Independent Review of Bangladesh's Development (IRBD)

বাংলাদেশের উন্নয়নের স্বাধীন পর্যালোচনা

State of the Bangladesh Economy in FY2015-16

Third Reading

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CENTRE FOR POLICY DIALOGUE (CPD)
BANGLADESH
a civil society think tank

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Independent Review of IRBD Bangladesh's Development

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The CPD team is grateful to all the participants at the consultation on 4 May 2016 for sharing their views, insights and comments on the study

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The CPD IRBD 2016 Team would like to register its sincere gratitude to *Professor Rehman Sobhan*, Chairman, CPD for his advice and guidance in preparing this report

Section I: Introduction

- In the face of formidable challenges, the Bangladesh economy continued to show signs of resilience throughout the FY16 period
- Economic stability was maintained thanks to falling inflation, contained budget deficit, impressive export growth, rising foreign direct investment, increasing foreign exchange reserves and private sector credit growth
- However, stagnating private investment, decline in agricultural growth, weak banking sector performance and low efficiency of development spending continue to nag the economy
  - ➢ National budget implementation concerns remain as revenue collection and public expenditure are projected to fall short of target and many infrastructural policy initiatives are yet to gain momentum

Section I: Introduction

- Sustainable and inclusive economic growth must be prioritised through greater resource mobilisation and efficacy of resource use
  - ➢ Improved public sector funding, strengthening of financial regulation and supervision, institutionalised loan recovery framework, further stimulation of private sector credit growth, and reforms to government regulation and auditing remain key objectives
- The report presents a detailed snapshot of the current state of the economy, segmented into sectional discussion on GDP growth and private investment, fiscal and budgetary framework, financial and monetary sector performance, the external sector, recent crop sector dynamics, and labour market performance

Section II: The Curious Relationship between Private Investment and GDP Growth

Sources of Growth

- Bangladesh's economic growth over the last several years has been impressive
  - However, it is important to identify the sources of growth in order to understand how sustainable this growth will be
- Economic growth originates from two sources:
  - a) Factor accumulation and b) Factor productivity
  - Over the last 24 years the growth of both physical and human capital of Bangladesh has been higher compared to that in India
  - For Bangladesh, growth of efficiency of input utilisation had a negative average over the period 1991-2014

Real GDP growth of economies from 2010-2014

	2010	2011	2012	2013	2014	Average
World	4.1	2.8	2.2	2.3	2.5	2.7
Developing economies excl. LDCs	7.8	5.8	4.7	4.6	4.3	5.3
LDCs	6.0	3.9	4.1	5.5	5.1	4.9
Bangladesh	6.1	6.5	6.5	6.0	6.2	6.3

Source: Author's compilation from UNCTADSTAT.

Section II: The Curious Relationship between Private Investment and GDP Growth

- If Bangladesh were to efficiently use the physical and human capital inputs over the years at the same level as India, the average annual growth rate would have been approximately 7% instead of the actual 5.32% over the period 1991-2014
  - ➢ The GDP per capita of Bangladesh would have been USD 1,568 in 2014, compared to the actual figure of USD 1,087 in 2014
- The total loss from the relative inefficiency has been approximately USD 607 billion (at 2014 prices) over the period 1991-2014
- This calls for necessary changes in national policies
  - ➢ Increasing FDI, improvement of ICT infrastructure, institutional improvements, greater efficiency of public expenditure, amongst others

Comparison of Per Capita GDP: Bangladesh and India (Constant 2014 USD)

Country/Ratio	1990	1995	2000	2005	2010	2014
India	515.61	598.53	733.19	934.34	1294.88	1581.51
Bangladesh (Actual)	470.75	525.69	600.36	706.51	894.24	1086.81
Bangladesh (with India's level of productivity)	470.75	554.75	692.50	880.31	1257.23	1568.03
Ratio of India-Bangladesh (Actual)	1.10	1.14	1.22	1.32	1.45	1.46
Ratio of India-Bangladesh (with same level of productivity)	1.10	1.08	1.06	1.06	1.03	1.01

Section II: The Curious Relationship between Private Investment and GDP Growth

Investment Trend

- Private investment is 21.78% of GDP during FY16 – fell by 0.3 point
  - Public investment experienced higher growth, led to higher total investment-GDP ratio
- Share of outstanding to LSI, MSI and SSCI in total advances decelerated
  - Sluggish investment in the manufacturing but advances in services continued - rising role of services in the growth of the GDP
- Large industries decide the trend in industrial term loan growth
  - LSI accounts major share in industrial term loan disbursement (75.6%)
  - A rise in term loan for LSIs in Q2 FY16, but lower than that of Q2 FY15
  - SSIs registered significantly higher growth - 70.8% and 59.4% in Q1 and Q2 of FY16
- Targeted initiatives helped to increase SME credit disbursement over the last several years
  - Lack of customised financial products and services in response to the demand of cluster-based industries have undermined availability and access to SME credit
  - Monitoring requires whether targeted activities correspond to the demands of the SME entrepreneurs

Agriculture and Non-farm Credit

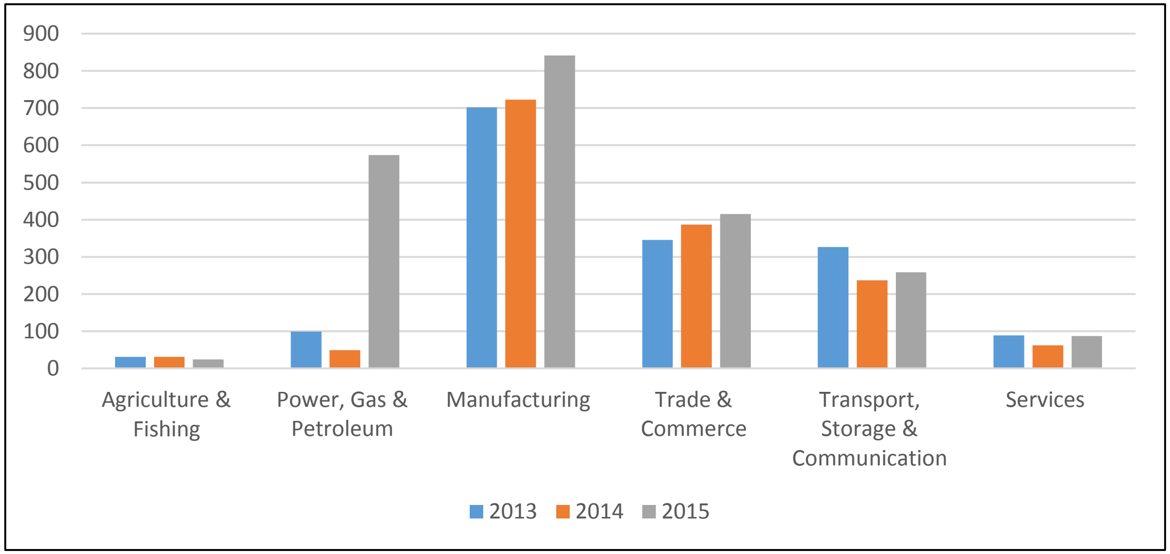
- Credit to agriculture and non-farm activities maintained a moderate growth
  - Agriculture credit has increased consistently, but growth of non-farm credit could not keep up the pace
- Sluggish growth in disbursement in FY15 has partly contributed to this year's moderate rise
- Special efforts should be taken by the central bank to reduce commercial bank's lending interest rate for agricultural credit
- Concerning agricultural price and profitability, CPD (2015) suggested that an '*Agriculture Price Commission*' be set up to identify measures to address the concerns

Foreign Direct Investment

- FDI has registered a considerable growth during 2015 (Jan-Dec)
  - Inward flow of FDI has crossed the USD 2 billion mark in 2015 (USD 2.24 billion)
  - 44% higher than 2014, 27.2% higher during July-February FY16

Section II: The Curious Relationship between Private Investment and GDP Growth

- FDI flow in recent years was directed more to manufacturing and trade and commerce related activities
  - ➢ A positive trend for creating more job opportunities for professionals and skilled workers
- Significant jump in FDI inflow in power, gas and petroleum sectors in 2015 transmitted a positive signal to the gas-starved energy sector
  - ➢ It is expected to go for exploration of new gas fields
- A large part of recent FDIs are actually reinvestment by existing companies
  - ➢ Perhaps indicative of the growing confidence of foreign firms to continue doing business in Bangladesh
- Deceleration in equity capital is indicative of the continuing hesitance on the part of new investors to invest
- Both number and amount of investment have registered a rise during Jan to Mar, 2016– according to BoI



Section II: The Curious Relationship between Private Investment and GDP Growth

Declining Role of Private Investment in GDP Growth

- Rising contribution of services sector in GDP growth; originated in sub-sectors which are relatively less capital-intensive in nature (e.g. public administration, education)
  - ➢ Sluggish growth in investment in the manufacturing sector
  - ➢ Lack of adequate infrastructural facilities including supply of quality electricity and gas
  - ➢ Relatively high rate of interest and slow global recovery
- Wearing apparels and textiles sub-sectors account for the major share (48.3%) of manufacturing sector
  - ➢ Proxy variables tend to indicate that new investment in the apparels sector has been rather slow
- The role of private investment in GDP growth is becoming rather weak;
  - ➢ Given the nature of service sector led GDP growth, an account of mainly public sector services, with sluggish growth in investment in the manufacturing sector

Section II: The Curious Relationship between Private Investment and GDP Growth

Law and Order Situation and Private Investment

- A panel regression exercise covering 65 developing countries (screened on the basis of data availability) was carried out to identify the determinants of private investment (based on data from 2006-2014)

- It was found that-
  - By achieving the law and order situation similar to Sri Lanka, private investment in Bangladesh would rise by up to 33 %
  - If the law and order situation was same as that of India, private investment would more than double

- Thus, rule of law emerges as a very significant factor in driving private investment, which in turn is quite crucial for ensuring high growth

Factors Affecting Private Investment in Bangladesh

- According to CPD's Perception Survey 2016, entrepreneurs have demanded changes, amendments in different policies, Acts and rules and regulations-
  - Higher demand for amendment in rules and regulations and reforms of related institutions
  - Changes in fiscal policies (tax and VAT)
  - Improvement in governance, transparency and accountability
  - Improvement in infrastructure
  - Reforming public services and judicial system
  - Improving public procurement system
  - Proper zoning of land and establishment of special economic zones across the country

Section III: Formulating Fiscal and Budgetary Measures for FY17

Revenue Mobilisation

- Following a meeting of the BMRC, it was indicated that the revenue target for FY16 was to be slashed by about Tk. 31,443 crore (including Tk. 26,370 crore for NBR) in the revised budget
- This drastic revision was inevitable as during the first six months of FY16, total revenue collection could attain a growth rate of 15.8% (BFY16 Target: 42.8%)
- Year-end revenue collection in FY16 was likely to be about Tk. 6,500 crore less than the revised target for FY16 (CPD estimation)
- NBR had put in an extra effort to infuse momentum in revenue collection in the last two quarters of FY16
- NBR revenue growth was 15.9% during July-March of FY16 (14.9% in FY15)
- There are indications that for FY17, the revenue growth target may be set at 37.3% over the revised target for FY16
    - ➢ The actual growth target for FY17 (accounting for the possible shortfall over the revised target) may increase beyond the 40% threshold
- Concerns relating to small tax base, low tax compliance and tax evasion have plagued revenue mobilisation in Bangladesh

Amendments/Implementation of VAT and SD Act

- The new VAT and SD Act 2012 is to come into force on 1 July 2016 with a uniform rate of 15% for almost all goods and services
- The Act envisages a number of significant changes including abolition of the truncated rates
  - ➢ Applying a universal rate on these items (at least 20) will see a drastic rise in applicable tax, and hence, prices of these services
  - ➢ With the new Act being implemented without any amendments, electricity bill of a consumer (for equivalent amount of usage) will increase from 1 July 2016 by about 9.5%
- The new Act will introduce an integrated online system for VAT registration, return submission, refund and payment. No preparatory work has been done as yet
- The NBR-FBCCI joint committee have proposed some other amendments some of which are crucially important. These include:
  - ➢ Imposing a 4% VAT on supply value of services sector
  - ➢ Differential treatment for bargaining shops
  - ➢ Reduced VAT on a number of commodities including iron and steel

If it demands, a 2-3 years plan may be developed to implement this Act in a realistic and staggered manner

Section III: Formulating Fiscal and Budgetary Measures for FY17

Reform in Advance Income Tax (AIT) Collection System

- Currently, there exists no formal registration system exists for AIT withholding entities with the NBR
- Bangladesh can follow the footsteps of the Indian tax system for AIT
  - For a TDS/TCS returns, an individual needs to quote Tax Deduction and Collection Account Number (TAN) which can be applied through "Form No. 49B" (under Indian Income Tax Law)
  - The TIN facilitation centres are responsible for receipt of e-TDS returns
  - The TAN is required for all TDS/TCS returns, all TDS/TCS payment challans and certificates that are issued
  - The tax collected must be submitted to the Income Tax Department's account
  - If the amount paid as advance tax is 10% higher than the total tax liability, there is scope for a refund at 6% on the excess amount
  - A penalty of Rs. 10,000 is applicable for the failure to apply for TAN or not quoting TAN in the specified TDS/TCS documents

Section III: Formulating Fiscal and Budgetary Measures for FY17

Introduction of Benami Property Bill

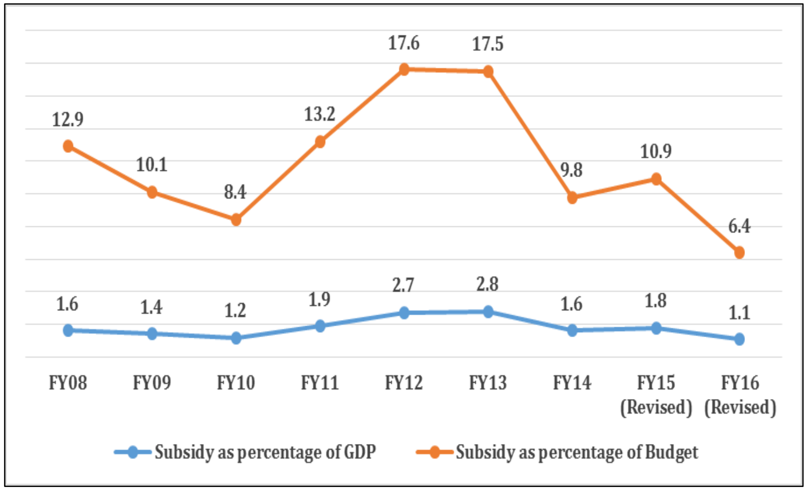
- Bangladesh has rising underground economy in addition to high tax avoidance, high illicit financial flow and corruption
- Special tax treatment provisions for investments in real estate and government treasury bonds and income generating sectors should be removed
- Benami Transactions (Prohibition) Act, 1988 has been enforced in India, which GoB may follow
    - ➢ Targets the real estate sector (gold and company stocks included) where individuals hold black money in the form of benami property and generate black money through domestic means
    - ➢ Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 has also been enacted targeting financial wealth stashed abroad by resident Indians
- In Bangladesh, prohibition of benami transactions is mentioned in Land Reforms Ordinance 1984, but not sufficient enough to tackle such activities
- The Law Ministry and Parliament Standing Committee should address for the introduction of such a bill to restrain the black money economy

The Transfer Pricing Cell should be strengthened to reduce illicit financial flows

Public expenditure framework needs to be redesigned to make effective use of the policy space in FY17

- Growth of public expenditure in early months of FY16 was well below the target
  - ‘Subsidies and Current Transfers’ and ‘Interest Payments’ were well within the limit
  - Tk. 1,200 crore was spent for recapitalisation of the SCBs (BFY16: Tk. 5,000 crore). Tk. 2,600 crore has been sought by Basic Bank for FY17
- Lower subsidy demand will provide fiscal space in the next fiscal year
  - Subsidies are set to be cut by 26% in the revised budget for FY16 thanks to the fall in fuel and fertiliser prices in the international market
  - BPC moved to the profit terrain in FY15 and continued earning profit in FY16 (drastic fall in international oil prices)

Subsidy as percentage of GDP and Budget



Recent administered price adjustment of petroleum products

- The government has stayed away from downward adjustments of administered prices of petroleum products in the domestic market for a long time to allow the BPC to repay its loans and recoup the losses it had incurred between FY00-FY15
- In April, the government went for cautious reduction in prices of major petroleum products, ranging from 4.4% to 10.4%, around two years after the start of global oil slump
  - ➢ It failed to generate any pass-through as it was not reflected in price of transport service (reduction of only 3 paisa/km)
  - ➢ Agriculture famers were not able to get benefits from this reduction in the Boro season
  - ➢ Kerosene, used by around 10% of poor households of Bangladesh as a source of fuel and lighting, has seen a reduction of price of only Tk. 3 which is not rational
  - ➢ Diesel price was reduced similar to kerosene which will lead to higher subsidy demand for power in the upcoming budget
  - ➢ On the one hand, revenue is generated from BPC, while on the other hand, subsidy as % of GDP was likely to rise. An option is to increase, price of electricity
- Government should clearly specify the future phases of fuel price

Section III: Formulating Fiscal and Budgetary Measures for FY17

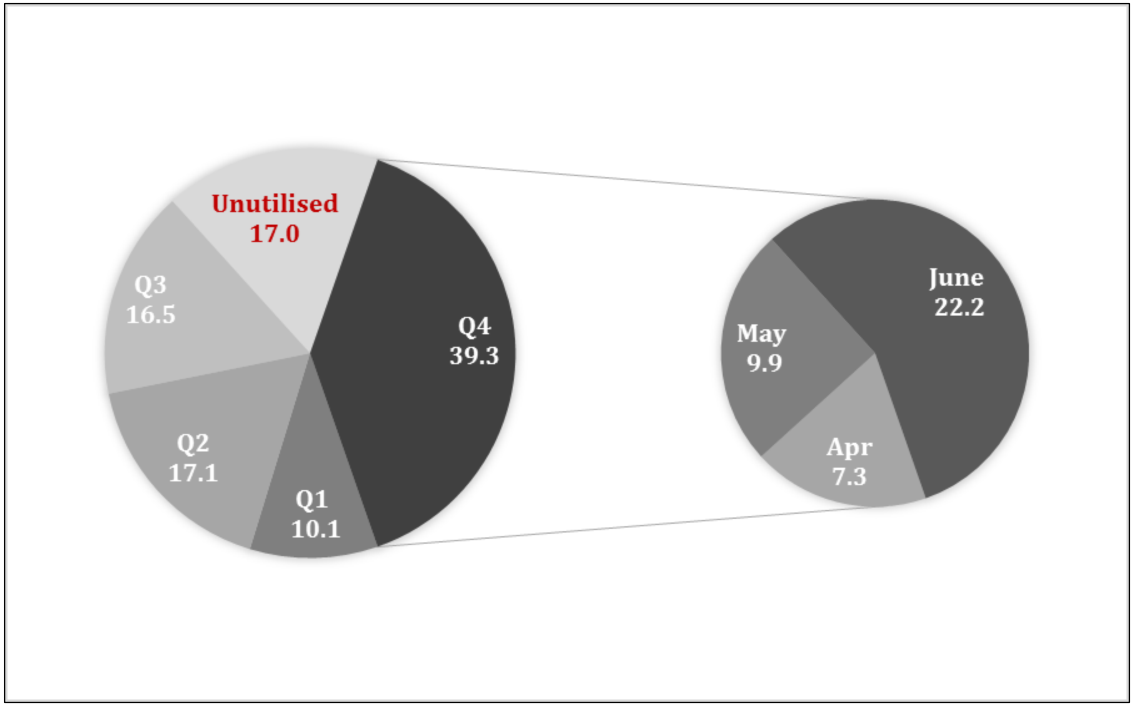
Emphasise allocation for social sectors and to implement National Social Security Strategy (NSSS) targets

- Bangladesh is ranked **155th out of 161** countries and **189 out of 190** countries as regards its public spending (as % of GDP) on education and health respectively
- Social sectors and social security programmes are not getting enough allocation in the budget - even lower than NSSS targets
- Recently, after a meeting with the Finance Minister, it was agreed to raise the coverage of 18 programmes under the SSNP for FY17 which is likely to raise the per month allocation of several major SSNPs, but will still be short of NSSS targets
- Allowance for Old Age Scheme was Tk. 1,440 crore in FY16 and is set to be Tk. 1,890 crore in FY17
  - ➢ In contrast, the NSSS targets are Tk. 2,010 crore, 3,530 crore and 3,740 crore for FY16, FY17 and FY18 respectively
- NSSS targets is to distribute Tk. 500 per month to the beneficiaries under the Old Age Scheme is likely to be Tk. 500 in FY17
- These SSNPs are also inadequate from the coverage point of view

ADP expenditure, against allocation, is the lowest in recent years

- 46.5 % of original ADP was spent during Jul-Apr of FY16 - lowest since FY09
- ADP was slashed by Tk. 6,000 crore (or 6.6%) to Tk. 91,000 crore
- Allocation was slashed for number of sectors (e.g. Agriculture, Oil, Gas and Natural Resources, Transport, Health) due to slow rate of implementation
- Chronic problem of low utilisation of allocation for Q1-Q3 of the fiscal year

Quarterly pattern of ADP implementation (10 years average) as against original allocation



The 'fast track' projects are not fast enough

Only 4 out of these 8 'fast track' projects are making visible progress. 2 new projects included. Remaining projects are still at their pre-execution phase

- The **PMB** project made 34% financial and 31% physical progress up to March 2015
  - Only 5% financial and 7% physical progress were made during Jul-Mar of FY16
- **DMRTDP** project attained 3.3% financial progress up to March 2016
  - Only 1.6% progress could be made during the first nine months of FY16
- **RNPP** project attained 79.3% cumulative progress up to November 2015
  - Only 0.1% could be added to the cumulative progress in the first five months of FY16
- **MUSCCFPP** attained only 0.9% cumulative progress up to November 2015
- Based on the initial cost, the newly included fast track project '**Dohazari Ramu Gundam Rail Track project**' (meter gauge) up to November 2015 was 16.9% and was already well behind deadline before being upgraded into dual gauge

Section III: Formulating Fiscal and Budgetary Measures for FY17

- CPD selected a set of **26 projects** under the ADP for FY15 for close scrutiny (share of these projects in ADP for FY16 was 17.6%)
- 14 of these 26 projects were supposed to be completed in FY15 (or even earlier)
  - 13 projects were carried forward to the ADP for FY16
- The 25 priority projects registered below average growth (39.9%) in Jul-Mar FY16
  - 23 out of these 25 projects experienced time extension in RADP of FY16
- Only 4 projects were closer to being completed by FY16
  - 3 out of these 4 projects had below than average progress in Jul-Mar FY16
  - 3 out of these 4 projects were already in the 'carryover' list
- 10 of these 25 projects were supposed to be completed in FY16 as per timeline
  - Only Tk. 3,116 crore was earmarked for these projects in RADP for FY16 (Tk. 8,771 crore was needed for timely completion)
- As per the revised allocation in FY16, at least 4 projects should be completed
  - They also have a poor implementation rate and need a 'final push'

Cost and time overrun have plagued overall ADP implementation

- Only 14.2% of the total to be completed projects (233) were completed within the stipulated time and planned allocation in FY14 (lowest since FY01)
- 51.1% projects experienced cost overrun which is the highest in last eight years
- A good number of projects in the top five sectors of ADP (65% share in FY16), have seen cost escalation of the projects in RADP FY16
- 6 out of the top 10 power sector projects, which have the potential to add around 4,000 MW in the national grid, faced time extension due to slow pace of implementation
- Cost escalation and time extension can also be observed for classic infrastructure projects

Cost and time overrun of major projects

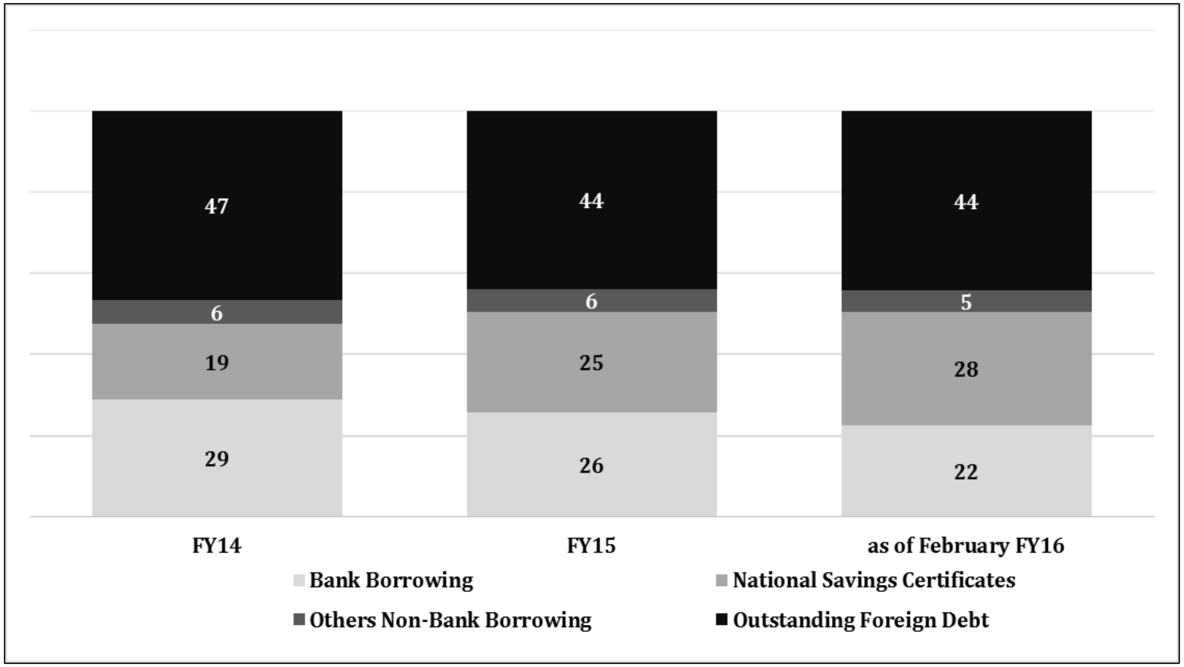
Project Name	Cost (Crore Tk.)			Timeline (Years)		
	Planned	Revised	% Increase	Planned	Revised	% Increase
Padma Multipurpose Bridge	10,162	28,793	183.3	7	10	42.9
Dhaka-Chittagong 4-lane project	2,147	3,817	77.8	9	11	22.2
Joydevpur-Mymensingh Road Improvement Project (JMRIP)	902	1,815	101.2	3	6	100.0

Section III: Formulating Fiscal and Budgetary Measures for FY17

Budget deficit financing needs an optimum mix

- Likewise the last four years, budget deficit was well within the planned limit after six months of FY16
  - ➢ Financing was characterised by low net intake from foreign financing sources as against a heavy reliance on domestic financing sources

Composition of outstanding public debt



- Currently about 56% of the public debt is attributable to domestic source and 44% to foreign finance
  - ➢ Within the domestic source, debt from non-bank sources is increasing, led by outstanding NSD, while declining from bank sources
  - ➢ Debt from domestic sources comes with a relatively high interest rates leading to the rise of overall interest payment burden of the government over the past years

Section III: Formulating Fiscal and Budgetary Measures for FY17

Fiscal and Budgetary Reforms

- Establish a Public Expenditure Review Commission (PERC)
- Formulate appropriate follow up mechanism for monitoring government tax incentives
- Disclose the financial accounts of state-owned enterprises including BPC
- Establish transparency in government's asset acquisition
- Ensure transparency in defense budget
- Bring transparency in local government financing
- Formulate a renewed foreign aid policy in view of the changing dynamics of global aid architecture and debt structure, as Bangladesh is now enlisted in the (lower) middle income country category
- Keep the NGO financing in purview while crafting development financing

Section IV: Financial Sector: Veering Off the Track?

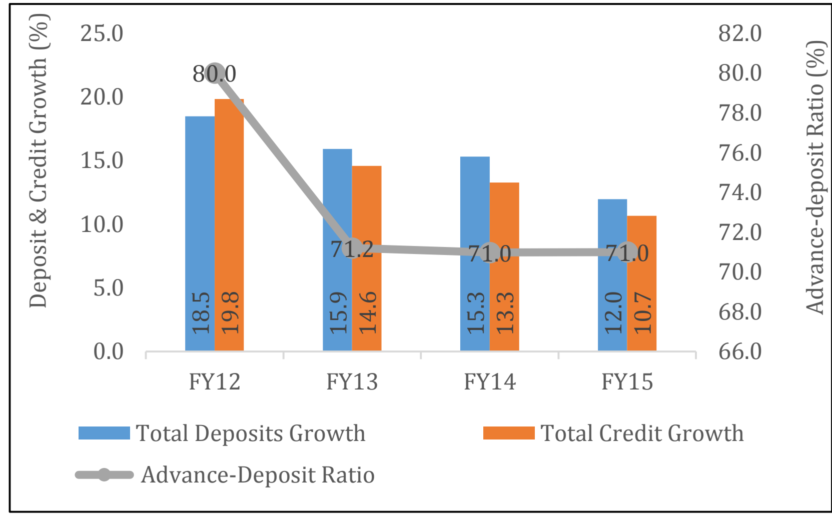
- Sharp fall in the Bangladesh's global ranking in terms of financial market development (from 66 in 2010-11 to 90 in 2015-16)
  - Availability and affordability of financial services, ease of access to loans, soundness, regularly measures guiding the financial sector, state of securities and exchanges performance are experiencing deteriorating trend
- Banking sector is confronted with various types of challenges
  - Slow implementation progress of BASEL III provisions, particularly in SCBs
  - NBFIs are also being confronted with many challenges in such areas as maintaining standards of management, efficient operation and good governance
  - New crisis has emerged in the field of cyber security
- Capital market is yet to gain an image as a reliable investment opportunity
  - Faced with various systemic challenges

Section IV: Financial Sector: Veering Off the Track?

Disbursement of loans and advances of banking sector afflicted by demand side constraints

- ADR has been declining since 2011
- Advances and deposits growth decelerated
- Cash management a growing concern
  - ➢ Excess liquidity has doubled over five years partly influenced by external borrowing
- Lending rate influenced by cash management
- Difference in rates of advances and deposits is relatively low between categories of banks, but much higher in particular category banks
- Spread below 5 % not adhered to by many banks
  - ➢ SBs maintained much lower than the 5 % & FBs significantly higher

Advance-Deposit Ratio and Growth of Deposit and Credit (%)



Type of Bank	Advances		Deposits		Spread	
	Weighted average rate	Differences between highest and lowest rates	Weighted average rate	Differences between highest and lowest rates	Weighted average rate	Differences between highest and lowest rates
SCB	9.93	4.28	6.07	1.64	3.86	4.49
SB	9.48	0.10	7.46	0.92	2.02	1.02
FCB	9.53	7.93	2.19	6.31	7.34	11.97
PCB	11.14	7.58	6.05	6.55	5.09	6.55
All	10.78	10.42	5.92	9.32	4.86	12.05

Section IV: Financial Sector: Veering Off the Track?

Sluggish loans & advances growth has changed the bank asset composition

- Asset growth in the banking sector was 12.2% in 2015, lowest since 2012
- Loans and advances, the predominant component in banks' assets, has seen a decline in share with the share of banks' investment experiencing a rise
- The rise in banks' investment calls for better clarity
  - particularly with respect to the kind of investments have been made
  - the time period and what are the rate of return from these investment etc.
  - significant 'unencumbered approved securities' detrimental impact on profitability

Till March, 2016 total NPL was about Tk.59,411 crore, 9.9 % of total loans

- The NPL has thus crossed the recent peak of December 2014 (9.69 %)
- Measures including appointment of observers had little impact on recent NPL
- NPL is above the average in South Asia and more than double of India and Sri Lanka

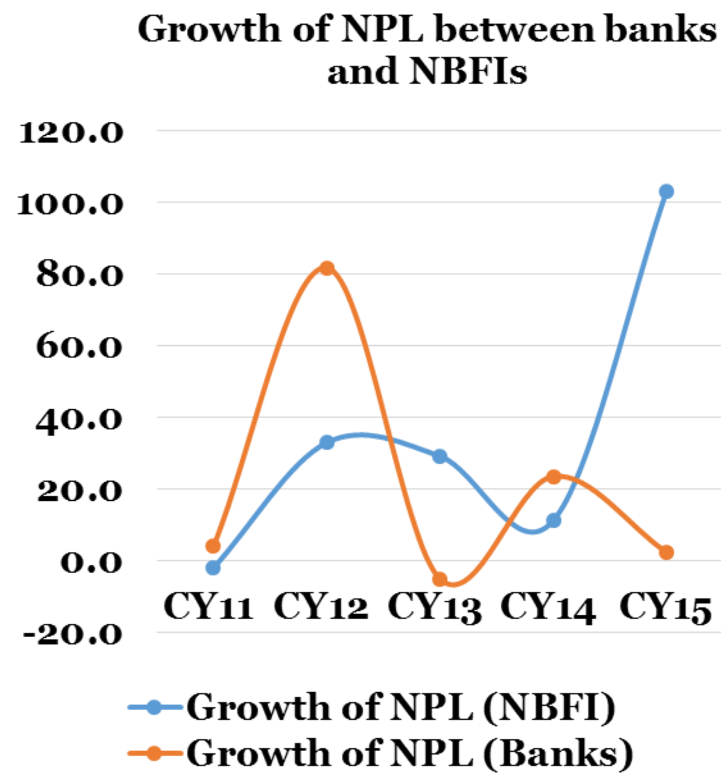
Section IV: Financial Sector: Veering Off the Track?

- As of December 2015, CAR of SCBs 6.4% against the minimum required 10%
  - Both SCBs and DFIs need to undertake energetic efforts to increase the CAR
  - During last three years, government has spent about Tk. 14,477 crore towards recapitalisation
  - This injection evidently had no tangible impact in improving the CAR and operational
  - Stress test indicates that eight banks have failed to meet the minimum requirement of 10%
  - Possibility of three biggest borrowers defaulting likely to make 21 banks non-compliant of maintaining CAR
- RoA & RoE are negative for past several years, both for the SCBs & the DFIs
- Within two years, new banks have expanded their branches by about four times
  - Profitability of most of new banks in 2014 was much lower compared to that of other established banks
  - New banks maintain higher lending and deposit rates compared to the PCB

Section IV: Financial Sector: Veering Off the Track?

Mixed Performance of Non-Bank Financial Institutions (NBFIs)

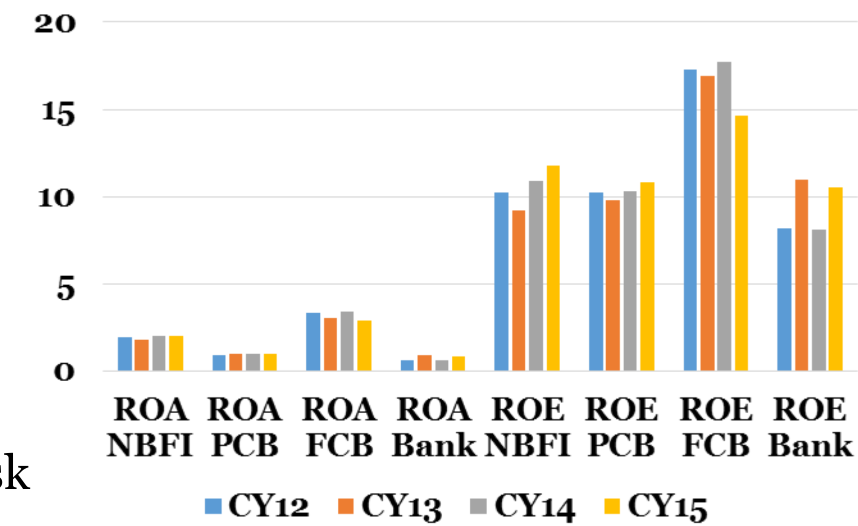
- The advance deposit ratio (ADR) is found to be quite higher compared banks. Growth of loans and leases of NBFIs was better than the growth of loans and advances of banks particularly in 2013 and 2015
- ***NPL of NBFIs is increasing at a higher pace compared to the banks***
  - In December 2015, growth of NPL in NBFIs was about 103 % while it was 2.4% in case of banks
  - In December 2015, the rate of NPL was 8.9 % for NBFIs while it was 8.8, 4.9 and 7.8% in case of banks overall, FCBs and PCBs
  - Disbursing loans to risky ventures like housing, merchant banking and margin loan may contribute to this rise of NPL in NBFIs



Section IV: Financial Sector: Veering Off the Track?

- However, high rate of NPL and high cash in hand raise question as regards the quality of assets
- NBFIs profitability is surprisingly high compared to all banks and similar to PCBs, but lags far behind compared to FCBs
  - ➢ In 2015, ROA of NBFIs was 2 and the ROA of all banks, PCBs and FCBs were 0.8, 1 and 2.9 respectively while the ROE of NBFIs was 11.8 and the ROE of all banks, PCBs and FCBs were 10.5, 10.8 and 14.6 respectively

Profitability of NBFIs and Banks



- NBFIs are in better shape in terms of risk management compared to the banks
  - ➢ It has been near about double compared to that of the banks for the last five years. In December 2015, capital to risk weighted assets for NBFIs was 18.7 % while for the banks this was 10.8 % on average. However, the NBFIs are still far behind the FCBs in this regard

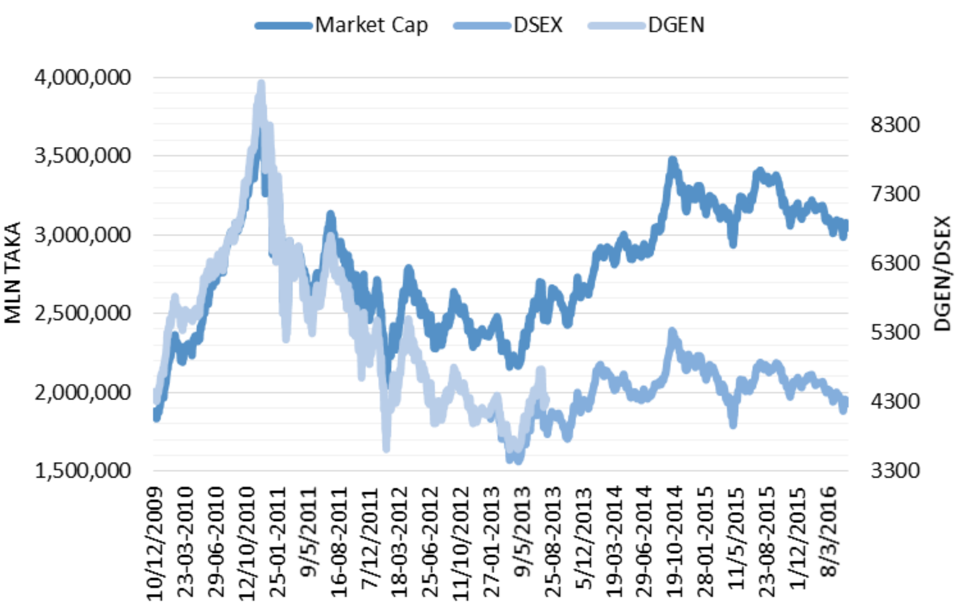
Section IV: Financial Sector: Veering Off the Track?

Despite the various initiatives capital market yet to regain lost momentum

- ➢ Decelerating trend in the associated indices since early June 2015
- ➢ Declining confidence has impacted adversely in daily market turnover
- ➢ A part of this story is explained by sluggish growth of private investment

- Market indices and market capitalisation hover around unchanged levels
- The market has experienced compositional changes in terms of market capitalisation since December 2010
  - ➢ Banking sector, the lions' share to market capitalisation lost its ground
  - ➢ Rising share of other sectors such as pharmaceuticals and telecom

Trend in Market Capitalisation and DGEN/DSEX Indices



Section IV: Financial Sector: Veering Off the Track?

- Investment decision in the secondary market is hardly influenced by P/E
- At present, 291 companies are listed in the capital market
  - ➢ Since the collapse in December 2010, the number of new companies listed was 73
- The depth of the capital market of Bangladesh is still shallow compared to neighbouring countries
  - ➢ Bangladesh's capital market has continued to remain at a melancholic subdued state for the two years
- Lack of strong monitoring and supervision, poor record in terms of enlistment of new companies, significant amount of loans having been invested in 'bad' shares, weak performance of institutional investors who have large amount of bad shares with them – all these have created a 'vicious cycle'

Section IV: Financial Sector: Veering Off the Track?

Banking sector challenges beyond traditional issues in digital era

- Recent heist from Bangladesh Bank's reserves exposed the weaknesses in cyber security and cyber governance concerning the operation of the central bank
  - Whilst SWIFT system was mainly to blame, the Bangladesh Bank and Federal Reserve Bank of New York could not avoid responsibility
- ATM scams of the private banks also showed the weak cyber security of private banks
  - about 70 % banks have no dedicated IT security and risk management department

Conclusion

- To address the attendant problems and identify remedial actions for quite some time CPD has been arguing for setting up of an Independent Financial Sector Reform Commission
  - The proposed banking commission may like to suggest ways to restructure the SCBs including rationalisation of branches, offloading of shares and handing over the SCBs under private management
- Good governance, transparency and accountability should be the watchwords in corrective measures

Export earning

- Export earning growth during Jul-Apr FY16 was 9.2%, (annual target: 7.3%)
  - RMG export growth was 10.1% while non-RMG exports growth was 5.5% - suggests further product concentration
- Export growth in the **US market** has come down to single-digit (9.2%)
  - RMG export growth was 8.2% and non-RMG exports growth was 20%
  - RMG export growth to US was mainly volume-driven (Jul-Feb FY16)
- In the **EU market**, export growth has increased to 8.5%
  - largely due to 17.3% growth in woven export
  - Growth of exports of RMG was price-driven (Jul-Feb FY16)

Price impact of Bangladesh and Vietnam's export growth (%) (Jul15-Feb16)

Country	Knit (61)			Woven (62)		
	Value	Quantity	Price	Value	Quantity	Price
US market						
Bangladesh	22.5	27.4	-3.8	26.7	16.9	8.4
Vietnam	11.4	15.0	-3.1	24.8	9.5	13.9
EU market						
Bangladesh	16.5	5.2	10.8	19.2	2.2	16.6
Vietnam	27.6	2.1	25.0	16.4	0.8	15.4

Section V: External Sector: Performance and Potentials

- A gradual shift from **traditional market (8.7% growth)** to **non-traditional markets (11% growth)** has been observed
- In the non-traditional markets, non-RMG products experienced a 12% growth whilst RMG products registered about 10% growth during July-April FY16
  - Share of non-RMG products in non-traditional markets is about 48%
  - A number of non-RMG products have enormous potentials in both traditional and non-traditional markets
- Export diversification has been identified as a key challenge in the **7FYP**
- The government has identified **12 priority sectors in the Export Policy for 2015-18**
  - These sectors are facing a number of challenges

Section V: External Sector: Performance and Potentials

- Government has separate budgetary allocations to support a number of **potential sectors** – in the form of export subsidy, soft and concessional short-term commercial loans, support from export development fund, export retention quota, import duty exemption on raw materials and other tax incentives etc.
  - In FY16, Tk. 3,500 crore was allocated for export subsidy
  - Currently **14 potential sectors** with over 150 product categories are availing many of these facilities
  - Major sectors are : RMG industries (over 50%), shrimp, leather, ship-building, plastic and jute
- Fiscal incentives should also target **services industry**, so that Bangladesh is able to reap gains from the services waiver facility accorded to the LDCs in the WTO

Import Payments

- During Jul-Mar FY16 import payment growth showed stability reaching 6.5%
  - Nine of the 23 products recorded growth higher than 6.5%
  - Edible oil (57.4%), petroleum products (34.9%), and crude petroleum (15.6%) registered high growths – which were mostly quantity-driven
  - Prices of crude oil and edible oil declined by (-) 44.9% and (-) 9.7% respectively
  - Rice imports have fallen substantially due to imposition of CD and RD
- Growth of investment inducing imports showed signs of improvement during the third quarter of FY16

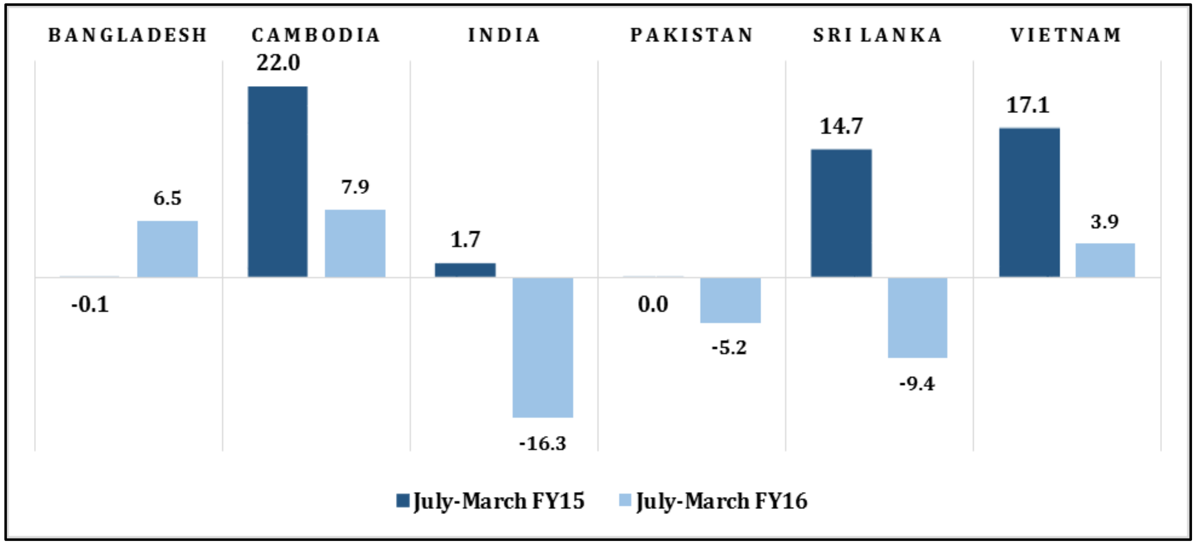
Growth (%) in selected imports in third quarter of FY16

Products	Jul-Dec FY16	Jul-Mar FY16
Capital machinery	-14.8	-5.6
Raw cotton	-9.9	-2.5
Yarn	2.1	5.5
Textile and articles thereof	8.6	9.3
Dyeing and tanning materials	-10.1	-4.4

Section V: External Sector: Performance and Potentials

- Import payments in India, Pakistan and Sri Lanka experienced negative growth
  - ➢ That in Cambodia and Vietnam showed positive growth

Cross-country comparison of import growth for Jul-Mar FY16



- **L/C opening** for Q1-Q3 FY16 declined by **(-) 2.3%** compared to Q1-Q3 FY15
  - ➢ L/C opening for **petroleum products** was **(-) 40.2%**,
  - ➢ Industrial raw materials: 2.9% and capital machineries: 13.9%
  - ➢ Growth of back to back L/C opening (9.5%) was consistent with previous year

Exchange rate and trade

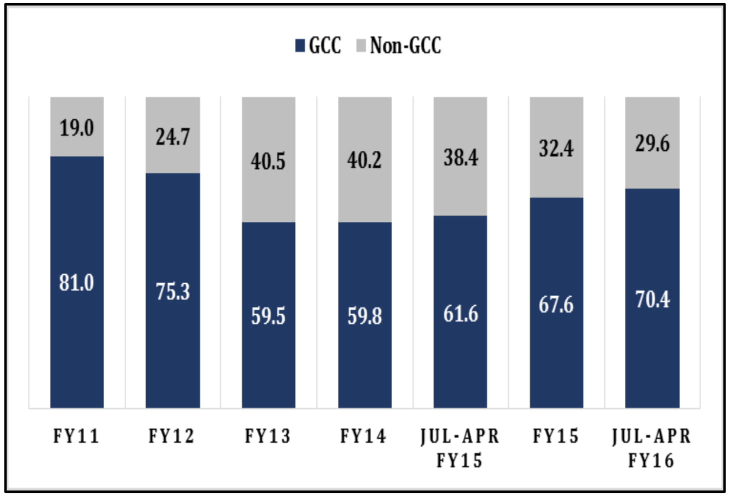
- Nominal Exchange Rate (NER) has remained stable during FY16
  - Average NER was Tk. 78.1/USD from July 2015 to April 2016
- In going for forex replenishment through purchase of dollar, there is a need to be cautious about its inflationary implication
- Both inflation and money supply growth are contained, inflationary pressure is not a concern at present - inflationary pressure is not a concern at present
- However, it will be advisable to keep a close eye on movements of these monetary correlates
- CPD exercises show that Bangladesh's trade balance movement from 1991 to 2015 can be explained through fluctuations in the in the REER after controlling for inflation and export/import price elasticities
- Recommendation for Bangladesh Bank to adopt REER calculation using extensive currency basket so that exchange rate movement ties more transparently to trade performance

Migration

Number of migrants going abroad during Jul-Apr FY16 was 5.6 lakh (51.2% growth) - a phenomenal rise was evident

- 70.4% migrants went to GCC countries
  - Saudi Arabia accounted for the highest incremental share (39.9%),Oman (1.4 lakh), Qatar (1.2 lakh) and Malaysia (50.2 thousand)
- Female migration continued to surge, passed 1 lakh (Jul-Apr FY16) for the **first time since FY92**
  - 78% of the female migrants were destined for GCC countries

Composition of outward migration



Remittance

- Inward remittances growth did not match with the trend of outmigration
  - **Globally remittance** inflow in 2015 had registered **a mere 0.4%** increase compared to 2014 – the slowest ever growth since the GFC 2008-09
  - In **Jul-Apr FY16**, remittance inflow to Bangladesh declined by **(-) 2.4%**
  - Other **regional partners** also experienced **subdued/negative growth**
  - Inflow from **GCC countries to Bangladesh** declined by **(-) 4.6%** for Q1-Q3 FY16
  - Non-GCC countries recorded positive growth of 2.4% for the same period
- However, **remittance outflow from GCC countries** increased **by 7%** (Saudi Arabia and Qatar) during Jul-Sep 2015

Section V: External Sector: Performance and Potentials

- SDGs have included the following Targets: **ensuring safe, orderly, and regular migration** (SDG 8.8); **limiting exploitation and abuse of migrants of all status** (SDG 10.7); **reducing the costs of recruitment and remittances** (SDG 10.c); and **improving data** (SDG 17.18)
  - Many Bangladeshi migrant workers had to return home - due to tightening labour markets, stricter visa regimes in major destinations including Saudi Arabia, the UAE, Kuwait and Malaysia. However, the actual number is not available
  - Bangladesh is enjoying benefits of relatively cheaper cost of sending remittances. However, a large number of migrants remained outside the formal financial system and tools available in host countries

Section V: External Sector: Performance and Potentials

- There is a need for **greater gender-sensitive policies** in view of the rising number of female migrants from Bangladesh in recent times
- **Rules, laws, institutions and programmes** both in home and host countries (in the GCC) should be designed in view of rising number of female migrants
- Bangladesh should have **data on returnee migrants** to promote policies towards existing overseas migrants
- Bangladesh is the chair of the Global Forum on Migration and Development (GFMD) in 2016
    - It's time for Bangladesh to contribute to **good governance in global migration**

Foreign exchange reserve

- Foreign exchange reserves stood at USD 28.5 billion as of 18 May 2016
- Bangladesh Bank's continued intervention to buy USD from the scheduled banks is resulting in reserve accumulation
    - ➢ This is required to provide cushion to external shocks and uncertainties.
- Major part of the official reserve assets was kept in the form of convertible foreign currencies (87.3%)
    - ➢ These are safe but low yielding assets
    - ➢ India has 93.4% of its foreign exchange reserves as foreign currency assets
- The current reserve is equivalent to more than 7 months worth of imports
- In 2014, Bangladesh's reserve to short-term debt was 5.4%
    - ➢ The ratio was 1.1 for Sri Lanka, 2.6 for Vietnam, 3.8 for India and 4.9 for Philippines
- Bangladesh's import was equivalent to 27.5% of GDP in 2014. Reserves to GDP ratio was 0.13
    - ➢ Other countries with approximately similar extent of import dependency (e.g. India, Indonesia, Sri Lanka) tend to maintain same reserves to GDP ratio as Bangladesh

Recent Dynamics of Crop Sector

- The area under rice cultivation dropped by (-) 1.1 % (303 thousand acres) in FY16 compared to FY15. This was largely attributed to (-) 3.2 % decline in area under Boro cultivation (by 383 thousand acres)
- Combined production of Aus and Aman in FY16 rose by 1.6 %
- Salient features of crop sector dynamics over the last five years:
  - Growth rates of production of Aus and Aman were comparatively higher than that of Boro, although a higher volatility is also visible
  - A higher adoption of modern varieties during Aus and Aman season
  - Volatility of climatic variables (e.g. maximum temperature; average annual rainfall)
  - Gradual increase in cropping intensity (in FY10 cropping intensity was 183 % which increased to 190 % in FY13)

Concerns in Crop Sector

- Increasing cost of irrigation, higher cost of agricultural labour and higher return from cultivation of alternative crops are discouraging farmers to remain engaged in rice cultivation
- Recent reports from various sources suggest that farmers are not being able to even recover the cost of production, let alone make profits
- Boro rice cultivation, which was the main driver of crop productivity in Bangladesh, is nearing the limits of existing technological potential
- The most significant challenge facing agriculture is the overuse, degradation, and change in quality of critical natural resources including land and water (World Bank, 2016)
- Delayed market intervention by the government (e.g. in case of declaring regulatory duty on import, oil price cut and initiation of rice procurement) is deterring the farmers from getting perceived benefits

Budgetary Allocation and Fiscal Space

- Budgetary allocation and actual expenditure for agriculture sector as share of total budget has been declining (except for one or two odd years) since FY09
- Lower global prices have provided some fiscal space for the government:
  - Actual expenditure on agricultural subsidy was Tk. 7,095 crore in FY15 which is about Tk. 2,000 crore less than the original allocation
  - The actual figure for FY16 is also likely to be similar
- According to CPD estimation, it is likely that the government is going to enjoy another Tk. 1,700 to Tk. 2,000 crore equivalent of fiscal space in FY17 if the agricultural subsidy allocation remains at Tk. 9,000 crore
- This is an opportunity for enhancing budgetary allocation for other heads under the agriculture sector

ADP Projects under Crop Sector

- Out of 149 agricultural projects, 56 concerning crop sector and irrigation were selected from the RADP for FY16
- *Time overrun*
  - ➢ The 15 projects which received time extension (for one or more times), had an average project life of about 42 months. These projects, on average, have already received an additional 35 months extension (83.6 % of original project life)
- *Delayed Take-off*
  - ➢ Among the 16 new projects (adopted in ADP for FY16) nine projects could not spend a single taka during the first five months of FY16

ADP Projects under Crop Sector

- *Cost overrun*
    - Average project cost overrun was estimated to be about 21 % of the original allocation
- In summing up, whilst the government has made plans, initiated projects in line with the medium to long-term strategies, because of institutional and administrative weaknesses, particularly at the implementation stage, the projects are not being completed in time
- Consequently, farmers as well as the sector is deprived of the envisaged benefits

Policy Perspective

- Further reduction in the administered price of diesel may be considered
- The procurement process needs to be expedited to ensure that farmers do get the benefits of the price support provided by the government
- The emerged fiscal space may be utilised to incentivise Aus and Aman cultivation as also towards agricultural diversification initiatives
- Balanced use of fertiliser and efficient use of water should be encouraged
- Effective implementation of projects is imperative to provide the envisaged benefits towards the farmers
- As Bangladesh has already reached the technological frontier in Boro cultivation, energetic measures will be needed to go for higher productivity and more productive technology

Introduction

- In light of impressive GDP growth, sluggish labour market growth and an emerging demographic dividend provide causes of concern
  - Employment-to-GDP elasticity, at 0.08 in 2015, was at a 14 year low
- Skill upgradation and productivity enhancement are becoming increasingly important issues for Bangladesh as a middle-income country
- Current and emerging labour market concerns are discussed using the inaugural Quarterly Labour Force Survey 2015 and existing rounds of the Annual Labour Force Surveys from 2002 to 2013

Recent Trends in the Labour Market

- Labour force has only grown by 0.7 million between 2013 and 2015, and has largely been stagnant amongst the urban and female workforces
- Rate of job growth has fallen from 1.4 jobs per year (2002-2013) to 0.3 jobs per year (2013-2015)
- Labour force participation rate has fallen marginally compared to 2010, primarily amongst females
- Unemployment rate has stagnated at 4.3%, as increased rural unemployment was offset by declining urban unemployment

Composition of Employment

- Shift in the active labour force towards paid employment through drop in unpaid family help (31%)
- Decline in employment in agricultural (1.5%) and industrial (5%) sectors have been compensated for by a surge in jobs in the services sector (8.5%)
  - Manufacturing in particular experienced heavy job loss (13.4%), which was almost entirely amongst female labour force participants
  - Growth in employment in services sector stem from a rise in construction, transportation and other urban-centric services
- Greater analysis of inter-sectoral labour mobility and total factor productivity needed to capture emerging job opportunities

Employment is still largely informal and regressive by education level

- Roughly half of all employments have remained informal over the last 5 years, as small drop in male informal employment was offset by corresponding increase in female informal employment
  - Informal work has decreased amongst youth workers
  - Agriculture and industry sectors have observed decline in informality, while services sector has experienced a small rise, particularly amongst female workers
- Unemployment rate for educated labour force (up to tertiary education) has increased significantly, but has fallen for uneducated workers and jobseekers – this regressive trend is a major concern for a country seeking to maintain middle-income status
  - The increase was particularly strong for secondary (18 percentage points) and higher secondary (49 percentage points) labour force participants

Section VII: Recent Trends in the Labour Market

Concerns regarding rising youth unemployment and falling real wages

- Sharp rise in youth unemployment rate (8.1% to 9.5%) had differential impacts by gender amongst youth labour force participants.
  - Female unemployment rate between the ages of 15-19 doubled between 2013 and 2015, while male youth unemployment shows no major signs of volatility.
  - Distribution of youth unemployment also shows regressive patterns by education, as almost 75 % of job-seeking youth have secondary and/or higher secondary education.
- Nominal wages have marginally increased nationally on all fronts between 2013 and 2015 (2.4 %), but haven fallen in real terms (15 %) as purchasing power parity has increased.
  - Fall in real wages was most strongly felt by urban female workers (19.4 %).

Recommendations for improving labour market outcomes

- Labour-centric drivers of economic growth must be prioritised through human capabilities development, private sector job creation, improved skills endowment, and increased total factor productivity
- Quality of employment should improve through increased provision of 'decent' formal work that ensures improved and equitable pay for men and women, fair working hours and safe work environments
- Greater female labour force participation can be encouraged in a sustainable manner that removes barriers to equality
- Adequate budgetary allocation and targeted initiatives will be needed to seize the opportunities of realising the demographic dividends in the near future

Section VIII: Concluding Remarks

How will FY16 be remembered?

The year when Bangladesh economy surpassed the threshold of 'Seven Per Cent'

- This discussion is not an assessment of the technical and factual aspects of GDP growth rate estimation
- Rather, it focuses on quality of GDP growth in FY16 – a contentious issue!
- Expected rise in GDP growth is not corroborated in the movements of –
  - private investment, term loan off take, import of capital machineries, tax collection from the domestic sources or growth in consumption
- Due to low level of TFP, Bangladesh is not being able to extract the potential benefits from the observed GDP growth
- Private investment failed to make any headway –
  - Enhanced inflow of FDI and some recovery in private sector credit
- Large entrepreneurs in Bangladesh are gaining confidence in terms of going for large scale private investment
- Deliver necessary infrastructural facilities according to planned timelines

Section VIII: Concluding Remarks

- Attained GDP growth rates did not create adequate employment opportunities
  - Pace of job creation has slowed down considerably during 2013-2015 period
- It is rather surprising to find that despite attaining a double digit value addition growth rates in the manufacturing sector in last two years, (in net terms) more than 12 lakh jobs were lost in this sector!
- Very weak employment generating capacity of GDP growth will not be able to serve the development ambitions

On a welcome note:

  - Headline inflation continued to decline
  - Export earnings rose at a faster rate compared to import payments
  - Positive BoP leading to augmented foreign exchange reserves
  - Less pressure from the subsidy requirements
  - Budget deficit has also been restrained
- Overall, the fiscal year will close with a maintained macroeconomic stability

Section VIII: Concluding Remarks

Mixed performance by a number of variables

- Nominal exchange rate remained stable but made gain against currencies of Bangladesh's major competitors → erosion of export competitiveness
- Rising non-food inflation has led to some discomfort
- Rice output of may decline only marginally, but low returns from cultivation
  - delayed delivery of policy support did not help much
- Overdue rationalisation of oil prices favoured the richer section – a surprise!

Will FY16 be marked as the year of 'central bank heist'?

Several areas may put negative shade to the portrayal of FY16

- Implementation of national budget was one of the weakest areas
- Income tax collection rose at slowest pace
- ADP implementation was weak
- Fast track projects – nothing special
- Implementation of foreign aided projects was as usual below par

Independent Review of IRBD Bangladesh's Development

Section VIII: Concluding Remarks

Persistent weakness in establishing good governance in the financial sector

- Repeated recapitalisation of state-owned banks at the expense of people's tax money is difficult to justify
- State could not provide adequate support to the poorest and marginalised sections of the country due to scarcity of resources
- Responsible people for banking scam were not brought to justice till date
- NPL continued to rise
- Commercial banks remained flooded with excess liquidity
- Fall in average interest rate on lending is welcome, but, interest rate on deposits declined with unchanged interest rate spread

- These weaknesses will continue to create challenges for implementation of budget and macroeconomic management in FY17

Section VIII: Concluding Remarks

- *New VAT and SD Act:* Diverse approaches need to be reconciled without delay - if necessary a staggered implementation plan may be developed
- *Readjust administered prices of diesel and kerosene:* Share the benefit with the entrepreneurs and poor people
- *Restructure public expenditure:* Favour the social sectors and programmes to support the marginal people
- *Utilise fiscal space created from lower subsidy requirement:* Reallocate resources to sectors which received scant attention (e.g. agriculture, education, health, social protection)
- *Deliver the public investment on time and within affordable cost:* Enhance administrative capacities of the government agencies
- *Provide heightened attention to ADP implementation:* Emphasise important ongoing ADP projects, which are close to completion alongside 'mega projects'
- *Pursue institutional and policy reforms:* most energetically in areas of revenue mobilisation, public expenditure, budget transparency and financial sector

Independent Review of
iRBD
Bangladesh's Development

Thank You