price declines; lending rates have declined modestly despite large excess liquidity; and the nominal exchange rate has remained stable while reserves have reached new heights. Revenue and development budget implementation shortfall continue to haunt fiscal outcomes while overall monetary management has remained cautious. The financial sector woes showed no sign of waning.

GDP growth averaged 6.2 percent in the past decade, well above global growth, despite slower growth in both developed and emerging markets, political turmoil, and structural impediments.

Against global headwinds and domestic unrest, domestic activity had weakened. The share of private consumption in GDP has steadily declined since FY11, while private investment has remained largely unchanged as a share of GDP since FY12.

Figure 1: GDP and Sector Growth Rates (%)
(Percent)



Source: Bangladesh Bureau of Statistics (BBS)

GDP growth surpassed 7 percent

The Bangladesh Bureau of Statistics released preliminary estimates of GDP growth in FY16 on April 5, 2016. For the second time in last three decades, GDP growth

in FY16, according to preliminary official estimates.

is estimated to have exceeded 7 percent, driven on the supply side by services and rise in public investment and consumption expenditures on the demand side (Figure 1). Services contributed 3.4 percentage points to the estimated 7.05 percent growth in FY16, followed by manufacturing contribution of 2 percentage points. Services alone contributed 0.4 percentage points out of the 0.5 percentage point increase in FY16 GDP growth relative to FY15. Of this 0.4 percentage points, 0.3 came from increased value added in public administration and defense and education sectors, reflecting the impact of a very large public sector pay increase implemented this year. On the demand side, private consumption remained the largest single source of growth, although its contribution declined from 3.8 percentage points in FY15 to 3.5 percentage points in FY16 (Table 1). The contribution of public investment nearly doubled from 0.8 percentage points in FY15 to 1.5 percentage points in FY16 while the contribution of private investment declined from 1.5 percentage point to 1.3 percentage point.[1]

Sustaining 7 percent growth will be a major challenge.

Taking the 7 percent official estimate at its face value, sustaining it will be a challenge since the boost out of the "6 percent trap" came largely from an increase in growth resulting from the public sector pay increases. Private investment rate is estimated to have declined from 22.07 percent of GDP in FY15 to 21.78 percent in FY16. There are limits to sustaining such high growth just through better utilization of existing production capacity. Without growth in productive capacity, aggregate demand stimulus through fiscal expansion cannot indefinitely increase growth. It is necessary to deal with supply-side factors such as the responsiveness of technological change and investments to public policies.

Remittances have weakened.

With the decline in crude prices impacting the fortunes of oil exporters, remittances from workers from Gulf Cooperation Council (GCC) countries to Bangladesh appears to have been hit already. The Middle East is home to a large Bangladeshi diaspora and the six GCC countries—Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates—account for around 68 percent of Bangladeshi workers abroad. The majority of migrant workers in GCC countries are low-skilled that include construction workers. Predictably, remittances from Bangladeshis abroad are correlated with investment demand in the Gulf countries, which includes spending on construction projects. Bangladesh's remittances amounted to around $15.3 billion in 2014-15, which was 7 percent higher than the level of remittances the year before. About 64 percent of this growth came from GCC countries. However, in the first seven months of FY16, total remittances declined by 1.1 percent. Decline in remittances from GCC countries constituted nearly 2.2 times the total decline. Historically, we find a fairly strong correlation (0.65 statistically significant coefficient) between oil price and remittances from GCC countries.

Decline in share of agriculture has continued despite

Growth in agriculture is estimated at 2.6 percent in FY16 with its share declining from 15.5 percent in FY15 to 14.75 percent. FY16 has been relatively free from political unrest. Crop cultivation did not suffer as farmers got necessary inputs

[1] It is difficult to understand where the BBS estimate of Tk 1313. 8 billion public investment (in current prices) is coming from. Total capital expenditure in the FY16 central government budget is Tk 957.7 billion, not all of which is likely to be actually spent. Expenditures budgeted for the state owned nonfinancial enterprises is Tk 284.9 billion, of which around 80 percent is capital expenditures. This leaves unexplained about Tk 125 billion. It is implausible to assume local governments have the capacity to finance investment of this size from outside the central government budget.

healthy production.

and could market their products in urban and semi urban areas without any disruption. Aus and aman rice have been harvested, and boro plantation has been completed. The Department of Agricultural Extension (DAE) has set the target for food grain production at 36.42 million metric tons (MT) for FY16 of which 35.02 million MT is for rice and 1.4 million MT for wheat, up by almost 1 percent from the previous year's actual production. Nearly 54 percent of the rice production is expected from boro.[2] Total area coverage for both aus and amanalmost reached the target. Ausproduction has been targeted at 2.48 million MT for FY16 which is more than 6 percent higher than the actual production last year. The Amanproduction target has been fixed at 13.56 million MT which is about 3 percent higher than for the previous Amanseason. Although planting had been hampered by erratic rain and floods, this target for Amanis expected to be achieved. The total acreage of boro is expected to be 4.7 million hectares, compared with 4.84 million hectares last year. Farmers are reportedly finding growing wheat, potato and maize more profitable than boro.

Non-crop agriculture, particularly fish, has expanded rapidly in recent years and continue to have significant potential for growth.

Growth in fisheries is estimated at 6.2 percent in FY16. Fisheries has been the fastest growing sector in agriculture in recent years, expanding at 6.2 percent on average per annum in last five years. Fisheries contributed around 3.3 percent to GDP in FY16. Over 17 million people are involved in the fish sector. Fish production in the country has been increasing to keep up with the growing demand at home and abroad for around a decade. According to the Department of Fisheries (DoF), the country produced 3.55 million tons of fish in FY15 and 3.45 million tons in FY14. For gearing up the production of fish, the government has set up 120 hatcheries in different parts of the country to provide training to the people and hatchery owners. The government also set a target to produce 4.52 million tons of fish by FY21. Proper utilization of the existing water bodies using the latest technologies could boost fish production.

Structural transformation within agriculture is needed to rejuvenate agricultural growth.

Most of the easily accessible productivity gains have already been captured in agriculture. Future growth in productivity requires major technological breakthrough, especially for the intensification of traditional crops. Important agricultural GDP gains can be obtained by promoting increased diversification of crop and non-crop agricultural production toward higher value and more nutritious foods.Improvement in agricultural productivity is a precondition for sustainable development, as productivity gains would allow extremely scarce resources such as land to be diverted to expand the non-agricultural production sectors, infrastructure, and housing.

Lackluster manufacturing growth.

Slight in large and medium scale manufacturing growth was offset by decline in growth of small scale manufacturing and consequently overall manufacturing growth remained unchanged at 10.3 percent. More detail data on manufacturing industries are available up to November 2015. During July-November of FY16, the general index (average, Base: 2005-06=100) of industrial production of medium and large scale manufacturing industries increased by 7.9 percent. Wearing apparel, food products, chemical and chemical products and basic metals had healthy growth. The index of small scale manufacturing industry in the first quarter increased by 1.1 percent over the corresponding period of FY15.

[2] Cultivated December-February, harvested April- May.

Table 1: Contribution to Growth

	FY11	FY12	FY13	FY14	FY15	FY16
GDP Growth	6.46	6.52	6.01	6.06	6.55	7.05
Contribution of Production Sectors (%)						
Industry	2.3	2.5	2.6	2.3	2.7	2.9
o/w Manufacturing	1.6	1.7	1.8	1.6	1.9	2.0
Services	3.3	3.4	2.9	2.9	3.0	3.4
Agriculture	0.8	0.5	0.4	0.7	0.5	0.4
Contribution of Expenditure Components (%)						
Private consumption	4.5	2.9	3.5	2.7	3.8	3.5
Government consumption	0.4	0.2	0.3	0.4	0.4	0.6
Private Investment	1.9	2.3	0.4	2.2	1.5	1.3
Government Investment	0.9	0.8	1.2	0.8	0.8	1.5
Exports, goods & services	4.7	2.4	0.5	0.6	-0.5	-0.1
Imports, goods & services	-5.6	-2.5	-0.3	-0.3	-0.7	1.9

Source: Bangladesh Bureau of Statistics (BBS), Growth are in constant term, National Account 2005-06

Manufacturing growth has been held back by constraints from both the demand and supply sides.

Global demand has been underpinned by slow global GDP growth and a slow rise in employment in major developed and some of the advanced developing countries. Import growth in Bangladesh's established markets has been tepid in recent years. This weak global demand for imports affected not only Bangladesh but also other exporting countries with a similar export basket. Domestic market-oriented enterprises also faced slow demand growth due to deceleration in the growth of per capita income in recent years, in part due to slower growth in remittances. Supply side factors affected production of both domestic and export-oriented industries. These factors include: reduced export orders to factories that do not comply with safety regulations (located mainly in shared buildings); real exchange rate appreciation vis-à-vis those of competing economies such as India, Vietnam and Indonesia; reduced supply and low pressure of gas; and a continued lack of adequate infrastructure facilities. A perception among entrepreneurs that infrastructure facilities are a key constraint has not changed much during recent years, except a perception about the availability and quality of electricity.

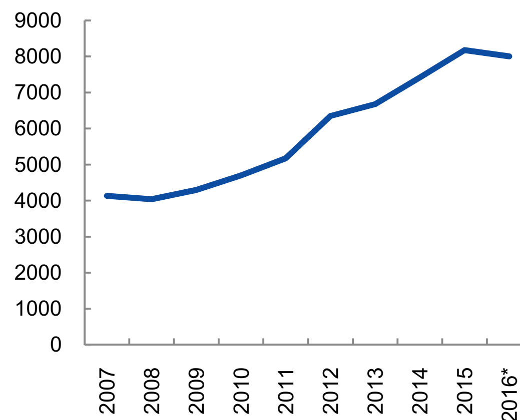
Construction growth has been healthy.

Construction has been the fastest growing sector, next to manufacturing, in recent years. Construction growth is estimated to have picked up to 8.87 percent in FY16, compared with 8.6 percent inFY15. The sector faces several constraints: land value distortion, absence of secondary property market, asset securitization and sale of mortgages, and backward linkage industries such as cement, ceramics, and brick manufacturing industries. Many construction projects remain incomplete as people who have invested their money face an uncertain future and many related industries are facing the consequence of the depression in the sector. Apartment sales have declined significantly over the last two years. Excess supply has forced realtors to slash apartment prices by about 15-30 percent on average to reinvigorate the depressed property market. According to the Real Estate and Housing Association of Bangladesh (REHAB), around 14,000 ready flats worth about Tk.120 billion are unsold. Sale of apartments fell as much as 60 per cent in 2013 and the situation is still unchanged. There are more than 2 million people working in this industry and their livelihood depends upon these apartment sales.

The power supply situation improved in the first half of FY16 but the demand for power is also increasing fast.

As of 31 December 2015, total actual generation during day peak hours was 5,039 megawatts (mw) and during evening peak hours was 6,553 mw (Figure 2). The demand was 6,078 mw and no load shedding occurred. Between October 2015 and January 2016, total installed capacity and derated/present capacity rose to 12,071 mw and 11,476 mw from 11,877 mw, and 11,282 mw, respectively, but production remained low because of gas shortage and also because some power stations were shut for maintenance.While short-term actions for power crisis management have contributed to sustaining growth, the longer term issues of sustainable power and energy supply remain unresolved. This includes sustainable development of local coal and gas where progress is almost non-existent. The government has set a target to generate 24,000 mw electricity by 2021. With this goal in view, the government increased the number of power plants, transmission lines and distribution lines. To reach the target, the government would concentrate on building big base-load power plants to generate electricity from coal as it eyes producing 50 percent of the total electricity from coal. Furthermore, the government would take up more large-scale renewable power projects. Also, the government has decided to establish three new divisions - coal, renewable and independent power producer (IPP) - to ensure smooth implementation of energy projects. The government is also working to increase electricity import from neighboring countries under regional cooperation and now giving priority to import from Nepal and Bhutan. Addressing the inadequacy of primary energy remain a key priority (Box 1).

Figure 2: Maximum Power Generation *(MW)*



Source: Power Development Board

The 7 percent official growth estimate is difficult to reconcile

Is 7.05 percent a plausible growth estimate for FY16? One way to judge this is to ask what evidence is there from the high frequency growth correlates that can justify the view that growth in FY16 has been 0.5 percentage points higher than growth in FY15. As shown in the Table-2 below, with the sole exception of exports, every other indicator grew significantly less in FY16 than in the corresponding period of FY15. It is true that the large wage increase in the public sector has both direct and indirect impact on growth. But the wage increase has not been fully rolled out (and had not been at all by end-January, due to administrative delays) and it would take an implausible degree of financial sophistication on the part of both consumers and lenders for the future expected wage increase to translate fully into actual consumption.

Table 2: High Frequency Indicators (%)

	FY16	Same period FY15
NBR Tax Revenue growth, July-February	14.4	16.2
ADP implementation, July-March	41.1	43.8
Industrial raw materials import growth, July-February		
LC Opening	2.5	8.36
LC Settlement	4.24	5.24
Growth in import of construction materials, July-January		
LC Opening	-3.6	14.4
LC Settlement	2.6	18.1
Growth in import of capital machinery, July-February	15.46	19
Remittances growth, July-March	-1.8	7.3
Growth in quantum Index of manufacturing		
Large and medium, July-November	7.9	14.5
Small scale, July-September	1.1	1.34
Credit flow to private sector, July-March	9.29	7.46
Exports, July-March	9	3

Sources: Bangladesh Bank, IMED, NBR, and EPB

Box 1: Towards Efficient Energy Pricing

Energy pricing reform needed for attracting investments in primary energy. Bangladesh's electricity market is a vertically integrated natural monopoly in the public sector. The electricity pricing policy is politically sensitive because prices are administered while the providers are public monopolies. Economic performance of these public enterprises is not satisfactory. Bangladesh Power Development Board (BPDB) and Bangladesh Petroleum Corporation (BPC) are the top two losers among the SOEs. The government has taken initiatives to involve private enterprises in the energy sector and has planned to mobilize private and joint venture investment during the Seventh Five Year Plan period. The most critical challenge is to diversify the energy-mix for electricity generation. New technologies raise the prospect of increasing the supply of onshore gas, providing clean and cheap energy for electricity generation. But Petrobangla lacks the technical capacity, making it necessary to attract investors with state-of-the-art technology into exploration and exploitation. However, natural gas tariffs in Bangladesh have been regulated at very low levels, which has led to abandonment of some very large gas development projects, exacerbating gas shortages. The tariffs were not adjusted between 2009 and September 2015—except the tariff for compressed natural gas (CNG) for automotive use, which was raised twice in 2011. The 2015 tariff increase was an encouraging step, but it did not affect fertilizer and power plants, which account for nearly half of the total gas consumption, and they continue to pay a mere US$1 per thousand cubic feet (mcf). Energy pricing policy needs to be reformed to encourage efficiency in production and use of primary energy.

This is also an opportunity for shifting taxes on petroleum products so as to reduce carbon emissions. Negative externalities from energy use are substantial.Underpricing of oil products reduces incentives for investment in energy efficiency and renewable energy. The high levels of vehicle traffic that are encouraged by subsidized fuels also have negative externalities in the form of traffic congestion, higher rates of accidents, road damage, and environmental pollution. While there are a very few countries globally that have reacted or made any efforts in this direction, Bangladesh as a global leader on protecting the climate – along with having among the world's lowest fiscal revenue as a share of GDP – can set the direction of taxation reforms intended to reduce carbon emissions and raise additional public resources.

A carbon tax would be a fiscally prudent measure to accomplish this goal. A carbon tax is a levy on the carbon content of fuels (principally coal, oil, and natural gas) that generate carbon dioxide (CO_2) emissions when burned. The tax typically applies at a specific rate per ton of coal, per barrel of oil, or per million cubic feet of gas, with the amounts adjusted to equalize implied taxes on carbon content. The rationale of such a tax is to reduce the greenhouse gas emissions primarily responsible for climate change.

- During last six years, power generation had double digit growth in FY10, FY11 and FY14 (Table-3). GDP growth was 6.5 percent in FY12 when power generation growth reached the highest 12 percent. In FY16, power generation is projected to grow 10.4 percent, but GDP growth is estimated at unprecedented level.

Table 3: Power Generation Growth and GDP Growth

	FY10	FY11	FY12	FY13	FY14	FY15	FY16
Power Generation Growth	10.23	7.21	12.00	8.86	10.37	8.63	10.37*
GDP growth	5.57	6.46	6.52	6.01	6.06	6.55	7.05

Source: Power Division (Annual Report, 2014-15) and BBS

- The rise in growth in large scale manufacturing from 6.1 percent in FY15 to 11.42 percent in FY16 is not supported by growth in the quantum index of production in large scale manufacturing nor with data on import of industrial raw materials.
- The rise in growth in wholesale and retail trade from 6.35 percent in FY15 to 6.61 percent in FY16 is inconsistent with decline in agricultural growth, 0.32 percent decline in real exports, and 8.9 percent decline in real imports.
- The rise in public investment rate from 6.8 percent of GDP in FY15 to 7.6 percent in FY16 is difficult to reconcile with budget data on the central government capital expenditures.
- The extent of decline in private real consumption growth does not match the extent of decline in agriculture growth and the extent of decline in the level of remittances.

There are no convincing signs yet of a pick-up in business confidence, which could have come from either accelerated implementation of high priority public infrastructure projects and faster implementation of policy reforms envisaged in the government's 7th Five Year Plan. In this context, the official growth estimate of 7.05 percent for FY16 appears high.

The debate is not about the resilience of the Bangladesh economy.

Bangladesh is among the top 12 countries (with a population of 20 million or more) out of 118 countries, who are likely to have achieved the 6 plus percent growth in FY16, as shown in Table-4. The relatively high GDP growth underscores the resilience and inner strengths of the Bangladesh economy which has withstood many headwinds, both external and internal. By any standard, the economy has done well. The debate on numbers or percentage points distracts attention from the forward looking growth agenda.

Table 4: Countries GDP Growth Above 6% and Population above 20 Million

	Real GDP-FY16 Growth (%)	Population-2015 (mill)
Ethiopia	10.2	99.4
Turkmenistan	8.5	53.5
Cote d'Ivoire	8.4	77.3
Congo, Dem. Rep.	8.0	22.7
India	7.3	1311.1
Uzbekistan	7.0	29.9
China	6.9	1376.0
Myanmar	6.5	53.9
Vietnam	6.5	93.4
Bangladesh	6.3	161.0
Cameroon	6.3	23.3
Mozambique	6.3	28.0

Source: World Economic Prospects, January 2016; Total number of countries 118, UN Population Database (Access on 13th April, 2016)

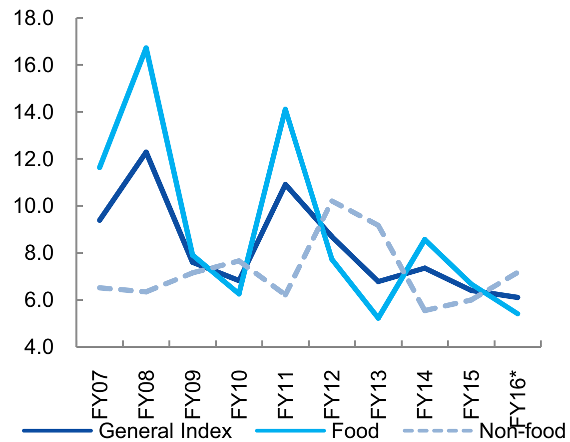
The debate should rather focus on the sustainability and inclusiveness of the growth process. Bangladesh is largely a private sector driven economy. Of the total 60 plus million people in the labor force, 95 percent are employed in the private sector. Bangladesh needs to increase the production capacity in the private sector to absorb the 2 million new entrants in the job market every year. If it cannot provide the existing and new entrants more and better jobs, growth will fail to be inclusive. Without a rising investment rate in the private sector, quality job creation will be in jeopardy. Hence, the immediate challenge for the country is to sustain the growth.

Overall inflation has moderated considerably.

Nonfood inflation has been on the rise.Good rice harvests in 2015, declining global prices and stable exchange rate contributed to deceleration in food price inflation, helping headline inflation to ease from 7.4 percent (year-on-year) in December 2013 to 5.6 percent (year-on-year) in February 2016[3] (Figure 3). In between, inflation reached its peak during February-April 2015 when supply chains were disturbed due to violence, strikes and blockades. Food inflation declined from 7.9 percent in July 2014 to 3.8 percent in February 2016. However, nonfood inflation has picked up by 2.8 percentage points during this period to 8.5 percent (year-on-year). Against general signs of weak demand, this uptick likely reflects one-off factors, including higher minimum wages in the garment industry, large pay increases for public employees and hikes in electricity and gas tariffs. Despite sustained lower international oil prices, domestic retail fuel prices have not been reduced. The persistence of high inflation in an environment characterized by declining commodity prices reflects the influence of supply side bottlenecks and lack of pass-through of international prices to domestic prices. Bangladesh's current inflation target of 6.1 percent is higher than its trading partners. India for instance has set a target of 4 percent, with a band of plus or minus 2 percentage points.

Figure 3: Inflation (y-o-y, %)

(BY 2005-06, y-o-y, percent)



Bangladesh Bureau of Statistics
*until February

Poverty reduction is likely to have continued, but the pace may moderate, as remittances weaken.

Declining food inflation is likely to have complemented growth in real GDP per capita in sustaining the pace of poverty reduction. However, the sharp rise in non-food inflation in both rural and urban areas and weak remittances of late are likely to have decelerated the pace of poverty reduction.

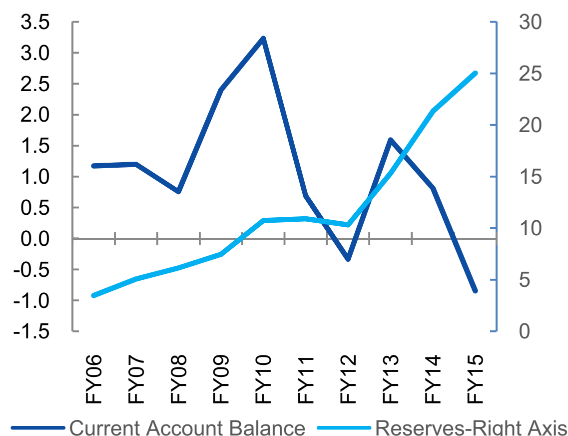
[3] Indeed, the global prices of almost all commodities, including food and fuel, declined considerably throughout 2015.

The external position remains comfortable.

(Figure-4) Following a moderatedeficit (0.8 percent of GDP) in FY15 on account of subdued exports, the Current Account Balance (CAB) returned to a surplus of about $2.1 billion in the first half of FY16 as imports fell and exports recovered while remittances remained flat. Remittances from Gulf Cooperation Council (GCC) countries recorded significant decline, reflecting the lagged impact of sustained low oil prices. The overall Balance of Payments (BoP) continued to record a sizeable surplus, supported by 8 percent increase in FDI and 16.7 percent increase in medium and long term loans. International reserves are adequate at over 8 months of imports of goods and services.

Figure 4: Current Account Balance and Reserve

(percent of GDP) *(USD in billion)*

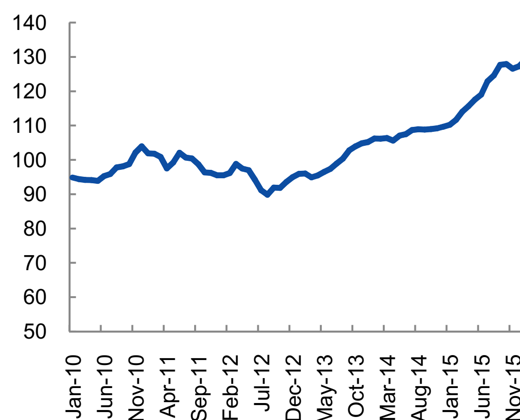


Source: Bangladesh Bureau of Statistics and Bangladesh Bank

Sterilized foreign exchange interventions by Bangladesh Bank (BB) kept the taka/US$ rate stable and restrained reserve money growth.

Bangladesh Bank purchased $2.1 billion in the first half to prevent appreciation of the taka-dollar rate. The surplus in the BoP is likely to have continued beyond the first half as evident from further BB purchase of $421 million in the first two months of 2016. Interventions notwithstanding, the real effective exchange rate (REER) has appreciated steadily for the past three years after remaining broadly constant for about two decades. In the 12 months ending January 2016, the REER appreciated by 21.5 percent (Figure-5). Nominal effective appreciation and relatively higher domestic inflation contributed about equally to this appreciation.However, there is no clear evidence of a lack of competitiveness: export market shares have remained strong and there is no import boom. Furthermore, the cost of Bangladesh's consumption basket (in purchasing power parity terms) is lower than predicted by the country's per capita income.[4]

Figure 5: Real Effective Exchange Rate



Source: International Monetary Fund (IMF)

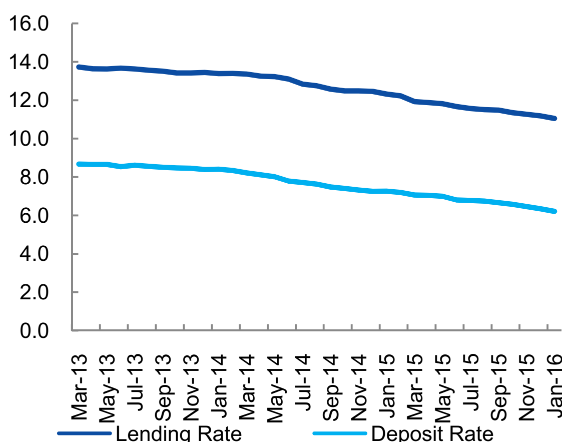
[4] IMF, Staff Report for 2015 Article IV Consultation, January 2016.

There are important structural weaknesses in the external sector.

In particular, exports remain concentrated in garments, and foreign direct investment (FDI) inflows remain much lower, as a share of GDP, than in most low-income countries, mainly due to the constraints on investment highlighted above.

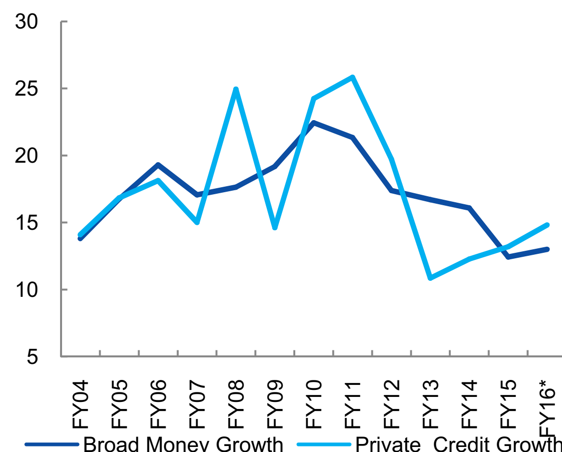
- Export performance was sluggish throughout FY15 and the first quarter of FY16 following which it recovered significantly to achieve 8.3 percent growth in the first seven months of FY16. The recovery was driven by both knitwear and woven garment exports to both the US (13.5 percent) and EU (5.8 percent) which accounted for 18.9 percent and 53.8 percent of total exports in the first seven months of FY16.
- Growth in import payments slowed to 7 percent in the first half of FY16, largely reflecting soft international commodity prices and sluggish investment demand.
- Remittances declined by 1.1 percent in the first seven months, reflecting a 6.8 percent decline in remittances from Saudi Arabia, a 5.1 percent decline from UAE, and a 1.6 percent decline from Malaysia.
- FDI inflows amounted to $795 million in the first half of FY16, compared with $736 million during the same period of the previous year.
- Net foreign aid disbursement was about $859 million in the first seven months, compared with $736 million during the same period of the previous year

Figure 6: Lending & Deposit Rate
(percent)



Source: Bangladesh Bank
*Until January

Figure 7: Broad Money and Private Credit Growth
(Y-O-Y, percent)



Source: Bangladesh Bank
*Until January

Monetary targets undershot due to restrained growth in domestic credit.

Monetary management in recent years has been challenged by sustained surplus in the overall balance of payments resulting in pressure on the nominal exchange rate to appreciate. BB purchases of dollars to prevent such appreciation caused large deviation in the growth of net foreign assets from the monetary program target, thus requiring sterilization of domestic credit to keep the reserve and broad money growth within the program targets (Table-5). Slower bank credit to the public and private sectors has contributed to high liquidity in the banking system and weaker broad money growth. As a result, short-term interest rates have

declined by 4.5 percentage points (on 91-day T-bills) in the 12 months ending December 2015, the call money rate is at a historic low (well below 4 percent), and rate on bank advances has declined by 1.27 percentage points in the 12 months ending January 2016. The interest rate spread, the gap between the interest rates on credit and deposit declined to 4.77 percentage points; which is below the BB prescribed ceiling of 5 percent (Figure-7). Private sector credit growth through January 2015 reached the 14.8 percent MPS target for the year while credit to the public sector shrank by 8.7 percent (Figure 6).

Table 5: Monetary Program Performance

	FY 14		FY 15		FY 16	
	Target	Actual	Target	Actual	Target	Actual*
Net Foreign Assets	10.0	41.2	3.6	18.2	11.1	25.6
Net Domestic Assets	18.6	10.3	20.2	10.7	16.2	9.3
Domestic credit	17.8	11.6	17.4	10.0	15.5	10.3
Public Sector credit	22.9	8.9	25.3	-2.6	18.7	-8.7
Private Sector credit	16.5	12.3	15.5	13.2	14.8	14.8
Broad Money	17.0	16.1	16.5	12.4	15.0	13.0
Reserve Money	16.2	15.5	15.9	14.3	14.3	15.9
Inflation (end of period average)	7.0	7.3	6.5	6.4	6.1	6.1
Growth	5.8-6.1	6.1	6.5-6.8	6.6	6.8-6.9	7.05

Source: Bangladesh Bank and Bangladesh Bureau of Statistics
*until February, 2016 for inflation and January,2016 for others

Box 2: The Bangladesh Bank's Reserve Heist

US $101 million was stolen from Bangladesh Bank (BB) reserve account in the Federal Reserve Bank of New York in early February. To heist about $1 billion, 35 transfer requests were sent through the SWIFT (Society for Worldwide Interbank Financial Telecommunication)interbank messaging system and used the necessary codes to authorize SWIFT transfers. Among 35 transfer orders, five transfer orders worth of $101 million slipped through. Of this, $20 million was sent to Sri Lanka in favor of a NGO but the money was not disbursed because the NGO's name was wrongly spelled in the transfer order. The rest, $81 million was transferred to Philippines banking system to 4 accounts of Rizal Commercial Banking Corporation (RCBC). A Philippines Senate panel hearing held on the money-laundering investigation suggested that US $81 million ended up with at least one local casino and two gambling junket operators via a local businessman's bank account.

The US Federal Reserve Bank of New York ruled out the breach on its systems because the payments were vetted through the "standard authentication protocols". Forensic investigation found that hackers installed a malware in the BB network, gathered the bank's confidential information and stole the money. The powerful malware destroyed the system on the computers itself, which are used by the officials to make transfer orders. It also destroyed data on the printers.

After this incident BB Governor Dr. Atiur Rahman resigned and two deputy governors in charge of overseeing payment system and IT operations and communications were asked to resign. The government appointed FazleKabir, former Finance Secretary and Chairman of state-run Sonali Bank Ltd. as the new governor of Bangladesh Bank. The government has appointed a three-member panel, headed by former Bangladesh Bank Governor Mohammed Farashuddin, with a computer scientist and an Additional Secretary as members. The committee will examine the appropriateness of the steps taken by the Bangladesh Bank to prevent the payment, the reasons behind hiding the information on the heist from higher authorities, the possibility of getting back the stolen money, and suggest measures to prevent such incidents in the future.

Bangladesh Financial Intelligence Unit (BFIU) is working with the Anti-Money Laundering Council (AMLC) of the Philippines to recover the money. Two engineers of SWIFT have come to Bangladesh to review its servers with the central bank. The Federal Bureau of Investigation (FBI) with the Criminal Investigation Department (CID) has also started to investigate. Moreover, BB has written to Bangladesh representative to the United Nations, the Federal Reserve Bank of the United States, and the Philippines authorities for helping to get the money back.

BB has requested assistance from the World Bank concerning the return of "stolen" assets. Along with others, the World Bank is working with Bangladesh Bank in their efforts to recover the stolen assets. The World Bank has been supporting BB to strengthen the financial sector (including a stronger cyber security in the Banking sector).

The banking sector still limping.

The Capital Adequacy Ratio (CAR) of the banking sector improved slightly as per BASEL II standards, but this increase in industry level CAR can partly be attributed to a relaxation in the large loan rescheduling requirements introduced by Bangladesh Bank (BB) for a specific period. A number of banks also failed to maintain the regulatory capital this year, and the insolvency of the State-Owned Commercial Banks (SCBs) significantly worsened. The asset quality of the overall banking sector deteriorated, even though a number of banks took advantage of the regulatory letup[5] and rescheduled their possible candidates of large non-performing loans to report lower NPL figures. Banking sector efficiency showed a declining trend and their profitability showed a mixed result. Overall, Bangladesh's banking sector continues to struggle with large and uneven interest rate spreads, high non-performing loans (NPLs) and uneven competition. Of late, cybercrimes have begun to infiltrate as well (Box-2).

The challenges confronting the state-owned commercial banks (SCBs) and the specialized banks (SBs) are particularly daunting.

Financial discipline of these banks was undermined by scams, high NPLs and inadequate capital followed by repeated recapitalization. Classified loans in the banking sector increased during the third quarter of FY15 to 10.5 percent of total outstanding loans but declined in the fourth quarter to 9.7 percent of total outstanding loans (Table 6). Despite the decline in classified loans at the end of the fiscal year, the SCBs faced capital shortfall which in turn created additional fiscal pressure for the government. The government provided Tk. 26.17 billion for recapitalization of SCBs in FY15. It is understandable that large banks like the Sonali Bank are too big to be allowed to fail. They need recapitalization in order to continue their regular operations. However, it is important to harden their budget constraints so that they complete a clean-up of all bad loans by a specified date (Box-3).

Table 6: Financial Soundness of Banking System
(In percent, end-of-June)

	2012	2013	2014	2015
Regulatory capital to risk-weighted assets (adjusted) 1/	10.2	8.3	7.9	7.5
Nonperforming loans to total loans (adjusted) 2/	..	..	14.6	13.9
Nonperforming loans to total loans (unadjusted)	7.2	11.9	10.8	9.7
Return on equity	13.5	9.7	8.4	6.6
Return on assets	1.2	0.6	0.6	0.5

Source: IMF

1/ An adjustment is made to exclude special accounts set up in state-owned commercial banks' balance sheets, which contain the accumulated losses arising from the difference in market and book value of assets. These amounts are deducted from state-owned commercial banks' assets and regulatory capital. From June 2015, Bangladesh Bank started adjusting away these accumulated losses from banks' capital position. Additional adjustments to capital is made based on information from Bangladesh Bank for banks that availed themselves to the temporary relaxation in loan rescheduling rules between December 2013 and June 2014.

2/ From December 2013 nonperforming loans are adjusted for the estimated impact based on information from Bangladesh Bank of temporary relaxation in loan rescheduling rules.

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5 BB's directive on large loan rescheduling window. Bangladesh Bank issued the 'Large Loan Restructuring Policy (LLRP)' on January 29, 2015 with an aim to support the large borrowers in face of any unfavorable business situation.

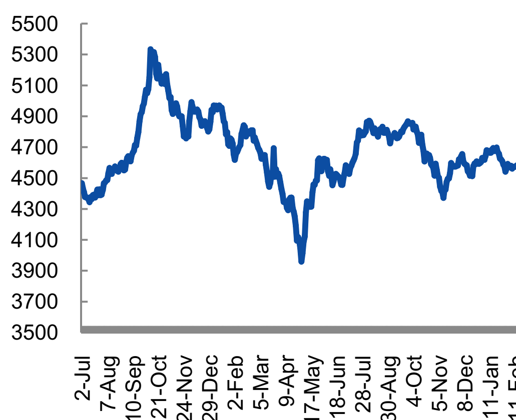
Box 3: Linking Recapitalization with Reforms

Unconditional recapitalization provides no incentive for doing some deep surgery to repair the banks' damaged balance sheets. The amount sought for recapitalization in FY17-18 is nearly $1.3 billion, equivalent to 0.6 percent of FY15 GDP. This is a huge burden on the budget. The Banking and Financial Institutions Division's (BFID) Annual Performance Agreement (APA) should have specific indicators on the solvency of each state-owned banks (SCBs) seeking recapitalization. Disbursement from the budgetary provisions for recapitalization should be linked to achieving the specified improvements in these indicators. Over the longer term, rising stress in the sate-owned banks will require more radical reforms in the structure of governance of the SCBs. The fundamental problems with the SCBs are the interdependence between banks and State-Owned Enterprises (SOEs), the way that banks are run as SOEs, and government's improper influences on the operations of SOEs and banks. Also, many private industrial companies have been hit by delays in making their investment projects operational due to unavailability of basic utility connections such as gas, water and electricity, leaving them unable to repay loans to SCBs. Though these problems have been around for a long time and are deeply rooted, they have never really been solved. Without a thorough reform of the SOEs and the way that banks are run as SOEs, the problems with the banking system will remain, even after the banks are fully or partially relieved of current NPL.

The capital market has remained bearish.

Over the last nine months[6] the capital market remained generally bearish with intermittent upward runs. The bullish run in June – July 2015, triggered by reduction in corporate tax rate of listed companies, interest rate cuts on national savings certificates by 200 basis points, and a favorable macroeconomic outlook, as portrayed by the national budget documents, stabilized in August – September.

Figure 8: Dhaka Stock Exchange General Index



Source: Dhaka Stock Exchange

(Figure-8) Since October 2015 a downward trend persisted amid monthly/bi-monthly cycles of ups and downs, coupled with low turnover, indicating cautious investor sentiment during the entire period. DSEX, the benchmark index at Dhaka Stock Exchange, reached its highest point at 4874 on August 5, 2015 before the downward mood set in, causing a 500 point decline in three months, as the peak turned into trough at DSEX's lowest value of 4372 on November 11, 2015. The generally down mood of the market is clear from the fact that during January 2015 – December 2015 total market capitalization decreased by around 4 percent (from $41.66 billion to $40.08 billion) despite an increase in the number of listed securities from 546 to 559.

Expectation of good year-end corporate declarations and more capital market friendly monetary policy in the backdrop of a relatively stable and largely positive macroeconomic situation set in a new wave of bullish run in mid-December, which sustained till mid-January 2016. Both institutional and individual investors started booking profits soon after Bangladesh Bank announced the monetary policy which cut the key policy rate by 50 basis points to stimulate investment and

[6] From July 2015 – March 2016.

growth. The largely positive Monetary Policy Statement (MPS) appeared inadequate to pull the investors out of their meticulous investment sentiment mainly due to lack of confidence in long run business environment. Forbes ranking of Bangladesh having the least favorable business environment in South Asia is an affirmation that investors are not going to put their money into long term equity and growth-seeking stocks.

Foreign portfolio investments have declined.

Efforts by the government and regulators to shore up the market since the 2011 debacle had limited success in achieving the desired results. The foreign investment in the capital market declined by 92.94 percent, driven by profit booking sales by overseas investors. The foreign investors bought shares worth Tk.38.25 billion and sold shares worth Tk.36.4 billion, to take their net investment for the year to Tk.1.85 billion, according to the DSE data. The net investment by the foreigners in 2014 was Tk.26.2 billion. The foreign investors sold bulk of their shares, especially in the second and third quarters of 2015, to realize the gains they made in the previous two years.[7]

The fiscal deficit has consistently been below the 5 percent of GDP budget target, but increasing.

Tax collections significantly underperformed in the past two years due to subdued economic activity and declines in import prices. But these are not the only factors as revenues have grown slower than nominal GDP. Already one of the lowest in the world, the tax-to-GDP ratio fell in FY14 and FY15 (Figure 9), reflecting persistent weaknesses in tax policy and administration. Nontax revenues declined significantly in FY15, in part due to lower dividends from public sector agencies to the government. The savings in current expenditures, helped in part by lower fuel subsidies and the usual under-execution of the capital budget were not sufficient to offset weak revenue performance. As a result, the fiscal deficit (excluding grants) is estimated to have risen to 4.2 percent of GDP in FY15, compared with 3.5 percent in FY14. Although the share of external and domestic financing of budget deficit remained stable, the composition of domestic financing shifted significantly towards much costlier sources, particularly the National Savings Certificates (NSC).

Figure 9: Budget Deficit & Domestic Financing
(percent of GDP)

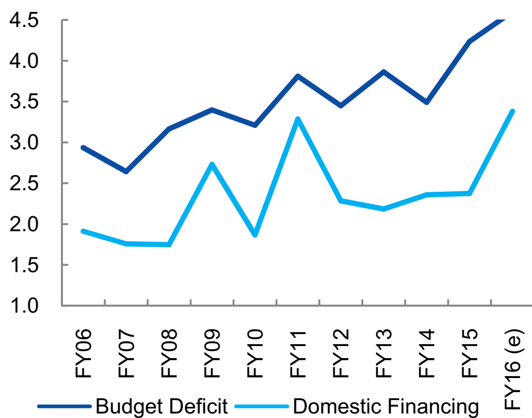
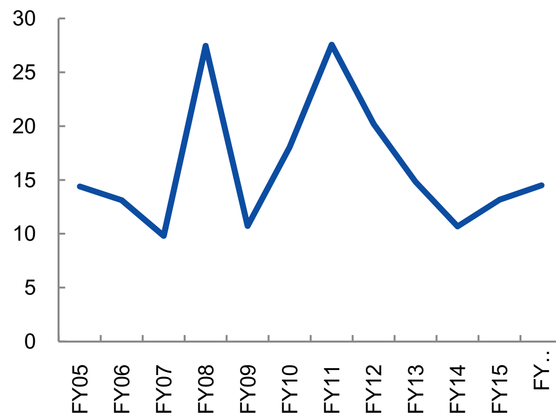


Figure 10: NBR Revenue Growth
(Y-o-Y, %)



[7] Foreign portfolio investment accounts for less than 1 percent of DSE's total market capitalization. Investors include fund managers such as Morgan Stanley, Goldman Sachs and Black Rock.

Source: IMF & Ministry of Finance

Source: National Board of Revenue
*until January

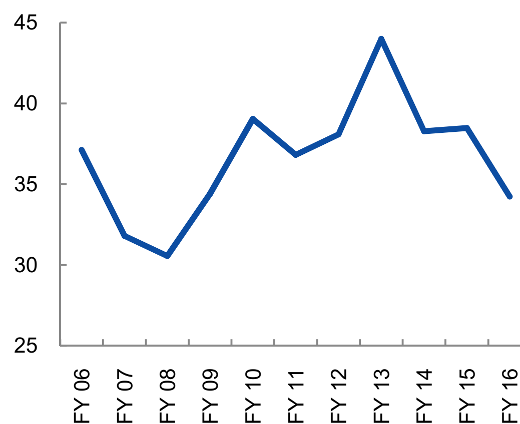
Revenue collection in FY16 is most likely to fall short of the target for the fourth consecutive year.

During the first seven months of FY16, National Board of Revenue (NBR) revenue collection was 14.5 percent higher than the corresponding period of FY15 (Figure 10), well behind the 42.2 percent target for the whole year. NBR revenue will have to grow by 43.9 percent during February-June 2016 relative to the same period in 2015 to achieve the FY16 NBR revenue target. Such revenue in the last five months of a fiscal year has not happened in recent memory.[8] Non-tax revenue collection of NBR and outside NBR have also not been very promising. There are a number of reasons behind the shortfall in revenue collection: (i) the budget target was overambitious to begin with, particularly in view of lackluster revenue collection performance in FY15; (ii) international prices fell significantly for a number of imported commodities, while the exchange rates against currencies of major trading partners appreciated; (iii) a number of tax incentives provided in the budget, including lower corporate income tax rate for publicly traded companies, significant reduction in custom duties and supplementary duties, adjustments as regards income tax rate at source for all export items from the originally proposed rate of 1 percent (to 0.6 percent for both RMGand non-RMG exports) and withdrawal of the proposed 2 percent advanced income tax (AIT) on import of essential commodities; and (iv) administrative capacity and revenue collection effort did not see any major improvement and the reform agenda failed to gain any visible momentum. Much will also depend on Bangladesh Telecommunication Regulatory Commission's (BTRC) success to hold the auction for mobile spectrum fee for 2G and 3G and subsequently its ability to collect the installments by the end of this fiscal year. .

Public expenditure is expected to be lower than the planned budget.

Total public expenditure declined 3.6 percent in July-October 2016 relative to the same period the previous year. (Figure 11) The pace of ADP implementation has deteriorated somewhat. According to first seven months' data, actual spending under ADP was 28.4 percent of originally planned allocation of Tk. 970 billion. This is the lowest implementation rate expenditure since FY08. Both taka and project aid components have been slow. The low rate of implementation reflects below par performance of six ministries/divisions: the Bridges Division, Road Transport and Highways Division, Ministry of Railway, Ministry of Health & Family Welfare, Ministry of Water Resources, and Energy and Mineral Resources

Figure 11: ADP Implementation in July-February
(percent of Original ADP)



Source: IMED, Ministry of Planning

[8] The highest recorded was in FY11 when NBR revenue in the last five months of the fiscal year grew by 27.7 percent.

Division. In view of a significant infrastructure deficit, better and faster implementation of the ADP, particularly that of growth enhancing infrastructure projects, remains a top policy priority. The carryover projects that could perhaps be completed by FY16 have not progressed fast enough. Further cost and time overruns for these priority projects cannot be ruled out.[9] The ability to implement ADP projects, in time and within initial estimates, remains elusive. The announced new pay scale for government employees did not come into effect until January 2016. Interest payments increased while lower level of international prices brought some respite on subsidy expenditure.Overall public expenditure is expected to rise significantly during the second half of fiscal year when the new pay scale for government employees will be implemented and ADP expenditure, following historical trends, is likely to accelerate. .

[9] Just recently, the estimated cost of the Dhaka-Chittagong Four Lane highway was revised upwards for the fourth time.

B. Structural Reforms

The 7th Five Year Plan, the government's medium-term development strategy document, has gone into action. Some important legal amendments pertaining to special economic zones, labor rights, bus rapid transit and others were approved by the government. The nontransparent practice of changes import tariffs through Statutory Regulatory Orders has continued as did additions of several new projects in the already stretched Annual Development Plan (ADP) portfolio.

The government has approved "Seventh Five Year Plan" with the long term vision for accelerated and inclusive growth.

The plan has targeted 8 percent GDP growth by 2020 with annual average growth at 7.4 percent during the period between FY16 and FY20. To achieve this goal, investment of Tk 31.9 trillion will be required, of which 77.3 percent will come from the private sector. Moreover, government has targeted raising exports to US$ 54.1 billion, remittances to US$ 25.4 billion, trade-to-GDP ratio to 50 percent, investment-to-GDP ratio to 34.4 percent, and foreign direct investment US$ 9.56 billion. In addition, total revenue will be raised to 16.1 percent of GDP, government spending to 21.1 percent of GDP, and the current 5 percent of GDP fiscal deficit target maintained. By the end of 7th FYP, poverty and extreme poverty will be lowered to 18.6 percent and 8.9 percent respectively. It is estimated that 12.9 million additional jobs will be available during the period between FY16 and FY20, including 2 million jobs abroad for migrant workers.

Parliament has passed the Bangladesh Economic Zone (Amendment) Bill, 2015.

The main purpose of this bill is to ensure economic development and encourage industrialization, employment opportunities, production, and export diversification. According to the bill, the economic zones will be set up on the basis of government-to-government agreements or mutual assistance or cooperation. Twenty four economic zones have been approved with two separate zones for Indian and Japanese companies. A total of 24,017 acres of land in different parts of the country have been allocated for these new economic zones.

In addition, the Executive Committee of the National Economic Council (ECNEC) has approved economic and industrial zone for Chinese investors. The proposed economic and industrial zone will be set up on 774.25 acres of land at Anwara in Chittagong costing Tk 4.20 billion. The government also offered a special economic zone (SEZ) to Spanish investors, who can choose any of the 30 zones that are being developed in the country.

The cabinet has approved a five-year "Industrial Policy, 2016".

Six industries have been included in the high priority category for policy and financial support: agriculture and food processing, garment, ICT and software, pharmaceuticals, leather and leather products, and jute and jute goods. Two dozens of industries including architecture, art and antique, design, fashion design, film and video, interactive laser software and media programs, bicycle, and light engineering are included in the list of creative industries. The policy has redefined the sizes of industrial units based on company's asset value. Asset value of over Tk 500 million and 300 employees will be considered as a large industry but a garment unit with staff of more than 1,000 will be considered as large industry category. For a medium industry, asset value will be between Tk 150 million to Tk 500 million and 121-300 employees. For small industry, it will be between Tk 7.5 million to 150 million and 31-120 employees. This policy also brings benefit for foreign investors. Foreign investors who take up green, high-tech or transformative projects will get a special financial incentive package. In addition, there will be one-stop service, country-specific economic zones or industrial parks for foreign investors. In addition, the foreign investors will also enjoy tax holidays. Any foreign investor who invests $1 million or more or transfers $2 million or more to a recognized financial institution can apply for Bangladeshi citizenship.

The government has approved the "Bangladesh EPZ Labor Law (amendment), 2016".

This amendment allows workers to form the equivalent of trade unions in factories located in the Export Processing Zones (EPZ). It ensures the right to bargain wage for workers where their representatives will be able to bargain directly with the owners for fixing wage and working hours. The bill addresses financial facilities for workers, their retirement benefits, mandatory group insurance, compensation in case of death, cash payment for earned leave, full salary as festival bonus, and maternity leave for 16 weeks. It also states that the family members of a worker will get compensation of Tk 0.2 million if he or she dies while on duty, and Tk 0.25 million has been fixed for any worker for his or her 'permanent' or 'complete' disability.

Government has approved "Domestic Workers Protection and Welfare Policy, 2015".

The policy recognized the work of the domestic helps as "labor" to ensure their protection, welfare, rest, entertainment, leave, and working environment. Under this policy, the minimum age will be 14 years for light work and 18 years for heavy work. The salaries would be determined upon mutual agreement between the house owners and the domestic workers but the housemaids can never be subjected to any kind of oppression, indecent behavior or physical and mental torture. In case of physical and mental torture, punishment will follow the existing law including penal code and the "Women and Child Repression Prevention Act". In addition, female workers will get maternity leave for 16 weeks.

The Asian Infrastructure Investment Bank Bill

This bill will allow the government to pay the subscription fee for the China-led Asian Infrastructure Investment Bank to be a founding member of the bank. Under the law, the country has to pay $132 million over the next 10 years as

2016 has been passed by parliament.

capital subscription on installment basis. Being member, Bangladesh will get capital approval of $100 billion. Now Bangladesh has 6605 approved shares of the bank and each of the shares is valued at $1 million.

BB has relaxed foreign exchange regulations.

Under this relaxed rule, all C-category (entrepreneur resident in Bangladesh) industries in the Export Processing Zones (EPZs) will be allowed to take low-cost loans from the Export Development Fund (EDF) of Bangladesh Bank. It will help all such industries located in the EPZs to meet their short-term liquidity requirements.

BB has allowed taking loans in the Bangladesh currency for housing finance for Non-Resident Bangladeshis (NRBs) working abroad.

Authorized Dealers (ADs) may extend mortgage loans in Taka to NRBs working abroad for the purpose of housing in Bangladesh with observance of the existing guidelines of Prudential Regulations for Consumer Financing (Regulation for Housing finance) issued by Banking Regulation and Policy Department. ADs will provide finance facility at a maximum debt equity ratio of 50:50. ADs may obtain securities and savings instruments held by NRBs in Bangladesh as additional collateral beside registered mortgage of the house with registered power of attorney. The repayment against the loans shall be made out of inward remittances. In addition, rental income from the house (net of applicable taxes) would be used for repayment.

Cabinet has approved "Public Procurement (4th Amendment) Act, 2016" to regulate unusual bidding in public procurement.

According to this amendment bidders cannot quote a price with 10 percent lower or higher than the official estimated price of a public procurement tender. With this violation, the tender will be cancelled. This amendment also increases the ceiling of the estimated price of a "limited tender" from Tk 20 million to Tk 30 million.

Government has passed the "Bangladesh Petroleum Corporation Bill (Amendment) 2015".

Bill stated that the Bangladesh Petroleum Corporation (BPC) will have an approved capital of Taka 10 billion and the government would provide the fund as per requirement of the corporation. The bill would give legal coverage to activities adopted under the annulled ordinance and defend continuation of the activities relating to crude oil import, refining and processing and others. The bill has allowed the corporation to borrow money or receive grant from local or foreign banks or any other source to increase its capital with approval of the government. Under the law, the government is authorized to appoint not more than five directors to the BPC. The BPC headquarters would be in Chittagong, but it could be shifted in the greater interest of the corporation.

The National Board of Revenue (NBR) made several changes in import duties.

The NBR has increased import duty on rice. It has withdrawn 7.5 percent VAT on private universities, medical and engineering colleges. With an existing 10 percent custom duty, NBR imposed 10 percent regulatory duty on rice imports. Moreover, it has imposed 15 percent VAT and increased tariff value on import of both raw and refined sugar. The tariff value of raw sugar went up from US$320 to US$ 350 per ton and from $400 to $430 per ton for refined sugar. The NBR also raised duty on medicine raw materials. Azithromycin and Erythromycin, and raw materials of anti-biotic import duty increased to 25 percent from the existing 10 percent. The NBR also signed an agreement with Bhutan to avoid double taxation to increase investments and trade.

The government has approved various projects to improve infrastructure sectors.

The executive committee of the National Economic Council (ECNEC) revised the cost of Dhaka-Chittagong Four-Lane Highway project. The cost has been increased by Tk 6.26 billion to Tk 38.2 billion (a 19.6 percent increase). ECNEC has also given approval to 12 new and revised projects involving Tk 66.50 billion. This includes Tk 36.84 billion for building bridges and culverts, Tk 10.59 billion to strengthen the local government system, Tk 2.75 billion to set up four textile institutes, Tk 2.37 billion for Dhaka bypass, Rajshahi's rural road construction at Tk 3.98 billion, Bhurghata-Barisal-Lebukhali bridge at Tk 1.06 billion, the unfinished Lalkuthi child health and maternal health center project at Tk 419.2 million, revised setting up of national science and technology complex at Tk 2.29 billion, construction of national laboratory medicine and referral center at Tk 1.94 billion, Barisal university project at Tk 1.52 billion, and setting up of seed breeding farms at Barisal and Patuakhali at Tk 2.12 billion.

The cabinet has approved some projects in power and energy sectors.

Installation of Single Point Mooring (SPM) with double pipe line project has been approved to ensure smooth unloading of crude oil and finished products. Eastern Refinery Limited on behalf of the Bangladesh Petroleum Corporation under the Power, Energy and Mineral Resources Ministry will implement the Installation of SPM project by December 2018. Among Tk 49.35 billion of total cost, Tk 9.20 billion will come from the budget, Tk 1.13 billion from the organization's own fund, and Tk 39.03 billion project assistance from Chinese EXIM Bank. Executive Committee of the National Economic Council has approved power project worth of Tk 69.15 billion for electricity supply to 1.5 million rural people. In addition, the cabinet body also approved projects to set up solar park in different parts of the country to reach a target of 2,000 MW, or 10 percent of overall capacity, generated from renewable sources by 2020. Private firm Edisun-Power Point and Haor Bangla-Korea Green Energy will set up a 32 MW peak solar park in Sunamganj district, Hetat-Ditrolic-IFDC Solar Consortium will set up a 50 MW solar park in Mymensing district, and Sun Edison Energy Holding (Singapore) Private Limitted will build 200 MW solar park in Teknaf. The state-owned PDB will purchase electricity from the park at a tariff of US 17 cents or Tk 13.26 per kilowatt/hour.

The cabinet has approved "Bus Rapid Transit (BRT) Act-2016".

The main purpose of this law is to reduce traffic jams in Dhaka and its adjacent areas. There will be six dedicated fast-moving bus lanes with the capacity to transport 40,000 passengers per hour on the Gazipur-Airport-Jhilmil route. The proposed law has suggested the formation of a seven-member committee for fixing the fares on the route. The law also states that the license holder of BRT permitted vehicles will be responsible for the compensation to people injured in any accident. In addition, the authority would ensure seat reservation for the war-wounded freedom fighters, children and the people with disabilities in each coach under the BRT system. Anyone operating buses in the rapid transit line without license, hands over the license without prior approval, and prints tickets without permission will face ten years of imprisonment or Tk 50 lakh in fine or both. If any employee of the BRT is found involved in producing illegal tickets, he or she would suffer two years of imprisonment or could be fined Tk 5 lakh. The proposed law incorporated a provision of conducting a mobile court to punish the offenders.

The government has approved "Cox's Bazar Development Authority Bill 2015".

As per the draft law, there would be a 15-member Cox's Bazar Development Authority comprising a female member, the Deputy Commissioner, Superintendent of Police and Mayor of Cox's Bazar and 11 non-permanent members. The authority will play the role of a facilitator to develop the town and enhance the living standards of its dwellers. Under the draft law, permission from the authority is mandatory for constructing establishments or undertaking development activities. Violation of law includes Tk 0.5 million charges or one year's imprisonment.

C. Outlook

The global outlook from a Bangladeshi perspective is mixed. Income growth prospects in Bangladesh's main export markets are uneven, but sustained low oil prices bode well for external and internal balance. With modest fiscal expansion and some easing of the infrastructure bottleneck, GDP growth is projected to rise toward 7 percent, albeit rather slowly.

Global growth continues to disappoint.

Global growth slowed further in the last quarter of 2015 to just under 1.6 percent,[10] its lowest level since the Euro Area crisis in 2012. Disappointing growth in the United States and Euro Area, a contraction in Japan, a further slowdown in China, and signs of an enduring recession in Brazil and Russia contributed to the global growth deceleration. Growth eased in India as well following a particularly strong third quarter. On the positive side, fourth quarter growth firmed slightly in the United Kingdom (2 percent), and accelerated in Indonesia, the Philippines, Singapore, and Malaysia. Global manufacturing activity was subdued through 2015, growing at nearly half the pace observed during the previous five years. Services activity has been more resilient, partly supported by robust consumer spending.

Weak growth among major emerging markets will weigh on global growth in 2016, but economic activity should still pick up modestly to a 2.9 percent pace, from 2.4 percent growth in 2015, as advanced economies gain speed.[11] Simultaneous weakness in most major emerging markets is a concern for achieving the goals of poverty reduction and shared prosperity because those countries have been powerful contributors to global growth for the past decade. Spillovers from major

10 Quarter-on-quarter, annualized.
11 The World Bank's January 2016 *Global Economic Prospects*.

emerging markets will constrain growth in developing countries and pose a threat to hard-won gains in raising people out of poverty. Global economic growth was less than expected in 2015, when falling commodity prices, flagging trade and capital flows, and episodes of financial volatility sapped economic activity. Firmer growth ahead will depend on continued momentum in high income countries, the stabilization of commodity prices, and China's gradual transition towards a more consumption and services-based growth model. Developing economies are forecast to expand by 4.8 percent in 2016, less than expected earlier but up from a post-crisis low of 4.3 percent in the year just ended. Growth is projected to slow further in China, while Russia and Brazil are expected to remain in recession in 2016. The South Asia region, led by India, is projected to be a bright spot. The recently negotiated Trans-Pacific Partnership could provide a welcome boost to trade.

Monetary accommodation likely to continue.

In response to deteriorating global growth prospects and financial market turmoil, major central banks have adjusted their monetary policy stance towards further accommodation. After hiking policy rate in December, the Federal Reserve indicated in February that it was closely monitoring external risks and the impact of market turbulence on U.S. growth. Combined with evidence of declining inflation expectations amid sharply lower oil prices, this has reduced the likelihood of further hikes in coming months. Markets are now predicting that policy rates will remain at current low levels well into 2017. The Bank of Japan at the end of January joined the European Central Bank, the Danish National Bank, the Swedish Riksbank and the Swiss National Bank in implementing negative policy rates. In February, the share of European and Japanese government debt trading at negative yields rose to record levels, accounting for respectively 34 percent and 55 percent of bonds traded. While supporting favorable financing conditions, the combination of negative rates, large excess reserves, and low long-term yields could undermine the profitability of banks by narrowing net interest margins and revenues from traditional maturity transformation activities.

Excess supply keeps downward pressure on oil prices.

Crude oil prices rebounded slightly in February after a sharp decline in January on a weaker U.S. dollar and speculation of production cuts, but excess supply persists. Iran's exports are rising, which combined with increases in Saudi Arabia and Iraq pushed OPEC's output to a record 32.65 million barrels per day in January. U.S. shale oil production is falling slowly, proving more resilient than expected due to efficiency gains and cost reductions. Other producers are also maintaining output, despite sharp cutbacks in investment.[12] On the demand side, the January assessment of the International Energy Agency anticipates slower growth in global demand for oil in 2016, following weak seasonal demand in the northern hemisphere. For 2016, prices are expected to remain low, on average at $37 per barrel.

Oil exporters feel the pressure.

Many oil exporting countries entered the oil price plunge with significant reserves and fiscal buffers, but these are eroding rapidly. Key challenges include weakening current accounts (Azerbaijan, Colombia, Kazakhstan, Russia), and depreciating exchange rates (Angola, Azerbaijan, Colombia, Kazakhstan, Nigeria, Russia), which in some cases have been met with the imposition of foreign exchange controls (Azerbaijan, Nigeria). Other challenges include accelerating inflation, tighter monetary policy (Colombia, Kazakhstan, Russia), falling government revenues, and tighter fiscal policy (Angola,

[12] Operating costs of most oil producers remain below current oil prices, amounting to around $32 per barrel in Brazil, $20 in Colombia, $17 in Angola, and $5 per barrel in Saudi Arabia, Iraq and Kuwait.

Colombia, and to some extent Mexico).[13] No country has yet faced balance of payment difficulties that would necessitate emergency assistance, but pressures persist, and weakened fiscal positions may be challenged further by oil price assumptions in current budgets that exceed the $37 average projected in the World Bank's January 2016 Commodity Markets Outlook.

Narrowing vulnerabilities and lagged benefits to growth in oil importing countries.

Pressures on external balances, inflation, and government budgets are easing for oil importers. The lower price of energy imports has helped narrow persistent trade deficits (Egypt, India, Turkey) and reduce stress on exchange rates. The pass through from lower oil prices has slowed inflation, and in many countries provided the scope for monetary easing in support of faster growth, including in high income countries. Fiscal balances have improved among several oil importers (Egypt, India, Pakistan, Turkey, as well as Bangladesh), as budgetary outlays on subsidies fall. In this context, several countries, both oil exporters (due to fiscal pressures) and importers have sought to eliminate or reduce fuel subsidies. Gains in consumer purchasing power, however, have not been able to offset the weakening of global demand for goods and services in much of the world.

Growth is projected at 6.8 percent in FY17 on the back of further increase in government consumption as the increased benefit package for government employees is implemented, increase in public investment, and a recovery in private investment, as regulatory and infrastructure constraints are eased and creditor confidence returns with improvements in governance in the financial sector (Table 7). Despite the recent REER appreciation, Bangladesh retains a sizeable labor cost advantage, which should make it an attractive source country as competing producers move up the value chain. With the tapering of public pay increase in FY18, growth is projected to fall back to 6 percent.

Table 7: Bangladesh Macro Outlook Indicators

	2013	2014	2015	2016 (e)	2017 (P)	2018 (P)
Real gross domestic product growth (%)	6.01	6.06	6.55	7.05	6.80	6.00
			Contribution of expenditure components (%)			
Private consumption	3.5	2.7	3.8	3.5	2.5	2.7
Government consumption	0.3	0.4	0.4	0.6	1.2	0.5
Gross fixed capital investment	1.6	3.0	2.2	2.8	4.0	4.0
Exports, goods & services	0.5	0.6	-0.5	-0.1	2.9	2.8
Imports, goods & services	-0.3	-0.3	-0.7	1.9	-3.7	-4.1
Statistical discrepancy	0.4	-0.4	1.3	-1.6	0.0	0.0
			Contribution of production sectors (%)			
Agriculture	0.4	0.7	0.5	0.4	0.6	0.5
Industry	2.6	2.3	2.7	2.9	3.0	2.7
Services	2.9	2.9	3.0	3.4	3.0	2.6
CPI Inflation, end of period average	6.8	7.3	6.4	6.6	6.8	6.6
Current account balance, % of GDP	1.6	0.8	-0.8	0.3	-0.3	-1.0
Total Revenue, % of GDP	10.7	10.5	9.6	10.2	9.2	9.3
Total Expenditure, % of GDP	14.6	14.0	13.8	14.8	13.6	13.6

[13] The World Bank, January 2016 Commodity Markets Outlook.

Fiscal balance (Excluding grants), % of GDP	-3.9	-3.5	-4.2	-4.6	-4.4	-4.3

Source: Bangladesh Bureau of Statistics (BBS) and World Bank staff

Inflation is expected to edge up in FY16–18 on account of higher public sector wages, a one-off effect from the introduction of the new VAT, and overheating with actual growth exceeding the potential growth rate. Private sector credit growth is expected to average around 15.5 percent over the medium term, with its share in GDP increasing by 2 percentage points to 40 percent by FY20. This is consistent with the envisaged investment and GDP growth paths, and also with pre-credit boom trends (prior to FY06) and cross country patterns of financial deepening. On the back of investment-led growth, the current account deficit is projected to widen to about 2 percent of GDP over the medium term.

Monetary policy continuity maintained.

The overall monetary policy stance announced in the January 2016 MPS maintains policy continuity. Nominal GDP growth is unlikely to exceed 13.3 percent in FY16. Thus, the revised 14.3 percent reserve money and 15 percent broad money growth targets are more than adequate to accommodate the projected 6.8 percent real GDP growth and 6.07 percent inflation target for FY16.[14] There was no reason to risk excessive divergence between nominal GDP growth and the growth of broad money. The revised broad money growth target reduces this divergence. Perhaps BB could have been a bit more ambitious in lowering the inflation target below 6 percent.But then without favorable developments on the supply side such a decrease in domestic petroleum prices, an inflation target well below the previous year's level is incongruent with a GDP growth target well above both the previous year and also the economy's potential growth rate.

Policy rates reduced.

The revised stance on policy rates provides a signal to bankers to expand private credit by reducing lending rates. Demand for repo has been weak, understandably so because of large excess liquidity in the system. Banks apparently are more interested in parking their excess cash in reverse repo. The offered amounts in reverse repo have far exceeded the amount accepted in recent auctions. Given that the overall balance of payments is projected to have a large surplus, reserve accumulation may have to continue for a while to prevent further erosion in the competitiveness of the real effective exchange rate. This would require continued sterilization. To avoid the adverse impact on the profits of the Bangladesh Bank, this was an opportune time to reduce the reverse repo rate and correspondingly the repo rate. These reductions signal to the banks to be more proactive in finding bankable projects to lend in the private sector. There is not much more to this than just the signaling aspect.[15]Even if the banks do not pass on the lower interest rates onto customers, they will be able to borrow more which they can pump into the system. There is also a risk which BB must guard against. Risks to the financial system increase, the lower the rate goes. With repo money getting cheaper, banks

14 These are Bangladesh Bank projections which differ from the Finance Division projections.

15 The transmission of monetary policy to the real economy—the monetary transmission mechanism—can be hindered by small and shallow financial markets, oligopolistic banking systems, excess bank liquidity, monetary policy frameworks with limited ability to anchor inflation expectations, and poor institutional and legal environments that raise the costs of lending. These factors are most frequently found in developing and emerging market economies.

with funding shortfall will be tempted to avail the liquidity support more. Funding shortfall can result from careless lending too. BB will need to be careful in accepting repo bids from poorly managed banks. The MPS does recognize that some the recent rise in NPLs are "alarming" while assuring BB "will not be lenient in this regard".

Real exchange rate stability needed.

There is uncertainty about the impact of the considerable REER appreciation of recent years on export competitiveness. Given this uncertainty, continued sterilized foreign exchange market intervention is warranted in the near term to prevent further erosion in competitiveness which could eventually impact growth, tax revenue, and bank asset quality. BB should monitor foreign exchange market developments and export performance, and adjust interventions as needed. BB should also consider using a basket of trading partners' currencies as a benchmark for such intervention, instead of implicitly pegging to the U.S. dollar alone. Given the importance of the euro area as an export market, this would provide a better basis for monetary and exchange rate policy. Arresting the trend of an appreciating REER will require measures other than nominal depreciation of the taka. These include reducing the inflation rate and the nominal rate of protection.

Box 4: Small Savings Scheme Reform in India

On March 18, 2016 the Government of India cut interest rates on deposit schemes offered by the Government to provide a risk-free investment option to households. The reduction across various schemes, ranging between 40bp and 130bp, came into effect on April 1, 2016. From now onwards the interest rates on small saving schemes will be reset on a quarterly basis, based on the average month-end Government security rates of comparable maturity in the preceding three months. For example, for the Apr-Jun quarter, interest rates were based on Dec-Feb month-end Government security rates.

This will be helpful in two ways:

- First, it should improve monetary policy transmission. Banks frequently cite the high small savings rate as competing away their bank deposits. Therefore, lower small savings rates, along with marginal cost-based pricing of loans from April 2016, should facilitate an improvement in monetary policy transmission (lower lending rates).
- Second, lower small savings rates will lower total accretion into these small savings schemes and increase government reliance on other sources of financing, especially market borrowings, to finance their fiscal deficit. However, this should reduce the interest burden for the central government as interest paid for borrowing from the National Small Savings Fund is higher than market rates.

Overall, the move to deregulate small savings rates is a win-win for both the government and the banks. It will give banks greater flexibility to lower deposit (and lending) rates in tandem with falling inflation, while lowering the interest burden for the government at the margin. While consumers will receive lower nominal interest on their savings, greater monetary policy transmission into lower lending rates over time will benefit consumers and corporates, boosting growth.

Moderate fiscal expansion on cards in the near term.

The overall fiscal deficit is projected to widen to 4.6 percent of GDP in FY16 with the implementation of the first phase of public sector pay hike. Over the medium term, the increase in pay and allowances and public investment is likely to be partly offset by lower energy-related subsidies and higher revenue from the new VAT. While public debt is moderate, its trajectory is highly vulnerable to revenue shocks given the low revenue base and high debt service burden. The debt-to-GDP ratio is projected to increase slightly and then stabilize as concessional external financing declines and interest costs rise, and as pension liabilities increase with aging. The need to use NSCs as a financing vehicle should be reconsidered. NSCs compete with bank deposits, potentially leading to disintermediation, set an

artificial floor on deposit rates, and reduce fiscal space for critical spending (See Box-4 for information on how India has recently reformed rate setting on small saving schemes). If NSCs are continued, their rates should be aligned with market rates. Forced subscription of treasuries by banks ("devolvement") need to be eliminated. There is room to resort to more external financing for the fiscal deficit, given the relatively low level of external debt, healthy reserve position, and manageable currency risks.

Financial and political shocks constitute the main risk to the outlook. Growth has remained constrained by infrastructure bottlenecks, shortage of power and primary energy, absence of investment friendly climate and lack of reform continuity. Structural reforms and public investment effort need to be intensified to overcome these impediments in order to enhance the country's growth opportunities.

Political, financial-fiscal, and external shocks are the main risks to the outlook.

A resumption of political violence or heightened uncertainty would adversely impact investment, growth, and inflation. Continued weakness in the banking sector, in particular at the SBs, could undermine credit and growth prospects and affect fiscal sustainability, as would a failure to launch the new VAT. On the external side, a protracted slowdown in the European Union (Bangladesh's main export destination) could hurt exports. Implementation of the Trans-Pacific Partnership (TPP), of which Bangladesh is not a member, could also erode the competitiveness of exports to TPP member countries (which account for around one-fourth of Bangladesh's exports), though the impact is likely to be moderated by Bangladesh's significant cost and scale advantages. Moreover, the outlook for remittances (a major driver of consumption) is uncertain: while worker outflows have recovered, persistent low oil prices could eventually affect investment and employment in key host countries. While previous oil price shocks had limited and short-lived effects on remittances, the current more pronounced and prolonged decline coupled with fiscal tightening in many oil-exporting countries is likely to hurt migrant worker earnings and consequently remittances. From a broader perspective, natural disasters and global climate change pose major risks for Bangladesh. Linkages with large emerging market economies and international financial markets remain limited, cushioning against potential shocks from these sources.

Credit shocks are the main risk for the banking system.

Poor lending decisions are a major concern in the SBs and some private banks. Main credit exposures are to services sectors and to large single borrowers (exposures to households and real estate are small). While banks' direct currency risks are low, rising external borrowing by business corporations poses an indirect risk.

Private investment and growth remain constrained by disabling regulations, infrastructure deficiency, financial sector weaknesses and political uncertainty.

Disabling regulations and continued bottlenecks in critical infrastructure, particularly in energy and transport, may have become more binding in recent years as the economy becomes more market-oriented. This is reflected in the non-enviable rankings Bangladesh gets in international benchmarking exercises (Table-7). These constraints stem in part from low public investment and inadequate infrastructure maintenance.Infrastructure plays a critical role in job creation, poverty alleviation, growth and competitiveness, Investment in high-quality infrastructure can provide basic services to households; lead to productive gains for industry; provide market

access for agriculture; enable sustainable urban development; open corridors of trade for poor and landlocked areas to the national and global economy; and help progress towards a more climate-smart world. Studies show a 10 percent rise in infrastructure assets directly increases GDP by up to 1 percentage point.[16] To meet the country's infrastructure development needs, the 7th Five Year Plan envisages a total financing requirement of about US$410 billion. This is about twice the size of Bangladesh's GDP.

Private sector participation can help address part of the infrastructure gap.

A sound Public Private Partnership (PPP) framework can assist in improved risk allocation between the private and public sectors. Ideally, the private partner should bear the commercial risk of the project, whereas government should address political risks, including those related to appropriately addressing social and environmental concerns. Government should also address the viability gap often resulting from the fact that private investors cannot fully appropriate the benefits from infrastructure investments. A promising PPP law was passed in September 2015, paving the way for greater private participation in infrastructure development. It would now be important to move quickly to draft regulations and guidelines which can accelerate the use of PPPs in practice. This said, private participation alone will be insufficient to address Bangladesh's wide infrastructure gap. A majority of investments in transport, or in river management, will require public funding. But this is bound to be challenging in a country where tax revenue amounts to less than one-tenth of GDP. To address this constraint it is necessary to focus on both indirect and direct taxation.

Major infrastructure projects have a history of problems in Bangladesh.

Cost overruns, delays, failed procurement, or unavailability of private financing are common.Most overruns are foreseeable and avoidable. Many of the problems are due to a lack of professional, forward-looking risk management. Large infrastructure projects suffer from significant under-management of risk in practically all stages of the value chain and throughout the life cycle of a project. Poor risk assessment and risk allocation, for example, through contracts with the builders and financiers, early on in the concept and design phase lead to higher materialized risks and private-financing shortages later on.

Competitiveness needs major strengthening.

In the recently released Doing Business 2016, Bangladesh ranked the second lowest in enforcing contracts, and was among the bottom five in registering property. Inadequate regulations and red tape are among the main concerns. Unlike other developing countries, Bangladesh has a strong and vibrant domestic private sector. Contrary to the standard pattern, participation in global value chains is not driven by FDI companies or foreign diaspora. Yet, the country has not succeeded so far in extending this success beyond the ready-made garment sector. Within this sector, competitiveness remains anchored in low labor costs rather than high productivity, and a move up the value-added ladder is still in the waiting. Apart from infrastructure, there are also regulatory constraints, highlighted by the non-enviable ratings the country gets in international benchmarking exercises, including the World Bank's *Doing Business* reports, and the Global Economic Forum ratings on global competitiveness indicators (Table -8). While the government has made progress in easing several regulatory constraints, additional

[16] César Calderón, Enrique Moral-Benito, and Luis Servén, "Is infrastructure capital productive? A dynamic heterogeneous approach," World Bank policy research working paper number 5682, 2009 (worldbank.org).

steps would help. They include: i) the enactment of rules under the Civil Procedures Code (CPC) regarding mandatory mediation of civil and commercial cases; ii) the approval of the new Customs Act; iii) the approval of the new Companies Act (and the associated rules and regulations); and iv) the approval of the Bangladesh Standards and Testing Institution Act. Note that some of the key obstacles to greater private sector efficiency are related to access to land. Efforts to remove this bottleneck through the creation of industrial zones are helpful, but the multiplicity of zones and oversight agencies with overlapping roles at times undermine such efforts.

Table 8: Bangladesh's Ranking on Business Climate

Global Competitiveness Ranking					
	2011	2012	2013	2014	2015
Total Observed Countries	142	144	148	144	140
Bangladesh Rank	108	118	110	109	107
Ease of Doing Business Ranking					
	2012	2013	2014	2015	2016
Total Observed Countries	183	185	189	189	189
Bangladesh Rank	122	129	170	173	174

Source: Global Competitiveness Reports, World Economic Forum; Doing Business Report

Financial sector weaknesses further derail investment and growth.

Asset quality, profitability and capital adequacy have declined in the banking sector since end-2012, particularly in state-owned banks (SBs), beset by scams and poor governance. Weak bank balance sheets and governance failures limit lending capacity, divert credit away from productive investment, and, in the case of SBs, impose large fiscal recapitalization costs. High levels of non-performing loans and the high rates on national savings certificates (NSCs), increase banks' operating and funding costs, putting upward pressure on interest rates. Rising (albeit still small) corporate borrowing from abroad has also reduced reliance on domestic credit. Finally, the 2010–12 stock market crash (which anecdotal evidence indicates was accompanied by a real estate price decline) had some impact on private demand. It also hit the banks, which were significantly exposed to the stock market, potentially affecting credit.

Policy priorities in the financial sector include:

Strengthening the SBs by: (i) appointing independent but accountable boards and enhancing internal control and compliance; (ii) shoring up SB balance sheets through recapitalization conditional on improved loan recovery and temporary credit growth limits; and (iii) speedy completion of branch automation to strengthen financial reporting and efficiency.

Enhancing financial sector regulation and supervision, by strictly enforcing existing rules and avoiding regulatory forbearance; and completing implementation of risk-based supervision, contingency planning, and lender of last resort policies. Loan rescheduling and restructuring policies should reflect the costs of such adjustments on bank balance sheets. Adoption of a coherent macro-prudential framework to mitigate risks and shore up financial sector resilience should also be considered.

Improving the legal and financial framework for loan recovery. Difficulties in realizing collateral and lengthy dispute resolution processes have weakened banks' ability to bring down non-performing loans. It is critical to institute simpler court procedures, alternative dispute resolution mechanisms, and asset management companies.

Addressing risks from concentration and macro-fiscal linkages. It is important to reduce banks' exposure to: (i) the sovereign (and reform the NSCs) (ii) the capital market, in line with the limit set in the law by the July 2016 and (iii) large single borrowers.

Political turmoil and uncertainty. Episodes of violence have affected economic activity both directly and via uncertainty. This appears to be reflected in subdued private sector credit growth. Credit growth slowed since mid-2013, with the private credit-to-GDP ratio below trend. However, causality also runs from weak domestic demand to slower credit because of uncertainties.

D. Bangladesh's Path to Developed Country Status

Bangladesh moved into lower-middle income status (LMIC) in 2015, when the FY14 GNI per capita reached $1,080. This follows a commendable social and economic performance over the last decade. If fast and shared economic growth continues, Bangladesh can hope to step up the 'development ladder' further, including graduating from IDA, the Asian Development Fund and Least Developed Country (LDC) status. Bangladesh will need to maintain its economic momentum as it slowly loses the benefits it gains from its LMIC and LDC status. These include access to concessional finance, access to technical assistance and preferential market access for its exporters. The focus topic below discusses Bangladesh's path to Developed Country status and some of the policies that can help guide the country along the path.

Bangladesh attained lower middle income status in 2015 thanks to strong economic and remittance growth. Experience of other countries suggests that the next step up will be tough. In a recent study, Felipe, Kumar and Galope (2014)[17] of the Asian Development Bank found that it takes the average lower middle income country over half a century to reach upper-middle income status.[18] The average country moves from upper-middle to high income in just 15 years. But these averages disguise two groups of countries: fast-growers, and slow-growers. Bangladesh will need to keep working hard to make sure it is in the first group. As Bangladesh succeeds, its access to external resources to finance development and the other benefits it receives – notably preferential market access – may come under pressure. While this may not be an immediate risk, it matters.

Post-independence economic and social successes...

Bangladesh has achieved significant success in economic and social indicators since independence. When it joined the group of Least Developed Countries (LDCs) in 1975, Bangladesh was a post conflict, agrarian economy with a population of 72 million, a GNI per capita of $200, and weak links to the global

[17] http://www.adb.org/sites/default/files/publication/149903/ewp-421.pdf

[18] Lower-middle income was defined as $2,000 per capita income at 1990 purchasing power, upper-middle income defined as $7,250 and high income as $11,750.

economy. In the 40 years that have followed, the population has more than doubled to around 156 million, GNI per capita has increased by more than five times, industries other than agriculture – notably ready-made garments (RMGs) have thrived, and Bangladesh has much stronger linkages to the global economy.[19]

Bangladesh has already met several MDG targets including attaining gender parity at primary and secondary education (attaining a ratio of 1.1 girls to boys, 2013), reducing under-five mortality (38 per 1000 of the population, 2015), containing HIV infections with access to antiretroviral drugs (45 percent of the population, 2012), increasing the proportion of children under five sleeping under insecticide treated bed nets (to 92.2 percent in 13 high risk malarial districts, 2014), detecting and curing tuberculosis (to 53 percent, 2014). In addition, Bangladesh has made remarkable progress in the areas of poverty reduction (6.5 percent poverty gap, 2010), reducing the prevalence of underweight children (32.6 percent of children under the age of 5 years, 2014), increasing enrolment at primary schools (97.7 percent, 2014), lowering the infant mortality rate (32 per 1000 live births, 2013) and maternal mortality ratio (170 per 100,000 live births), improving immunization coverage and reducing the incidence of communicable diseases.[20]

Many of these improvements have been achieved using domestic resources but Bangladesh has also benefited from a considerable amount of overseas development aid (ODA). In addition, a private sector that benefits from preferential market access to developed economies has helped to increase output and employment growth, particularly of women, driving social change.

These improvements are reflected in the fact that Bangladesh graduated from low-income to lower-middle income on 1st July, 2015. This graduation was the first step of a long ladder out of least developed country status. The country has the potential for three more graduations: second – to graduate from the group of countries receiving International Development Aid (IDA), third – to graduate from the group of countries receiving assistance from the Asian Development Fund (ADF) and fourth – to graduate from Least Developed Country (LDC) status, and on to even higher status. But these continued successes would mean the help Bangladesh receives in terms of aid and market access would shrink little by little as resources are diverted toward less successful countries.

...with a little help from my friends

While graduation from IDA, ADF and LDC status will reflect an improved quality of life for Bangladeshis, this growth will come with challenges (Box 5). In particular, Bangladesh will need to come to terms with slowly reduced development aid, or aid with hardened conditions. Increased debt servicing costs will, among other things, require higher and more diversified sources of revenue for the Government and/or a higher return public investments that increase productivity, growth and incomes.

[19] Merchandise trade as % of GDP has increased about 9 times to 45%, with remittances currently at record levels ($24 billion, 6 months of imports of goods and services) substantially above conventional benchmarks used to measure countries external resilience to financial shocks.

[20] See MDGs – Bangladesh Progress Report; Sept. 2015.

Box 5: Counting up the benefits from IDA, ADF and LDC status

Benefits from Asian Development Fund (about $2.78 billion over 3 years)

Bangladesh, as an ADB blend (Group B) country, receives both highly concessional ADF and less concessional Ordinary Capital Resources (OCR). In the period between 2016 to 2018 the indicative resources available for sovereign operations amount to $2.78 billion of which ordinary capital resources (OCR) is $1,502 million and Asian Development Fund resources is $1.276 billion with a tentative annual Technical Assistance program that averages about $3.7 million a year in the same period (see ADB Country Operations Business Plan, Oct. 2015). As an OCR beneficiary, Bangladesh has already started the transition of reducing its dependence on highly concessional loans.

Benefits from International Development Assistance (about $3.9 billion over 3 years)

Bangladesh is the largest recipient under the 17th replenishment of IDA. Its financing envelope accounted for 9 percent of IDA resources (about $3.9 billion) in the FY15 to FY17 cycle. While not yet a blend country, Bangladesh's low risk outlook means that IDA resources are administered as highly concessional loans.

While graduation from IDA is not imminent, it is something that Bangladesh should aim toward as it will reflect improving living standards. Graduation from IDA will bring positives and some things to be dealt with. Assuming that Bangladesh's low risk outlook continues, upon graduation Bangladesh will have access to a broader range of sources and borrowing instruments. With the need for IDA much diminished, accelerated repayments are triggered once Bangladesh is judged creditworthy for IBRD borrowing and its per capita GNI exceeds the IDA threshold for three consecutive years. Should Bangladesh not be judged creditworthy, as a blend country, it will be able to access IDA resources but in lower volumes and on harder terms than currently. In the event that Bangladesh's income per capita continues to improve (beyond the threshold) but its debt risk outlook deteriorates, it would not be eligible for IBRD assistance either as a blend country or as an IDA graduate. It would instead be classed as a "gap country" and the terms of IDA loans are hardened – increased servicing cost and shorter loan periods.

Benefits from Least Developed Country status

LDC specific support provides Bangladesh with five principal benefits:

Access to concessional foreign assistance - with 0.15-0.2 percent of GDP of OECD countries allocated to LDCs

Preferential market access - duty and quota free market access on goods and services exported under the Everything-But-Arms arrangement

Priority access to technical assistance for capacity building - research, policy analysis and advice, advocacy, support relevant intergovernmental processes

Flexibility in the implementation of different international agreements - in the areas of trade, intellectual property, standards, etc.

Reduced financial obligations - budget caps for LDC contributions to regular budgets of international institutions – United Nations (UN) Secretariat, International Labor Organization (ILO), United Nations Industrial Development Organization (UNIDO), World Meteorological Organization (WMO) etc. – and access to a special travel funds providing financial assistance to attend UN and World Trade Organization (WTO) meetings

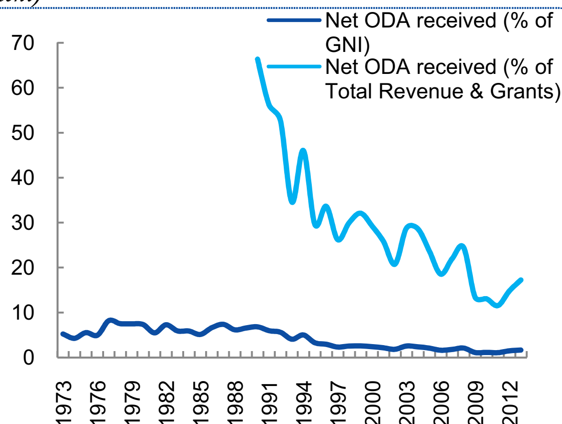
LDCs can continue to receive some of the special and differentiated treatment for six to nine years after graduation to assist the transition to developing country status. In practice this would mean that if Bangladesh meets the LDC graduation thresholds in 2018, it would not be until 2024 (at the earliest) with no transition period or 2027 that special and differentiated treatment will stop.

Similarly, Bangladesh will need to develop a more diversified external sector to capture greater value added from the global value chains that Bangladeshi exporters are linked to. While room to expand within Bangladesh's conventional growth drivers – principally the RMG sector – exists, a more sustained exit from LDC status will be more likely if Bangladesh can diversify both what it exports as well as who it exports to. A duel strategy of capturing more value added from RMG exports while at the same time developing new export products and markets will strengthen Bangladesh's resilience to global shocks, enhance macroeconomic stability and preserve growth trends as preferences are withdrawn.

How dependent is Bangladesh on the benefits it receives as an LDC?

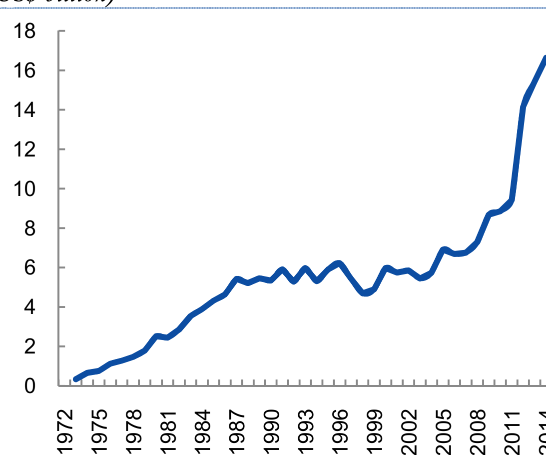
Net ODA as a percentage of GDP has fallen from around 6 percent at the time of joining the group of LDC to about 1.3 percent in 2015 (Figure 12). However, as a proportion of total revenues and grants it remains substantial at around 13 percent.

Figure 12: The Importance of ODA
(percent)



Source: WDI 2014

Figure 13: Unused Foreign Aid Pipeline
(US$ billion)



Source: Ministry of Finance

With one of the lowest tax to GDP ratios globally at 10-11 percent of GDP and the current number of taxpayers being only 1.2 million in recent years in a country with a population of 160 million, the Ministry of Finance has recognized the need to take action. Also with investment accounting for about 40 percent of total government expenditures, the government needs to address institutional capacity issues to utilize the increasing level of unused foreign aid, although this stems partially from an increasing aid pipeline (Figure 13).

As a percent of exports, ODA is about 10 percent. While this has halved since 2001 it still remains significant, and replacing the value of ODA with increased export revenues would prove a challenge given Bangladesh's dependence on a narrow range of export products as well as export markets.

Merchandise trade is important to Bangladesh and accounts for about 45 percent of GDP. Exports of goods and services, of which 90 percent are manufacturing, account for 17 percent of GDP. Of exports, three-quarters are ready-made garments. In the past 15 years earnings from this sector have increased over eight times with growth averaging about 16.5 percent per annum. While export sectors other than RMG - jute and shrimp - have also been important to Bangladesh, export values are at much lower levels.

By destination, two-thirds of Bangladesh's exports are sold to European Union (EU) and United States (US) and while garments are exempt from US preferential treatment[21] (with apparel included on the sensitive products list), they enjoy, and

[21] Generalized System of Preferences (GSP)

have done so since 2002, zero tariff and quotas free access to the EU market under the Everything-but-Arms (EBA) agreement. The EU accounts for 28 percent of all woven exports and 92 percent of all knitwear exports from Bangladesh. Together woven and knitwear RMG account for 80 percent of Bangladesh's total exports.

One of the biggest risks to Bangladesh's development progress for the next five years is a sudden loss in its competitiveness in RMG exports. A removal of EBA would cause substantial economic disruption for Bangladesh. The challenge faced by Bangladesh in the next decade will be one of diversifying exports and markets so that when least developed country benefits, particularly trade preferences, are phased out Bangladesh has built sufficient resilience to preserve prosperity.

Reduction of other LDC benefits may also have an impact. The impact of removing priority access to technical assistance for capacity building, flexibility in the implementation of different international agreements, and reduced financial obligations, will be important though this may not be as significant as the benefit Bangladesh receives from ODA and particularly trade preferences.

The road to developed country status may be long.

Despite the challenges ahead, Bangladesh should continue to chart its development course. As it becomes wealthier and moves through the graduations, some of the challenges discussed above will become lighter, as more domestic resources (public and private) are created and channeled into development. Bangladesh graduated from low-income to lower-middle income 40 years after becoming an LDC. This graduation was the first step of a long ladder out of least developed country status. In the next 12 years Bangladesh has the potential to graduate from the group of countries receiving IDA, the group of countries receiving assistance from ADF and LDC status, and on to even higher status. While exiting from low-income status means that Bangladesh passed the GNI per capita threshold of $1,046 set by the World Bank on 1st July 2015, graduating from IDA, ADF and LDC status will require sustaining, and even surpassing, this performance across a broader set of targets. As the graduation criteria become more stringent each year Bangladesh must also outpace future movements in these thresholds. Here, we assess where Bangladesh is relative to current thresholds.

Graduation from International Development Assistance (IDA).

Countries with a per capita income of less than $1,215 (as of FY15) qualify for IDA. As a country approaches this threshold, IDA will undertake an assessment to determine whether graduation procedures should begin.[22] The process of graduation would normally take five years, although the World Bank adopts a flexible approach to facilitate a sustained exit from IDA.

- For IDA countries in which there is a strong case for graduation, a graduation program is formulated in the Country Partnership Framework (CPF), under which the World Bank and the government agree on areas of cooperation. This comprises a phase-out of IDA lending, a phase-in of IBRD lending, special economic and sector work studies and technical assistance to help address transitional issues, increased role of Multilateral Investment Guarantee

[22] In the case of India, exceptional transitional support was agreed by IDA Deputies in the IDA17 replenishment discussions. To be eligible India needed to have a GNI per capita below the historical ceiling ($1,985), was able to show a strong forward agenda on poverty reduction, and demonstrate a marked reduction in new IDA commitments from the World Bank.

Agency (MIGA) and the International Finance Corporation (IFC) to improve private sector capital inflows and the application of triggers to accelerate the repayment of IDA credits.[23]

- IDA countries judged to have weak credit worthiness but that have GNI per capita levels above the threshold - *gap countries* - can continue to access IDA credits on hardened terms until such a time when they are deemed creditworthy for IBRD loans. Table 9 shows the ttypical credit terms for such countries.

Table 9: Credit Terms

	IDA	Typical IDA Blend
Maturity (years)	38	25
Grace period (years)	6	5
Principal repayments (years 1-20)	3.125%	3.300%
Principal repayments (years 21-25)	3.125%	6.700%
Interest plus service charge	0.750%	2.000%

With a GNI per capita of $1,080 and a low risk outlook, Bangladesh is an IDA-only country with 100 percent of its allocation administered as concessional loans by the World Bank. Currently its income per capita level is still some way below the threshold of $1,215 (and the threshold increases over time) and although it has a low risk outlook, it has yet to be judged suitable for IBRD loans and therefore blended assistance. Before reaching the graduation threshold for IDA, Bangladesh may first become a blend country, as it is already classed by the Asian Development Bank.

Graduation from Asian Development Fund (ADF).

Similar to the World Bank, the Asian Development Bank operates two forms of financial assistance - the Asian Development Fund (ADF) and regular Asian Development Bank assistance/ordinary capital resources (OCR). Beneficiaries of these funds are classified into three groups - Group A (ADF only), Group B (Blend Countries) and Group C (OCR only) - determined by two criteria - GNI per capita and creditworthiness. Bangladesh is currently classified as a Group B blend country, which allows it to receive a mix of ADF and OCR financial support. The ADB uses the same income threshold as the World Bank. Graduation from ADF resources is normally triggered when a country exceeds the per capita GNI threshold and achieves adequate creditworthiness for OCR. Graduation involves close consultation with the beneficiary country. The process of graduation normally takes about four years to complete, after crossing the income threshold. As the ADB follows the same income threshold as IDA, Bangladesh is still below the threshold of $1,215. However, unlike the IDA, Bangladesh is already classified as a blend country allowing it access to both ADF and OCR financial resources. It is therefore developing its credit history with the bank and capacity to take on future OCR finance on more commercial terms.

Graduation from Least Developed Country (LDC) Status.

Every three years the UN Economic and Social Council (ECOSOC) reviews the list of LDCs based on recommendations from the Committee for Development Policy (CDP). The CDP assesses LDCs against three criteria - income, human development and economic vulnerability. Countries recommended for graduation must fulfil two of the three graduation criteria or have a GNI per capita of at least twice the graduation threshold level.

[23] Accelerated payments of IDA loans are triggered when a country is creditworthy for IBRD borrowing and its per capita GNI reaches or exceeds the threshold for IDA eligibility for 3 consecutive years.

- **Income Graduation threshold** – eligible countries have increased their GNI per capita so that the average over the past three years is at or above the graduation threshold. The graduation threshold set for the 2015 review was $1,242.[24]
- **Human Development threshold** - The Human Asset Index (HAI) is used to measure a country's level of human development. This index is made up of four equally weighted indicators[25] and countries with a score of 66 or above meet the HAI criteria for graduation.
- **Economic Vulnerability threshold** - The Economic Vulnerability Index (EVI) is used to measure a country's stability both in terms of the degree to which they are exposed to stress and the potential impact from trade and natural shocks.[26] Countries with an Economic Vulnerability Index of 32 or less meet the level set for graduation for this threshold.

In the LDC review of 2015 Bangladesh scored 25.1 for the Economic Vulnerability Index (EVI), 63.8 for the Human Asset Index (HAI) and had a 3-year average GNI per capita of $926 for the period FY11 to FY13.[27] Bangladesh met only one of the three graduation thresholds - EVI - and will need to wait until 2018 before it can be assessed again for graduation.

Table 10: Decomposing the LDC assessment for Bangladesh

Index	Graduation Threshold	Value	Met/Unmet
GNI per capita	An average of at least $1,242 in the period 2011 to 2013	926	Unmet
Economic Vulnerability Index	32 or below	25.1	Met
Exposure Index		22.7	
Shock Index		27.5	
Human Asset Index	66 or above	63.8	Unmet

- **GNI per capita threshold** - Bangladesh is still some way from meeting this threshold. In the years FY14 to FY16, Bangladesh would need to achieve an average GNI per capita of at least $1,242. With FY14 GNI per capita at $1,080, Bangladesh would likely need to surpass the $1,242 threshold in both FY15 and FY16 to bring the average up to the new higher threshold set for 2018. Assuming that the income threshold remains unchanged, Bangladesh would therefore need to surpass recent levels of income growth to achieve this goal in 2018. 2021 seems more likely and if Bangladesh is able to meet the thresholds set for the Economic Vulnerability Index and Human Asset Index it will have more time to meet the income per capita threshold.

24 This is 20% higher than the inclusion threshold of $1,035.

25 Percentage of the population under-nourished, the mortality rate of for children aged 5 years or under, the gross secondary school enrolment ratio and the adult literacy rate

26 For a country's exposure to stress, the EVI takes in to account the country's size, its location, its economic structure and other environmental factors. For the potential impact of a shock, the EVI takes into account the country's trade openness as well as past impacts from natural shocks measured by the number of victims in past events and degree of resilience in agricultural production.

27 Using the World Bank Atlas methodology for calculating GNI per capita.

- **HAI threshold** - Having already met the graduation criteria for economic vulnerability, Bangladesh still has a chance of being recommended for graduation in 2018 if it is able to sustain its performance on economic vulnerability and improve human development. Table 10 shows that in the 2015 review Bangladesh was close to meeting the graduation threshold set for the HAI. As Table 11 and Table 12 show, Bangladesh needs to address human development shortfalls in the areas of adult literacy, the secondary school enrolment rate and nutrition if it is to comfortably meet the HAI threshold in 2018.

Table 11: Comparing Bangladesh HAI to regional comparators

	Bangladesh	India	Nepal	Sri Lanka	Pakistan
Human Asset Index	63.8	68.1	68.7	88.7	49.4
Nutrition	16.7	15.2	13	24.6	21.7
Infant Mortality	41	53	40	10	86
Literacy	58.8	62.8	57.4	91.2	54.7
Secondary school enrolment	53.6	68.5	66.6	99.3	38.3
GNI p.c.	926	1,426	695	2,811	1,222

Table 12: Bangladesh's performance on selected MDG indicators most closely associated with the HAI

	Latest data	Target (%)	2013 Status
Prevalence of under nourishment in total population (% of pop.)	19.5% (HIES 2005)	Below 14	Lack of data but 2015 assessment indicates goal has not been met.
Under 5 mortality (per 1,000)	44	Below 48	Goal met
Adult literacy rate (% of pop.)	58.8	100	Needs attention

Preparing for graduation...

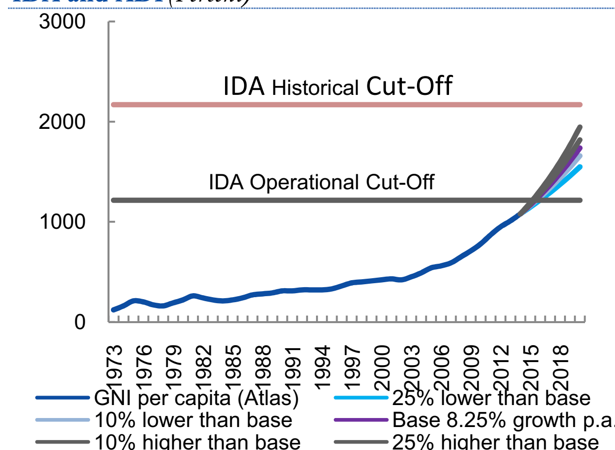
Having already met and surpassed the graduation threshold for the EVI in 2015 the objective for Bangladesh will be to sustain this performance. If Bangladesh can improve on this score in 2018, it is likely that this will be sufficient to pass the threshold. This would definitely be the case if the threshold of the EVI decreased by the same amount between the 2012 and 2015 reviews (36 to 32 respectively).

... fromIDA and ADF?

There are two thresholds relevant to IDA and ADF graduation – income and creditworthiness. Graduation is not mechanistic and relies on careful case-by-case evaluations. The eligibility and graduation criteria are constructed around the concept of relative poverty, as measured by GNI per capita below the IDA operational cut-off and the absence of creditworthiness. Countries typically move from IDA-only, to IDA-gap to IDA-blend and then to IBRD-only. Similar to the threshold set for middle income status, graduation proceedings are set in motion when an IDA or ADF beneficiary (including blend countries) GNI per capita exceeds the threshold. This has been set at $1,215 for FY15.

Figure 14 shows potential trajectories for Bangladesh's GNI per capita. Over the past decade the growth rate of GNI per capita has averaged 11 percent. On the assumption that the threshold increases by the same annual amount that it has increased each year in the past 3 years ($20), Figure 3 shows that Bangladesh would pass this threshold in 2016. This is necessary but not sufficient for graduation.

Figure 14: GNI per capita graduation scenarios for IDA and ADF*(Percent)*



A positive assessment of IBRD creditworthiness is required to reclassify a country from IDA-only to blend status (IDA/IBRD). Once a country has been declared creditworthy for IBRD, IBRD financing is phased in gradually. The assessment of creditworthiness is based on a rigorous evaluation of eight broad components, namely political risk, total external debt and liquidity, fiscal policy and public debt burden, balance of payment risks, economic structure and growth prospects, monetary and exchange rate policy, financial sector risks, and corporate sector debt. The second criterion relevant to graduation is the level of Bangladesh's creditworthiness. Since the ADB assesses Bangladesh to be a blend country, the ADB finds Bangladesh as having the capacity to take on ADB debt on regular ADB/OCR terms.

.....from LDC status

Table 13: GNI per capita scenarios for Bangladesh

GNI Growth (%)	Growth Scenario relative to baseline	2015 FY11-13	2018 FY14-16	2021 FY17-19	2024 FY20-22
8.25	25% lower	926	1,157	1,417	1,734
9.9	10% lower	926	1,176	1,506	1,929
11	Baseline (decade average)	926	1,188	1,568	2,070
12.1	10% higher	926	1,201	1,632	2,219
13.75	25% higher	926	1,220	1,732	2,461
Threshold	**$50 increase**	**1,242**	**1,292**	**1,342**	**1,392**

Income thresholds

For graduating LDC status, it is a country's 3-year average income performance that is important. For the 2015 review the GNI per capita threshold was set at $1,242. Since 2006, the graduation threshold has increased but at a progressively smaller

amount.[28] Bangladesh is unlikely to meet the income threshold for LDC graduation until 2021 (Table -13)

Human Development

Bangladesh has met the Millennium Development Goal indicator for under 5 mortality, but has some way to go on making sufficient progress on nutrition, adult literacy and secondary school enrolment to improve its HAI score. Some of these indicators are more slow-moving than others (for example, adult literacy). However, Bangladesh may be able to make faster progress on secondary school enrolment and nutrition.

In the absence of the individual scores associated with the four indicators which make up the HAI, it is only possible to infer from the performance of comparators (or now somewhat dated MDG assessment) what more Bangladesh needs to do in each of these three areas. Graduation, however, is not mechanical. It is preceded by detailed impact assessment and vulnerability profile. The views of the country are also taken into consideration.

Policies to sustain growing income for Bangladeshis

Over the time period of these graduations, the Bangladesh economy will evolve. In the three forthcoming graduations there exist in-built transition mechanisms to facilitate Bangladesh's smooth and sustained exit. However, these transition measures alone are not enough and the GoB, civil society and donors will have a role to play to help shape the economic structure of Bangladesh allowing it to replace existing channels of concessional finance and trade support with sustainable alternative sources of finance. The direct effects of these graduations will be felt in terms of aid flows, trade flows, debt and debt-servicing costs, institutional contributions and other forms of technical assistance. Bangladesh has already highlighted the way forward through investment-led growth in its Seventh Five Year Plan. Currently the investment rate is below what is needed to increase growth to 8 percent by the end of the Plan period. Its strategy for increasing public, private and foreign investment in Bangladesh is ambitious. Achieving this higher level of ambition would require modernizing the country's *infrastructure*; increasing the availability and affordability of *energy*; and boosting the country's overall *competitiveness*.

[28] In 2006 the GNI per capita threshold was set at $900. This increased to $1,086 in 2009 and $1,190 in 2012.

Appendix

Appendix: Table : Bangladesh Macroeconomic Indicators

Description	FY08	FY09	FY10	FY11	FY12	FY13	FY14	FY15
Growth Rates (%)								
GDP Growth	6.0	5.0	5.6	6.5	6.5	6.0	6.1	6.6
GDP Growth Per Capita	4.9	3.9	4.4	5.3	5.3	4.8	4.8	5.4
Per Capita GDP (current US$)	618	684	760	838	859	955	1087	1212
Per Capita GNI (current US$)	666	738	822	905	932	1032	1159	1291
Per Capita GNI Atlas Method (US$)	650	710	780	870	950	1010	1080	1190
Inflation (%)								
Rate of Inflation (CPI, %) (year on year)**	12.3	7.6	6.8	10.9	8.7	6.8	7.3	6.4
Inflation (GDP deflator)	7.9	6.8	7.1	7.9	8.2	7.2	5.7	5.8
Saving & Investment (% of GDP)								
Gross Domestic Saving	19.2	20.3	20.8	20.6	21.2	22.0	22.1	22.2
Gross National Saving	27.8	28.6	29.4	28.9	29.9	30.5	29.2	29.0
Private Investment	21.7	21.9	21.6	22.2	22.5	21.7	22.0	22.1
Public Investment	4.5	4.3	4.7	5.3	5.8	6.6	6.6	6.8
Central Govt. Budget (% of GDP)								
Total Revenue	9.9	9.1	9.5	10.1	10.8	10.7	10.4	9.6
Total Expenditure	13.0	12.5	12.7	13.9	14.2	14.6	14.0	13.8
Overall Budget Deficit	3.2	3.4	3.2	3.8	3.4	3.9	3.5	4.2
Total Public Debt	40.7	39.6	37.3	38.3	37.4	35.8	35.3	34.6
Balance of Payments (% of GDP)								
Trade	36.7	35.0	32.6	41.2	43.0	40.1	38.4	36.6
Exports	15.4	15.2	14.1	17.6	18.0	17.7	17.2	15.8
Imports	21.3	19.8	18.6	23.6	25.0	22.4	21.2	20.8
Services & Income (net)	-2.7	-3.0	-2.4	-3.0	-3.4	-3.7	-3.9	-3.9
Current Transfers	9.3	10.0	10.1	9.7	10.06	9.95	8.64	8.14
Current Account Balance (including transfers)	0.7	2.4	3.2	0.7	-0.3	1.6	0.8	-0.8
External Indicators								
Total Debt as % of GDP	40.7	39.6	37.3	38.3	37.4	35.8	35.3	34.6
External Debt (US$ b.)	21.0	23.0	22.4	25.4	25.5	25.4	30.4	32.6
Ext. Debt as % of GDP	22.9	22.4	19.4	19.7	19.1	16.9	17.6	16.7
BB Gross Reserves (US$ b.) (end of period)	6.2	7.5	10.75	10.9	10.3	15.3	21.3	25.0
BB Gross Reserves (in months of imports)	3.4	3.7	5.4	3.9	3.3	5.5	5.8	6.2
Money and Credit								
M2 Growth (%, year-on-year)	17.6	19.2	22.4	21.3	17.4	16.7	16.1	12.4
Net Domestic Asset Growth (%, year-on-year)	18.1	17.8	19.1	25.0	18.5	11.8	10.3	10.7
Ratio of Private Sector Credit to GDP (%)	30.2	30.9	33.9	37.2	38.7	37.7	37.8	37.9
Exchange Rate								
Nominal Period Average (TK/US$)	68.6	68.8	69.2	71.2	79.1	79.9	77.7	77.7
Nominal End of Period (TK/US$)	68.5	69.0	69.5	74.2	81.8	77.8	77.6	77.8
Real Effective Exchange Rate-REER Index, 2000-01=100 (8 Currency Basket)	86.0	91.3	97.7	89.4	91.4	94.1	104.6	111.9
Memorandum Items								
GDP at Current. Prices (Taka bill.)	6,287	7,051	7,975	9,158	10,552	11,989	13,437	15,158
GNI at Current. Prices (Taka bill)	6,771	7,610	8,621	9,883	11,445	12,954	14,332	16,142
GNI at Current. Prices Atlas Method (US$ bill)	96.0	106.1	118.3	133.5	146.8	158.3	171.3	194.4
GDP at Current. Prices (US$ bill)	91.6	102.5	115.3	128.6	133.4	150.05	172.9	195.2
GNI at Current Prices (US$ bill)	98.7	110.6	124.6	138.8	144.7	162.12	184.4	207.2
Population (mill.)*	148.3	149.9	151.6	153.4	155.3	157.2	159.1	161.0
Human Development Index (value)	*0.515*	*0.463*	*0.494*	*0.549*	*0.554*	0.558	0.570	

Source: Bangladesh Bureau of Statistics, Bangladesh Bank, Ministry of Finance, The World Bank and IMF
* Population data is from DECPG.

Appendix: Table: Bangladesh Current Macro Economic Indicators

	FY13	FY14	FY15	FY16 (estimated[1])	FY16 (July-Mar)	FY15 (July- Mar)
GDP Growth (%)	6.01	6.06	6.55	7.05	..	..
Inflation	6.8	7.3	6.4	6.6	6.1	6.5
Export Growth (%)	11.2	11.7	3.4	8.5	9.0	3.0
Import Growth (%)	0.8	8.9	11.3	12.0	*6.4	*1.3
Remittance Growth (%)	12.6	-1.6	7.7	5.0	-1.8	7.3
Reserves (Months of Import)	5.5	5.8	6.2	6.8	6.8	5.9
Exchange Rate (Taka per Dollar)	79.9	77.7	77.7	78.2	78.5	77.8
Total Revenue (% of GDP)	10.7	10.5	9.6	10.2	..	..
o/w Tax (% of GDP)	9.00	8.6	8.5	8.7	..	..
Total Expenditure (% of GDP)	14.6	14.0	13.8	14.8	..	..
o/w Current Exp. (% of GDP)	8.3	8.2	7.9	8.9	..	..
o/w Subsidies (% of GDP)	2.7	1.6	1.4	1.1	..	..
ADP (% of GDP)	4.2	4.1	4.3	4.7	2.3	2.3
Fiscal Deficit (% of GDP)	3.9	3.5	4.2	4.6	..	..
NBR Revenue Growth (%)	14.8	10.7	13.2	6.1	*14.4	*16.2
ADP Utilization (% of ADP allocation)	95.5	94.6	91.4	84.5	41.1	43.8
M2 Growth (%)	16.7	16.1	12.4	13.5	*13.1	*12.8
Growth of Credit to Public Sector (%)	19.7	6.7	-6.2	0.3	*-6.5	*-0.5
Growth of Credit to Private Sector (%)	10.8	12.3	13.2	14.7	*15.1	*13.6

[1]Estimations are based on IMF, World Bank and government estimates

*until February of relevant fiscal year
Base Year 2005/06
All growth rates are year-on-year

Source: Bangladesh Bank, Bangladesh Bureau of Statistics, Export Promotion Bureau, IMF and WB staff estimate

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