Independent Review of Bangladesh's Development (IRBD)

State of the Bangladesh Economy in FY2015-16

First Reading

Dhaka: 3 January 2016

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

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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.

Expert Group Consultation

The CPD team is grateful to all of those presented at the consultation on 22 December 2015 for sharing their views, insights and comments for the draft report , however, they are not responsible for opinions expressed in this report

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Contents

Section I: Introduction

Section I: Introduction

- The present report is the first reading of the State of Bangladesh Economy in FY2016, prepared under the flagship programme of the CPD titled Independent Review of Bangladesh's Development (IRBD)
- The purpose of this report is to present an assessment of the performance of key sectors of the Bangladesh economy and to track trends in major macroeconomic variables during the first half of FY2016
- The review examines quality of macroeconomic management and underlying strengths and weaknesses of the economy, at the halfway mark of the ongoing fiscal year
- The report considers latest available data and information from domestic and international sources, as well as insights gleaned from key informants

Section II: Revisiting Macroeconomic Trends in FY2015

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- GDP fell short of target (7.3%) but increased by only 0.4 percentage points to 6.5% in FY15 compared to FY14
- Private investment continued to remain sluggish (around 22%)
- Ambitious fiscal targets did not come true for both income and expenditure – e.g. revenue shortfall Tk. 36,997 crore
- A better year for crop production, but much reduced growth as compared to FY14
- Inflation experienced a consistent decline except the months of political turmoil
- Growth rates of the monetary aggregates remained rather subdued except for net foreign assets

Section II: Revisiting Macroeconomic Trends in FY2015

- Despite the decline in classified loan at the end of FY15, the SCBs faced capital deficit which in turn created additional fiscal pressure for the government
- Export target was missed by a significant margin
- Net foreign aid had seen certain amount of volatility throughout FY2015
- Remittances inflow returned to its positive growth trend in FY2015 after experiencing a major setback in FY2014
- BoP remained comfortable despite widening trade deficit
- Exchange rate was stable
- Foreign exchange reserve accumulated

Section II: Revisiting Macroeconomic Trends in FY2015

Fiscal Framework for FY2015: Target vs Reality of Growth (%)

Sources	Target Budget FY15	Target Revised Budget FY15	FY15 Proj_CPD over FY14 Actual	Actual FY15 over FY14
Revenue Collection	**30.3**	**16.4**	**9.0**	**4.0**
NBR Tax Revenue	34.4	21.2	15.5	11.3
Non-NBR Tax	14.8	-2.1	-16.3	-24.0
Total Expenditure	**33.1**	**27.3**	**10.0**	**8.2**
Annual Development Programme (ADP)	45.2	35.6	22.9	7.7
Non-ADP	28.1	23.9	4.6	8.4
Overall Deficit (Excluding Grant)	**41.2**	**59.5**	**13.0**	**20.5**
Net Foreign Borrowing and Grants	150.1	122.4	23.6	-32.4
Domestic Borrowing	13.5	43.4	10.3	33.9

Section III: Public Finance

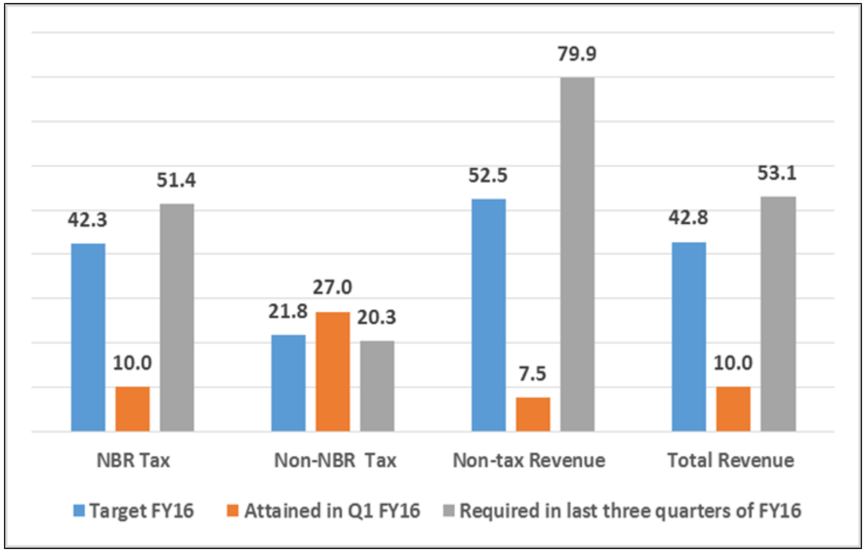
Section III: Public Finance

Fiscal Framework for FY2016: Target vs Reality Growth (%)

Sources	FY16 (B) over FY15 (RB)	FY16 (B) over FY15_CPD Proj	FY16A over FY15A
Revenue Collection	**27.6**	**36.3**	**42.8**
NBR Tax Revenue	30.6	37.0	42.3
Non-NBR Revenue	13.2	32.3	45.8
Total Expenditure	**23.1**	**42.6**	**44.9**
Annual Development Programme (ADP)	29.3	42.6	62.8
Non-ADP	20.3	42.5	37.5
Overall Deficit (Excluding Grant)	**13.6**	**60.3**	**50.3**
Net Foreign Borrowing and Grants	39.6	151.1	359.2
Domestic Borrowing	3.3	34.4	10.6

Revenue earnings: A large shortfall is inevitable

GROWTH RATES OF REVENUE COLLECTION COMPONENTS (%)



- Strategies identified by NBR
  - ➢ Building a partnership with business bodies
  - ➢ Partnership with BBS to collect macro data
  - ➢ Speed up the ADR mechanism

- Revenue shortfall in FY16 could be around Tk. 40,000 crore
  - ➢ Overambitious targets
  - ➢ Low international price of imported commodities
  - ➢ Incentives in budget (Tax breaks and significant reduction in CD and SD)
  - ➢ Withdrawal of proposed 2% AIT on import of essential commodities
  - ➢ Lack of major improvement in administrative capacity
  - ➢ No significant progress on the new Direct Tax Act and Customs Act

Section III: Public Finance

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

Expenditure (July-November) over original ADP in the last 10 years

FY	Taka	PA	Total
Jul-Nov FY07	20.0	21.1	20.4
Jul-Nov FY08	15.2	16.7	15.7
Jul-Nov FY09	19.8	15.3	17.7
Jul-Nov FY10	22.7	22.6	22.6
Jul-Nov FY11	24.1	14.8	20.4
Jul-Nov FY12	25.3	12.8	20.2
Jul-Nov FY13	27.2	20.8	24.7
Jul-Nov FY14	21.7	17.0	20.0
Jul-Nov FY15	19.3	20.7	19.8
Jul-Nov FY16	18.6	13.6	16.8

Implementation of Top 10 Ministries (Jul-Nov, %)

Ministries/Divisions	FY13	FY14	FY15	FY16
Local Govt. Division (Including Block Allocation)	29.8	30.9	27.6	26.6
Power Division	38.9	13.2	18.3	18.8
Bridges Division	3.9	2.4	10.2	12.5
Road Transport and Highways Division	32.4	20.3	17.4	14.2
M/O Railway	12.8	25.2	9.7	13.1
M/O Health & Family Welfare	15.1	16.6	18.2	15.9
M/O Primary & Mass Education	36.4	30.4	29.2	21.1
M/O Education	30.4	25.4	23.5	17.5
M/o Water Resources	22.0	22.3	4.4	10.0
Energy and Mineral Resources Division	25.6	36.8	34.8	15.0
Top Ten Ministry	**22.0**	**21.1**	**19.8**	**18.4**
Grand Total	**24.3**	**20.0**	**19.8**	**16.8**

Section III: Public Finance

- 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)
  - Apart from the Haripur 412MW Combined Cycle Power Plant project, the remaining 13 projects were carried forward to the ADP for FY16
- The 25 priority projects registered better growth than average in Jul-Oct FY16
  - Mainly driven by 8 projects while 6 projects had zero implementation rate
- Only 7 projects were closer to being completed by FY16
  - 5 out of these 7 projects had below than average progress in early FY16
- As per the allocation in FY16, at least 5 projects should be completed
  - They also have a poor implementation rate and need a 'final push'

Section III: Public Finance

- **Cost and time overrun has become more pervasive in recent years**
  - Only 14.2% of the total to be completed projects were completed within the stipulated time and planned allocation in FY14 (lowest since FY01)
  - About half of the completed projects experienced time overrun (highest since FY01)
  - 51.1% projects experienced cost overrun which is the highest in last eight years
- **Specific recommendations**
  - Formulating a task force for timely implementation of the priority projects
  - A renewed reform agenda needs to be initiated to revisit the project completion obstacles including the public procurement system
  - Parliamentary system should take more responsibility for monitoring the timely completion of the priority projects

Financing the Budget Deficit: Need to improve the mix

- FY2016, at the end of three months, budget balance was in a surplus – to the tune of Tk. 1,157 crore
- Budget Deficit was mainly financed through bank borrowing and NSD sales
  - Both net foreign and domestic borrowing figures were negative
  - Net sales of NSD certificates during the first quarter was similar to last year
  - High level of borrowings from the banking system in Q1 of FY16
  - Without improving implementation of aided ADP projects, budget deficit financing will continue to remain dependent on domestic borrowing
- Under the circumstances and considering the high level of forex reserve, it may be a good time to carefully assess the possibility of floating international bonds

Need for revisiting the fiscal framework

- The fiscal framework for FY16 needs a serious revisit
    - Both from income and expenditure sides, the final figures will be much lower
- The government should also seek to restructure its public expenditure
- Allocation for 6 Ministries related to social welfare and security, has experienced persistent decline both as % of GDP and of budget (see table on next page)
- As per the Medium Term Budgetary Framework (MTBF), this downward trend will continue in the forthcoming two fiscal years
- Social sectors and social security programmes are not getting enough allocation in the budget - even lower than NSSS target
- Allowance for Old Age Scheme was Tk. 1,440 crore in FY2016 and will remain the same in the coming two fiscal years
- In contrast, the NSSS targets are Tk. 2,010 crore, 3,530 crore and 3,740 crore for FY2016, FY2017 and FY2018 respectively
- While the target spelt out NSSS is to distribute Tk. 500 per month to the beneficiaries under the Old Age Scheme, it is currently affixed at Tk. 300 per month
- A marginal increase of budget deficit beyond this traditional threshold may not be harmful

Need for revisiting the fiscal framework

Ministry wise Allocation as Total Public Expenditure

Ministries	FY13A	FY14A	FY15A	FY16A	FY17P	FY18P
As % of GDP						
Ministry of Education	0.97	0.98	1.03	1.00	0.95	0.92
Ministry of Primary and Mass Education	0.82	0.89	0.90	0.84	0.82	0.79
Ministry of Health and Family Welfare	0.78	0.71	0.74	0.74	0.72	0.69
Ministry of Social Welfare	0.17	0.16	0.19	0.19	0.18	0.17
Ministry of Women and Child Affairs	0.11	0.11	0.10	0.10	0.09	0.09
Ministry of Disaster and Relief	0.49	0.49	0.48	0.43	0.42	0.41
Total Six Ministries	**3.33**	**3.33**	**3.45**	**3.30**	**3.17**	**3.07**
Allocation for Total Public Expenditure	15.99	16.56	16.55	17.19	18.50	19.30
As % of Budget						
Ministry of Education	6.0	5.9	6.2	5.8	5.1	4.8
Ministry of Primary and Mass Education	5.1	5.4	5.5	4.9	4.4	4.1
Ministry of Health and Family Welfare	4.9	4.3	4.5	4.3	3.9	3.6
Ministry of Social Welfare	1.1	1.0	1.2	1.1	1.0	0.9
Ministry of Women and Child Affairs	0.7	0.7	0.6	0.6	0.5	0.4
Ministry of Disaster and Relief	3.0	2.9	2.9	2.5	2.3	2.1
Total Six Ministries	**20.8**	**20.1**	**20.8**	**19.2**	**17.1**	**15.9**

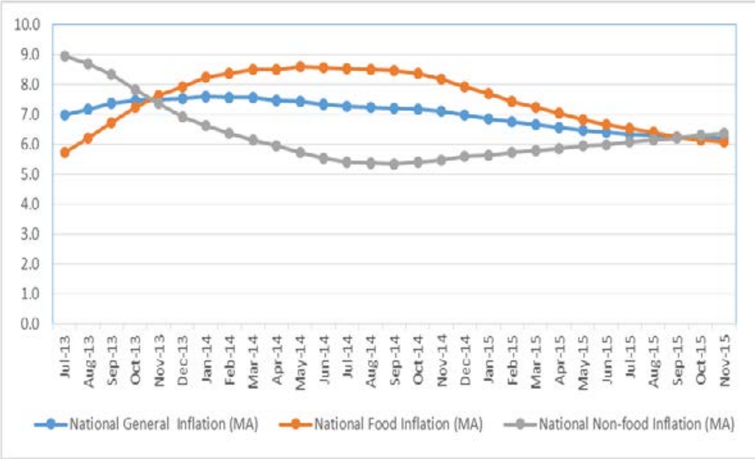
CPD (2016): State of the Bangladesh Economy in FY2016 (First Reading)

Section IV: Inflation and Banking Sector

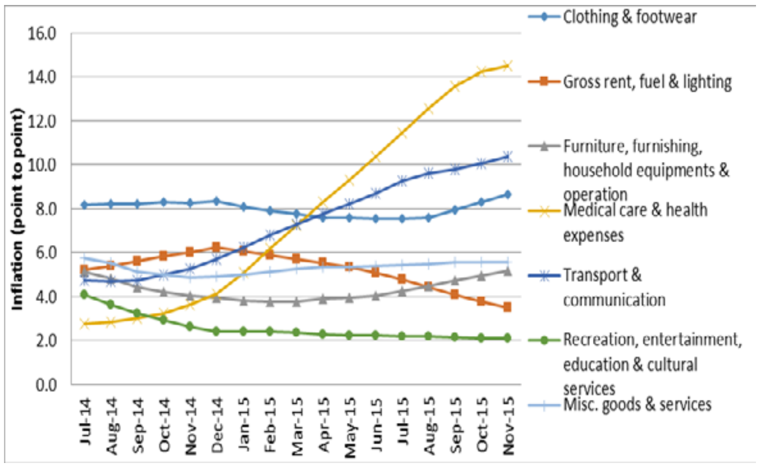
Benefits from tamed inflation have to be reaped further

- Since FY10, for the first time, inflation rate is to meet the target of MPS
  - Mainly by lower food inflation that continues to prevail since June 2014
  - Non-food inflation, though relatively low, is showing an increasing trend

Annual Average Inflation Rate



Composition of non-food average inflation (%)



- Transport and communication and medical care and health expenses have been major sources of non-food inflation in recent months

Impact of 20% import duty on rice market

- To ensure fair price for paddy farmers, the GoB has recently imposed a 10% CD in addition to the existing 10% RD in December and May of this year, respectively
- An attempt has been made here to estimate the welfare impact of this cumulative 20% duty using a comparative statics model (Bairagi 2015)
- Preliminary analysis reveals that local paddy price would increase by about 14% due to the introduction of the 20% duty on rice import. The quantity supplied by the private importers will decrease as import will be relatively more expensive than before the intervention
- The paddy farmers will enjoy highest surplus gain among the beneficiaries due to the introduction of rice import duty. The estimated annual welfare gain for paddy farmers in 2015 prices would be about Tk. 411 Crore (USD 53 million)
- However, as would be expected, consumers will suffer loss due to this fiscal measure

Section IV: Inflation and Banking Sector

- Depressed global commodity prices, particularly falling global oil prices have been a key driver for lowering inflationary trend
- In addition, restrained growth of broad money supply and stable exchange rate between taka and US dollar (discussed in Section V) have also contributed to this downward trend

Growth of monetary variables (%)

Monetary policy variable	Latest 2015	Target (BB) (Dec 15)	FY10	FY11	FY12	FY13	FY14	FY15
Inflation (Fiscal target)	6.1 (Nov)	6.2	7.3	8.80	10.6	6.8*	7.4*	6.4*
Reserve money growth	17.1 (Oct)	16.5	18.2	21.0	9.0	15.0	15.5	14.3
Broad money growth	13.8 (Oct)	15.0	22.4	21.3	17.4	16.7	16.1	12.4
Net foreign asset	23.4 (Sep)	17.5	41.3	5.3	11.7	43.9	41.2	18.2
Net Domestic Assets	10.3 (Sep)	14.3	18.8	25.0	18.5	11.8	10.3	10.7
Domestic Credit	10.1 (Oct)	13.1	17.8	27.5	19.5	11.0	11.6	10.0
Credit to the public sector	-2.5 (Oct)	7.9	17.3	32.3	-9.5	-38.4	34.7	30.9
Credit to the private sector	13.2 (Oct)	14.3	24.2	25.8	19.7	10.8	12.3	13.2

- Lower inflationary trend has had a diverse range of impacts
- Higher purchasing power, with higher real return on deposits
- However, investors may not have enjoyed a commensurate benefit

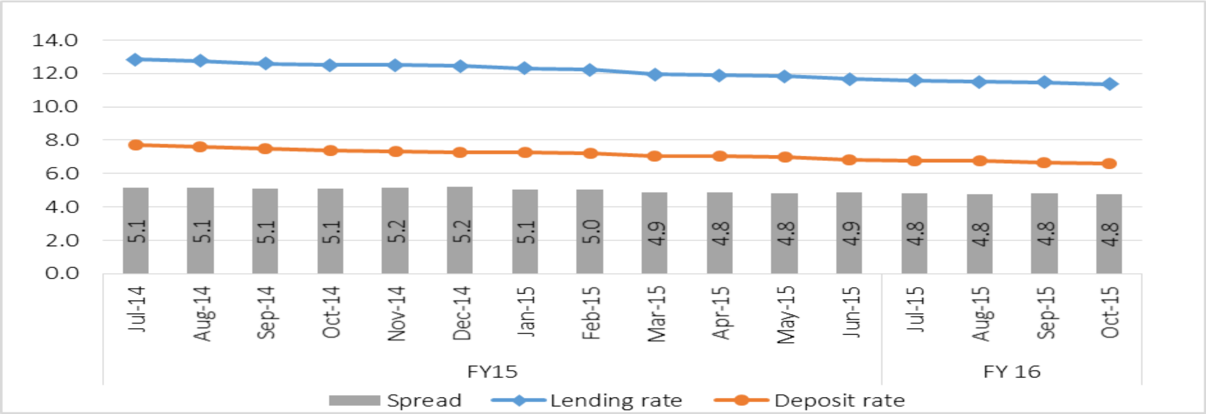
Bangladesh Agriculture Costs & Prices Commission (BACPC)

- The Commission will be mandated to provide strategic guidelines to ensure food security of Bangladesh, suggesting incentive/subsidy to producers, giving guidelines for price signals in the market and for procurement, reduce farm gate and retail price of agri-products, balance consumer-producer interests and guarantee fair price for farmers
- Such a commission may be a one-off endeavour, or a permanent body to provide ongoing recommendations to the policymakers, which may be constituted as an independent body, with representations of key stakeholder groups including farmers' associations
- The BACPC could produce four reports: (i) enterprise budgeting reports: Boro, Aman, Raw Jute, Vegetable (Rabi and Kharif), and poultry, (ii) fiscal-incentive-guidelines reports, (iii) price guideline report, and (iv) statistical database reports

Section IV: Inflation and Banking Sector

- There have been attempts to lower lending rates and reduce spread
  - Average lending rate of banks has declined to 11.3% in October 2015 compared to 12.5% in October 2014
  - However, in spite of the lower inflation rate, the real lending rate has not reduced significantly
  - Interest rate spread, though still within the suggested limit of 5%, has not experienced a significant reduction during the first four months of FY16

Interest rate spread (%)



Section IV: Inflation and Banking Sector

- In order to step up investment, business community has been consistently demanding a lower lending (interest) rate
  - Perhaps, now is the time for the central bank to cut rates slightly so that the benefits of low inflation rate could be reaped by the investors.
  - Of course, banks can do this based on their marginal cost of funds, which is regrettably rather high in Bangladesh due to inefficiency
- Given that the global economic outlook does not look promising in the coming year, inflation may decline further
- Though the inflation rate seems to be on course to attain the target of 6.2% by June 2016, there is no room for complacency
- Maintaining the sustainability of lower inflationary trend will be an important task for the central bank in FY16

Watershed period for the banking sector has to end fast

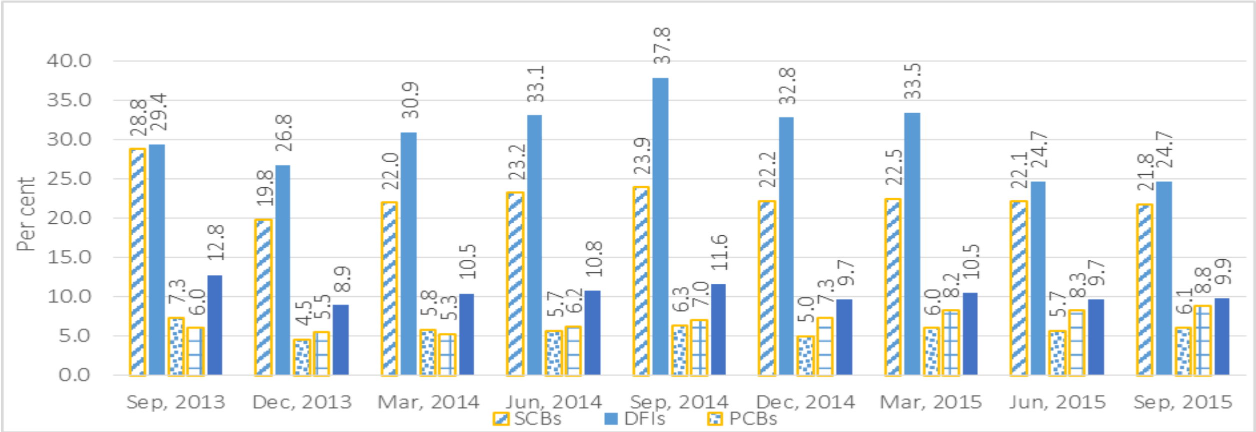
- The performance of the banking sector continues to be worrying
- Since large financial irregularities in Sonali and BASIC banks were discovered, monitoring and inspection by the Bangladesh Bank have intensified
  - The results, however, are yet to show up in the performance indicators of these banks
- Profitability, measured by return on asset and return on equity, has been negative for the SCBs
- For PCBs, though the indicators are positive, these are very low

Section IV: Inflation and Banking Sector

- In case of non-performing loans (NPLs), similar performance is observed
  - Though the share of NPL to total loans in SCBs has slightly declined in September 2015 from June 2014, the rate is still as high as 21.8%
  - On the other hand, NPL in PCBs and FCBs have increased
  - Because of high NPL, state-owned banks are having to make larger provisions.
- Implementation of BASEL III requirements that capital adequacy ratio to be raised to 12.5% by 2019 will be challenging for SCBs
  - As of September 2015, capital adequacy ratio of SCBs was only 6.2 %
  - Lower profits in SCBs are mainly due to bad assets, inefficiency and political interference

Section IV: Inflation and Banking Sector

Non-performing loan in banks (%)



- In case of PCBs, stricter compliance and low appetite for credit by the private sector are the major reasons for lower profits
  - The advance-deposit ratio little over 70% in November 2015 even though banks are allowed to lend up to 80% of their total deposit
- Despite anemic performance of the sector, good governance in banks still remains a distant reality

Section IV: Inflation and Banking Sector

- The Anti-Corruption Commission has been slow to take action against the identified people for embezzlement of money from banks
- The Hall Mark group has not returned any money to Sonali Bank till now
- Flexible measures favouring powerful people and lack of punishment for fraudulence in banks have worsened the situation
- The oversight mechanism has clearly been less effective
- CPD has repeatedly suggested that a 'Financial Sector Commission' be set up to come up with concrete recommendations to address the current weakness and give strategic directions for future
- It may be mentioned here that in 1998, a Commission on Banking and in 2002, a Banking Reform Committee were constituted to make recommendations for the improvement of the performance of banks

Section IV: Inflation and Banking Sector

- The Commission will scrutinise the overall performance of the sector, assess the need of customers and the economy, identify the current problems and emerging challenges, and suggest concrete recommendations towards prudential banking in the short to medium terms
  - May also include non-bank financial institutions within the remit of its scrutiny, such as insurance companies and capital market, as these are interconnected
- The broad terms of reference of the commission will be to critically assess the problems and weaknesses of the banking industry in order to find whether there is any disconnect between demand of the growing economy and the realities of a back-dated financial system that is failing to meet the emerging needs
- On the basis of a comprehensive scrutiny, the Commission will prepare guidelines and make recommendations as regards **reforms needed, automation, risk-management, real-time scrutiny, checks and balances, in-built good governance mechanisms, internal control, role of various players in banks and other financial institutions**

Section V: External Sector

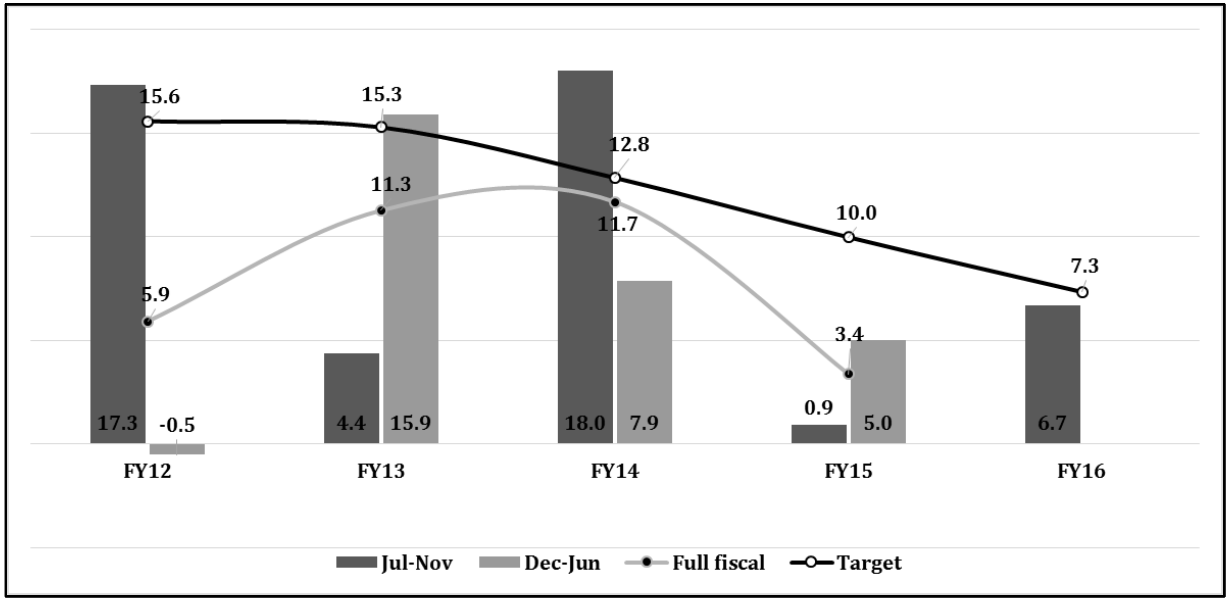
Section V: External Sector

Export performance remained subdued in the backdrop of lower targets

- Export earnings failed to achieve target for the fourth consecutive year since FY11
- Higher competition in Bangladesh's traditional export markets
- New developments in international trade regime
- During Jul-Nov FY16, export earning registered a 6.7% growth against the low base of 0.9% growth during the matched period of FY15

- A cyclical pattern of growth performance during the two halves
- Growth over second half of FY16 may prove to be more challenging

Export growth (%) targets and achievements in recent years



Section V: External Sector

- In key markets (of USA and EU) the price effects and volume effects (in export value growth) experienced diverse fortunes
- During Jul-Nov FY16, export growth in the USA was 16.8% and in Canada it was 13.8%
  - To contrast, export increased only by 2.2% in the EU - the robust growth potential in the EU driven by change in *rules of origin* (2011) may proved to be exhausted
- Export growth of non-RMG products has been more volatile than the RMG products
- Increasing concentration favouring apparels exports because of lower export growth of non-RMG products

Monthly market-wise export growth (%) in FY16

	Jul	Aug	Sep	Oct	Nov	Jul-Nov
Traditional market	**-13.1**	**27.3**	**-5.3**	**16.6**	**14.6**	**6.0**
Canada	-9.1	34.1	14.5	24.7	21.5	13.8
USA	-2.8	44.6	11.3	23.5	14.7	16.8
European Union	-16.3	21.2	-11.6	14.1	14.2	2.2
Non-traditional market	**-7.9**	**30.5**	**-12.4**	**34.9**	**-28.3**	**-2.2**
Total export	**-12.0**	**28.0**	**-7.0**	**21.2**	**13.7**	**6.7**

Section V: External Sector

- Both knit and woven growth are driven by volume growth in the US market indicating increasing pressure on prices
- China's knit export growth was 2.6% while woven export growth was (-) 2.4% in the US market in FY15 (both products shared over 40% of USA's total RMG import)
- A CPD analysis of Bangladesh's top ten knit and top ten woven products (at 10-digit level) reveals that Vietnam has emerged as a major market competitor in the US market
  - Vietnam has already emerged as the second largest exporter of both knit and woven products in the US market, after China
  - 6 out of Vietnam's top 10 knit products were same as Bangladesh's top 10 knit items in the US market. In case of woven export, the corresponding number was two
  - It also appears that Bangladesh and Vietnam are also catering to same product range markets
  - Average price of Vietnam's export in the US market was found to be higher - indicating that even at disaggregated level Vietnam was catering to higher-end market

Section V: External Sector

Comparative analysis of Bangladesh and Vietnam's RMG export in the US market

Indicator	Knit (61)		Woven(62)	
	Bangladesh	Vietnam	Bangladesh	Vietnam
Value of export in July 2014-June 2015 (Bangladesh's FY2015) (million USD)	1,285.1	5,854.0	3,640.5	4,002.4
Rank in July 2014-June 2015 (total export in US market)	9th	2nd	3rd	2nd
Value of export in July-October 2015 (million USD)	604.9	2,391.8	1,322.6	1,673.3
Share (%) in July-October 2015 (of total export in the US market)	3.1	12.3	9.1	11.5
Growth (%) in July-October 2015 (of total export in the US market)	29.6	9.9	7.5	15.0
Weighted average tariff (%) in 2014 (tariff data at 6 digit level)	13.9	14.5	10.6	11.7
Share (%) of Bangladesh's top ten export items in the US market	4.5	17.4	18.1	6.8
Share (%) of Bangladesh's top ten export items in respective country's total export	42.8	41.8	52.4	15.5
Average price of Bangladesh's top ten export items (USD/dozen)	18.2	31.3	65.7	82.0
Price range of Bangladesh's top ten export items (USD/dozen)	6.9 to 68.0	5.1 to 76.2	41.7 to 96.3	43.8 to 129.4

- This is particularly important in view of the recently signed Trans-Pacific Partnership (TPP) Accord
- The other challenge for Bangladesh is the WTO MC-10 decision to do away with export subsidies on cotton – likely to raise cotton price in global market

Section V: External Sector

Import payments remained negative terrain

- Imports rather remained consistent, month on month, in the negative terrain: (-) 2.3% during Jul-Oct FY16
    - As Bangladesh Bank reports, 15 of the 23 products experienced negative growth
- The negative growth of import was also experienced by other South Asian economies. Import growth in India was in the negative terrain for last seven consecutive months
- Cambodia and Vietnam, Bangladesh's two close competitors in RMG exports, experienced high positive growth of import payments over the high benchmark growth in FY15
- A disaggregated analysis of import does not indicate that Bangladesh was able to reap the full benefit of falling POL prices in the global market
    - During Jul-Oct of FY16, price of POL import decreased only by 7.2%
- Fall in cotton prices have benefitted producers of yarn and fabrics
- Fall in capital machineries import by (-) 17.5 per cent is worrying and reflects depressed investment demand

Section V: External Sector

- Total L/C opening for Jul-Oct FY16 has posted negative growth of (-) 6.9%
  - Growth of L/C opening for capital machineries import has increased by 15.0%
  - Back-to-back L/C opening growth was positive at 4.2%
  - Outlook were negative for raw cotton and cotton yarn import
  - Signals for both domestic production and export-oriented industries are rather mixed

Section V: External Sector

Positive current account balance contributed to continued surplus BoP

- In FY15, current account balance was negative for the first time since FY2005, at (-) USD 1,645 mln
  - Consequence of record trade gap of USD 9.9 bln
- During Jul-Oct FY16, current account balance remained positive - USD 936 mln which was USD 136 mln during Jul-Oct FY15
- During Jul-Oct FY16, overall balance remained positive at USD 1,936 million (USD 1,246 million in Jul-Oct FY15)
  - Significant compositional change was observed in the structure of the financial account
  - Other investments such as MLT loans, trade credit came down to USD 85 mln only from USD 881 mln
  - Other investments singly added **USD 2.3 billion** additional financial account surplus in FY15)

Section V: External Sector

Remittance inflow has stagnated despite rising overseas employment

- In Jul-Nov FY16, 2.5 lakh migrants migrated (41.3% growth)
  - Resumption of hiring by Saudi Arabia
  - Higher demand for female workers
- In Nov 2015, about 63.4 thou migrants had deported - highest for a single month since January 2012
- Remittance inflow during Jul-Nov FY16 was USD 6.2 bln ((-)0.7% growth)

- This is somewhat puzzling, although benefits of higher numbers leaving would perhaps come with some lag
- **A CPD study (2015) urges the need for comprehensive database of returnee migrant, financial education and financial inclusion of migrants**
- Since the number of female workers are rising, issues of social security and safety ought to be given high priority
- Safe migration and migrants' rights have also been recognised in the context SDGs

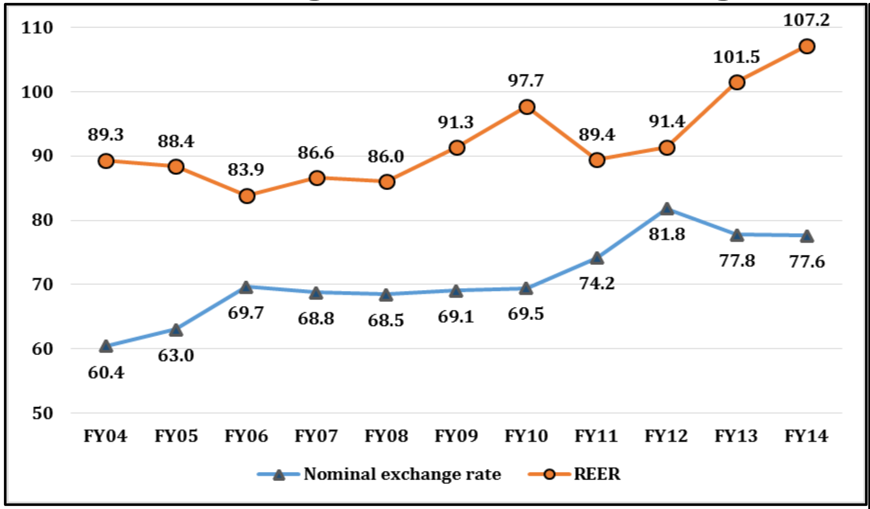
Independent Review of iRBD Bangladesh's Development

Section V: External Sector

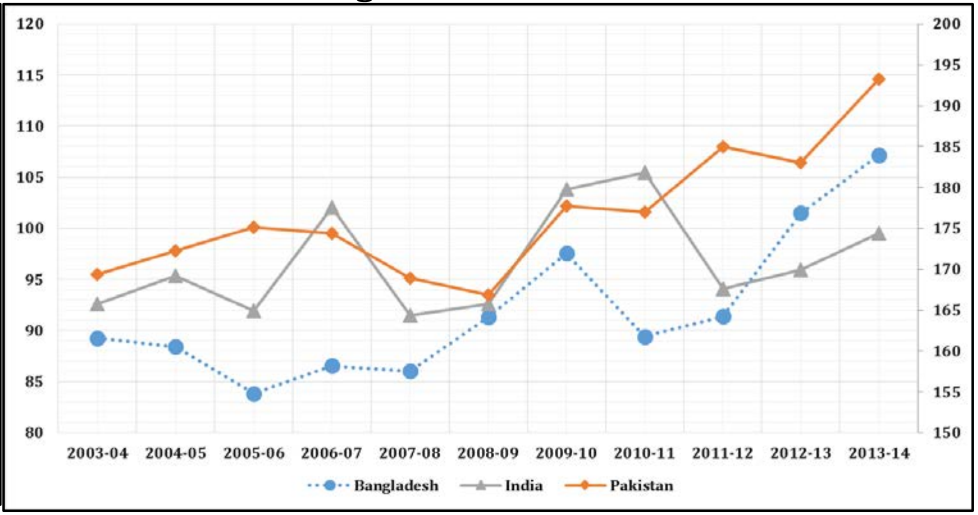
BDT has depreciated marginally against USD

- The REER of BDT has experienced a rise over the past couple of years
  - REERs of India and Pakistan also indicate that INR and PKR remain to be somewhat appreciated

Nominal exchange rate and REER of Bangladesh



REER in Bangladesh, India and Pakistan



- *There is some scope to let the BDT depreciate to some extent*
- *The implications for various sectors and the overall economy will need to be carefully examined*

Section V: External Sector

Foreign exchange reserve continued to rise

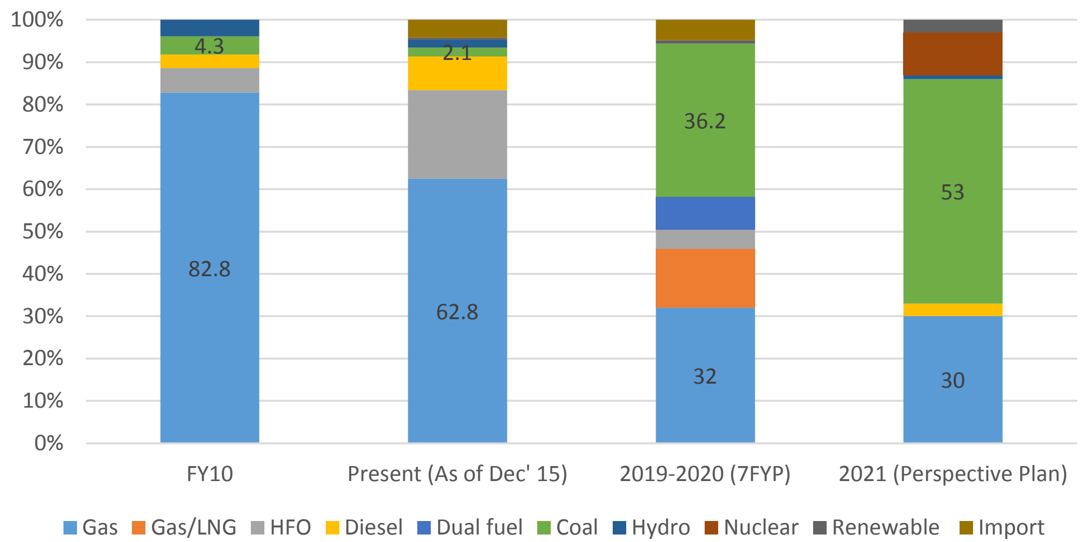
- As of 30 December 2015, the reserve stood at USD 27.4 bln (USD 25.0 bln as of 30 June 2015) – equivalent to 8 months of imports of goods and services
- About 85% of the reserve was in the form of convertible foreign currencies – which included both 'securities' and 'depository to foreign national central banks'
  - Strategically, Bangladesh Bank tends to resort to relatively safer options
  - Significant change is also observed in case of SDR (4.6%)
  - Export development fund is among the other options (6.7%)
- *The pros and cons of the rising reserve and its multi-dimensional implications should be closely examined*

Section VI: Power and Energy Sector

Energy-mix

- Electricity generation capacity (derated) has reached 11,467 MW on 27 Dec 2015
- The targeted generation capacity set in the PSMP for FY16 has been met already
- The GoB has planned to adopt a new diversified energy-mix to achieve the targeted electricity generation capacity (double that of current generation) by FY20

Current and planned energy-mix in Bangladesh



Energy-mix

- For implementing the new energy-mix policy, a large amount of budgetary support may be necessary because the mix will be expensive. Electricity tariff may once again need to be readjusted to reduce the likely significant fiscal burden.

- Electricity generation from imported coal will be cheaper than imported LNG. Coal imports will require substantial investment in infrastructure development. Consequently, it may not be achievable in the short run

- Import of electricity is a viable option—Bangladesh has been importing electricity from India since FY14
- To gain from cross-border trade, Bangladesh should focus more on investment in upgrading transmission lines
- The current reserve of gas is likely to be depleted in less than 10 years
- There is a need for saving gas and use it efficiently (reducing transmission and distribution losses, increasing efficiency of power plants, supplying to the end-users in a cost-effective manner and expanding pre-paid metered system, introducing Combined Cycle Gas Turbines (CCGT) technology for power generation).

Section VI: Power and Energy Sector

Electricity and Gas market

- Significant progress has been made in terms of electricity generation during the last five years—generation capacity has indeed doubled
- However, the gaps between the derated capacity and peak and evening utilisation have been widening over time; this cannot be narrowed down because of the sector's existing problems (i.e. forced outage, aged plants, system loss, corruption, and inefficient management)
- Gas reserve in Bangladesh is limited (total extractable gas reserve is approximately 27.12 tcf, of which Bangladesh has already consumed 12.3 tcf by 2014) and expected to be depleted by FY23 if the demand for gas rise at 7% per annum (7FYP).
- There is a need for saving gas and use it efficiently; so implementation of gas allocation policy is a prerequisite
- Pre-paid metering system for household could be expanded

Section VI: Power and Energy Sector

Technical Efficiency (TE) analysis of BPDB's own plants

- The Stochastic Frontier Analysis method is applied with a translog production function for FY06 to FY15 period
- Estimated mean efficiency of BPDB's power plants is 0.48 (TEs are determined as, $0<TE\_i\leq 1$), which implies that the BPDB's plants are half way to the efficient point (mean efficiency is found between 0.7 and 0.8 for power plants in India and Pakistan)
- Only 4 power plants (Baghabari, Fenchuganj 2x 90 MW, Ghorashal and Hatiya diesel generator plants) out of 34 BPDB's plants are technically efficient (TE >0.9)
- There has not been much improvement in technology of BPDB's plants, as the technology parameter is negatively correlated to output
- Efficiency may increase if per unit electricity generation cost could be reduced

Section VI: Power and Energy Sector

Oil tariff

- Domestic prices of petroleum products have not been adjusted with the declining trend in international prices since January 2013
    - ➢ India has been adjusting its local prices regularly with the international prices
- There is a strong demand from stakeholders for reducing petroleum prices
- BPC, after incurring loss for 15 years in a row, made a profit of Tk. 5,268 crore in FY15
- It may be expected that, with same level of international petroleum price and unchanged selling prices in domestic market, BPC's profit may go up to Tk. 11,000 crore

Domestic and import prices of crude oil and diesel

Year	Bangladesh's import price (USD/bbl)		International price	Domestic price		
				Bangladesh	India	
	Crude oil	Refined oil	Crude oil	Tk./Ltr	Rs/Ltr	Tk./Ltr
2010-11	93.13	113.69	92.68	56	41.2	68
2011-12	112.95	128.3	105.39	61	43.5	64
2012-13	109.22	127.7	102.28	68	50.3	66
2013-14	109.6	125.27	105.47	68	57.9	75
2014-15	75.23	90.16	71.75	68	55.5	68
17 Dec-15	61.31		36.0	68	46.1	56

Section VI: Power and Energy Sector

Oil tariff

- Regrettably, as of now, there is no clear reporting on the part of BPC
- CPD undertook a CGE exercise to estimate the economy-wide impacts of a possible decline in fuel prices in the domestic market and found that there is a case for revising downward the fuel prices
- However, to what extent this will be made should be calibrated by taking into cognisance
    - ➢ the revisions of gas and electricity prices
    - ➢ overall impact of the price-change mix on major stakeholder groups
    - ➢ government's subsidy-related expenditure and earnings

Shock: Impact of cut in the petroleum price by 10%

Indicators	Change (%)
GDP	0.3
Inflation	-0.2
Government savings (as a % of GDP)	-0.4
Export (RMG)	0.4
Household consumption	0.6
Household consumption (Rural)	0.7

- Within the fuel-mix, a differentiated approach will need to be taken – higher reduction for diesel, furnace oil and kerosene
- The strategy of monopoly import of fuels by state agency will also need to be revisited to explore the possibilities of deregulating the import regime

Section VII: Challenges Confronted by the Manufacturing Sector: Reforms Needed

Production in the Manufacturing Sector

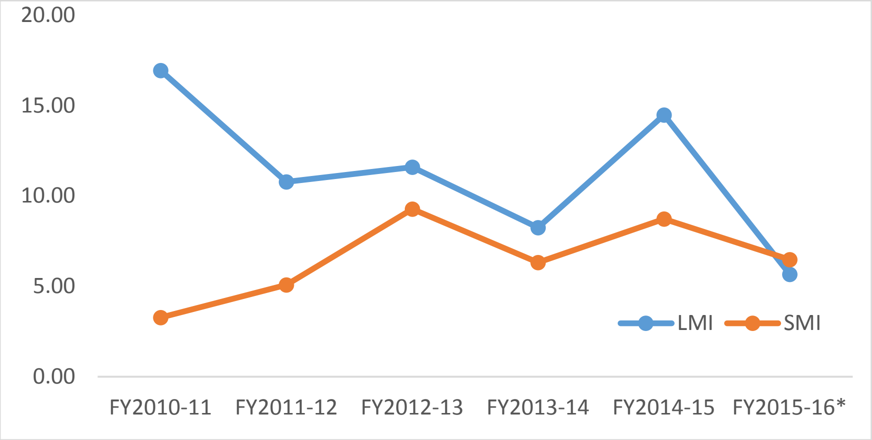
- Recently observed subdued performance trend in manufacturing production and investment is not in line with what has been targeted to achieve in FY16 under the 7th FYP
- Slowdown of growth of QIP of LMIs has been accompanied by rise of QIP of SSIs (see figure)
  - Volatility in QIP was seen to be higher for the LMIs compared to the SSIs
- Import of raw materials and intermediate products reflects the same downward trend
  - It is, to some extent, related to reduction in the unit value of import (see table)

% Changes in Average Value of Selected Imported Products

HS codes	Volume (kg)	Value	Average value (value/kg)
25 to 27 (minerals)	-0.67	-7.8	-17.34
28 to 38 (chemical products)	-1.92	-1.27	2.1
50 to 60 (textile and articles)	15.18	-7.24	-28.08
72 to 83(base metals and articles)	34.93	6.78	-20.55

Source: NBR data

Comparison of Growth of QIPs of LMIs and SSIs



Source: Based on BBS data

Section VII: Challenges Confronted by the Manufacturing Sector: Reforms Needed

Private Investment: Manufacturing Sector

- Growth of private investment could be termed 'average'
  - Investment/GDP is hovering at 22% level for last several years
  - Growth of private investment has decelerated – from 18% in FY11 to 12.8% in FY15

- A subdued situation during the 1^{st} half of FY16: Highly unlikely to achieve the target in FY16 (23.7% of GDP/$52.3 bil.)

- Depressed private investment scenario in Q1 of FY16
  - Negative growth of industrial term loan (-0.86%)
  - Poor disbursement of SME loan (2.7% vis-à-vis 20.7%): Near to reach the target at the end of the calendar year 2015
  - Slow compositional change in advances: a rise in the share of industry
    - Sustainability of this trend will depend on whether advances in the industrial sector will rise in the upcoming quarters

Section VII: Challenges Confronted by the Manufacturing Sector: Reforms Needed

Private Investment: Manufacturing Sector

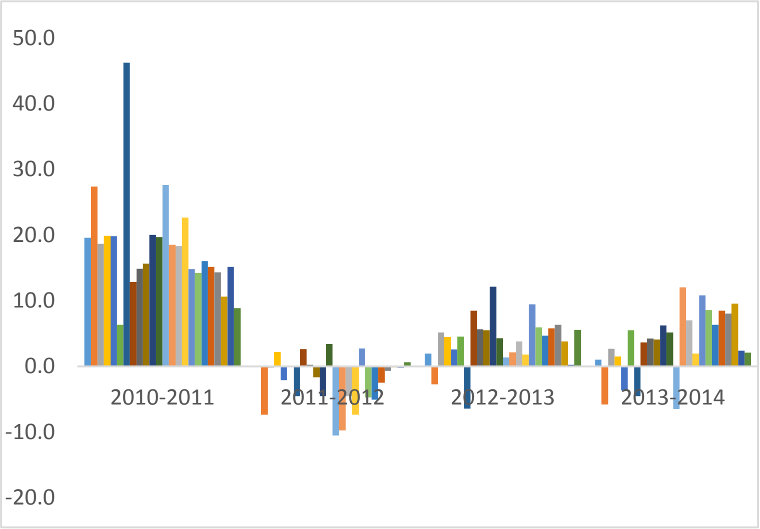
- Compositional change in FDI: reinvestment & intra-company loan are high
  - Ratio of equity capital, reinvestment earnings and intra-company loan has changed: from *1:0.2:0.4* in 2000 to *1:3.5:0.9* in 2014
- Existing FDIs will likely to have positive impact on growth in FY16
  - Observed for Q1 in FY16 (35.6%)
- New investors ('equity' investment) are facing increasing difficulties in undertaking actual investment
  - Amount of proposed investment (registered at BOI) is 27.7% less in Q1
- Only 3 IPOs offloaded in the capital market during Jul-Nov, FY16 (10 in Jul-Nov, FY15)
  - Price fluctuation of new IPOs (even lower than initial offered price) raised doubt about the quality of IPOs allowed by the SEC
- Commercial bank's overexposure to the capital market is yet to be brought down
  - Various decisions of the central bank need to be carefully examined; otherwise these measures would transmit wrong signals to the market

Section VII: Challenges Confronted by the Manufacturing Sector: Reforms Needed

Factors Responsible for Production Slowdown

- Performance of LMIs and SSIs is driven by different set of factors both in demand side and in supply side
- Demand side factors affecting LMIs/SSIs include
  - Sluggish global demand reflected in low import growth of products of Bangladesh's export interest (figure)
  - Slow rise in demand in the domestic market reflected in deceleration in the growth of per capita income

Changes in Global Import of Selected Products which are of Bangladesh's Export Interest



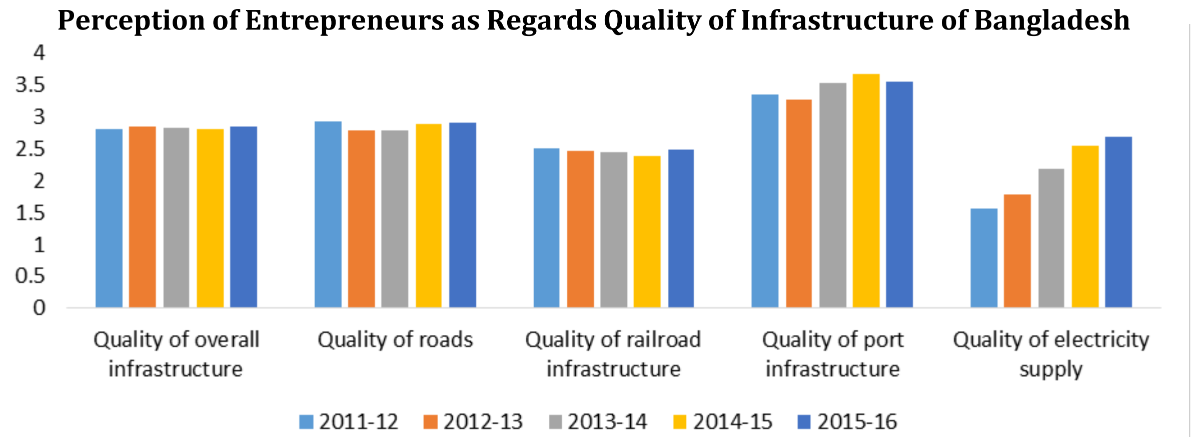
Source: Trade Map

- Supply side factors that affect production and export
  - Reduced export orders to non-compliant RMG factories
  - Appreciated cross-exchange rate of Taka (INR, VND, IDR)
  - Reduced supply and low pressure of gas
  - Difficulty in getting gas connection for new industries

Section VII: Challenges Confronted by the Manufacturing Sector: Reforms Needed

Factors Responsible for Investment Slowdown

- Supply side factors that affect investment: Lack of adequate infrastructure almost no change in entrepreneurs' perception except that on electricity (see figure)
  - Additional generation of electricity and gas is limited for industry
  - Increased public investment yet to have a significant crowd in effect
  - High rate of interest for commercial borrowing: further efforts require close the spread between lending and deposit rates



Source: Various issues of Global Competitiveness Report

- Given the slow growth in global and domestic demand, performance of the manufacturing sector will likely suffer in the near-term

Section VII: Challenges Confronted by the Manufacturing Sector: Reforms Needed

Need to Undertake 'Next Generation Reform' Measures

- Bangladesh needs to focus more on improvement of institutional efficiency to reignite private investment: from 'first generation' to 'second generation' reforms

Policies/Acts/Rules/Regulations

- Investment and business-related policies need to be amended and upgraded
    - Customs Act, Companies Act, Foreign Private Investment Act, Trade Mark Act, Mine Act, Port Act, Export and Import Control Act, Patent and Design Act, and Inland Shipping Act, Weight and Measurement Act, Acquisition and Requisition of Immovable Properties Act
- Rules and regulations related to different laws and acts need to be upgraded/amended/added
    - Investment Act, Port rules, PSI Order, Import, Export and Indentors' Registration Order, Patent and Design rules

Section VII: Challenges Confronted by the Manufacturing Sector: Reforms Needed

Operational Issues

- Business-related services need to be simple, transparent and hassle-free
  - Reducing the number of documents, lengthy approval process and related cost
  - Introduction of on-line platform for processing related documents, updates and paying fees
  - This will also likely to discourage rent-seeking and corruption
- Developing authorised public domains where necessary documents and related formalities will be put on the website – especially for SMEs
  - Lack of clarity as regards business processes also discourage foreign investors
- Large gap between adopted policies/rules/regulations and their implementation
- Foreign investors are confronted with a variety of ‘hidden’ barriers
  - Cases of non-cooperation from various agencies and institutions
  - Access to industry-related information is difficult – market size, share, major market players and market risks

Section VII: Challenges Confronted by the Manufacturing Sector: Reforms Needed

Institutional Reform

- Institutional reforms are urgent to raise efficacy of public institutions
  - BIDA (previously BOI), BEPZA, BSCIC, BEZA and different local authorities require clear division of focus and labour
- MoI should be developed as the focal point for all types of industries
  - Should play a broader role in the context of Bangladesh's industrialisation
  - Act as a repository of industry-related information, providing technical support and ensuring facilitation of businesses (e.g. BSTI, NOP, Patent office)
- GoB should design an appropriate policy to lease out the additional land of the SoEs to the private sector for establishment of new enterprises
  - Ensuring adequate crowd-in impact of public investment– timely implementation of fast-track projects
- Setting up a Commission to identify institutional bottlenecks both at macro and micro levels
  - Commission will come up with concrete suggestions for respective Ministries and Departments to undertake necessary measures in a time bound manner

The Issue of Further Relaxing Outward FDI from Bangladesh

- During 2012-13, Central Bank's research division prepared a draft note on 'Road map' for liberalisation of foreign exchange regime towards greater capital account openness
    - It is important to examine the rationale of this plan in the current context and the status of implementation of the measures.
- Outward FDI from Bangladesh has started to rise in recent years although it is still very low
    - From $15.4 million in 2010 to $48.4 million in 2014
    - Far Behind other comparator countries: Vietnam ($1.1 billion), Sri Lanka ($67 million), Pakistan ($116 million), India ($9.8 billion) and China ($116 billion).
- Data shows that investment was realised only in banking and mining-related activities in different countries.
    - Total amount of 'actual' investment abroad would be much higher
    - Despite the fact that a number of monitoring and overseeing measures have been undertaken, the capital flight remain a continuing concern
- In this backdrop, the idea is to explore whether further relaxation of the rules guiding outward investment from Bangladesh is a feasible option or not under the current circumstances

Section VII: Challenges Confronted by the Manufacturing Sector: Reforms Needed

Experiences of Other Countries and Relevance for Bangladesh

- *Rationale*: To penetrate new markets; to escape high cost and difficult labour markets at home; to have specific interest on potential sectors such as banking, transport; and to access regional markets
  - 'Pull' factors dominate over 'push' factors
- *Pull factors for Bangladesh:* increasing demand for investment in forward and backward linkage parts of the value chain; demand for undertaking market-seeking and efficiency-seeking investment in strategic sectors; investment in other LDCs in order to enjoy the benefits of preferential market access
- *Push factors for Bangladesh:* Making more profit by investing in suitable ventures abroad when scope of investment at home is limited; substantial foreign exchange reserves that create an opportunity for long term investment abroad by the private sector.
- *Preconditions:* Developing countries need to fulfill a number of benchmark macroeconomic preconditions (Schneider, 2000)
  - Apparently, Bangladesh is able to meet only one or two criteria (out of 5)
- In case of India, 'Committee on Capital Account Convertibility', commonly known as the 'Tarapore Committee' recommended as follows
  - Capital account opening but only on a limited scale and in a staggered manner.
  - Transition from one phase to the next will be made, only when certain preconditions are met

Section VIII: Concluding Remarks

Section VIII: Concluding Remarks

- Performance of the Bangladesh economy in FY2016 will be critical in terms of setting the stage for implementation of the 7FYP
- As the Bangladesh economy moves into the second half of FY2016, a number of challenges have emerged, addressing of which will be crucial to realising the potentials of the Bangladesh economy
- Inability to take advantage of the relative macroeconomic stability to stimulate private sector investment remains an enduring concern
- The present study has suggested a policy package in the short run in this context. The analysis presented in this report shows that, the fiscal framework of FY2016 has come under severe strain in the early months
- Both resource mobilisation and resource utilisation are likely to be significantly off the mark compared to FY2016 targets
- The paper, in this context has argued for a moderately expansionary and restructured public expenditure stance favouring the social sectors

Section VIII: Concluding Remarks

- Diverse approaches that continue to inform the discourse on implementation of the proposed VAT and SD Act will also need to be reconciled on an urgent basis
- Important ADP projects which are close to completion, should receive heightened attention from the policymakers
- And utilisation of foreign aid needs to be prioritised
- These steps are critical to energising and stimulating private sector investment by taking advantage of the crowd-in impacts of public investment
- Thankfully, inflation has come down in the recent past with concomitant positive implications for the interest rate
- In line with the falling inflation, the central bank will need to consider revisiting the policy rates to ease cost of funds for the commercial banks
- This may contribute to lowering lending rate, which will reduce cost of capital for the private investors
- Low global commodity prices, particularly of fuel, and the attendant fiscal space, provide an opportunity for making use of the saved resources

Section VIII: Concluding Remarks

- Benefits of these will need to be shared among key stakeholders (e.g. government, consumers and entrepreneurs)
- External sector was able to demonstrate notable resilience, though declining flow of remittance and volatility in export earnings emerged as a concern
- In view of the movement of the REER, exchange rate of BDT may be depreciated by a small margin to maintain export competitiveness of Bangladesh vis-à-vis its competitors
- Lack of movement in undertaking and implementing the needed reforms is emerging as a major impediment to steering the economy to higher growth trajectory
- The government will need to rigorously pursue a set of institutional and policy reforms (including in the areas of financial sector, revenue mobilisation, public expenditure management, PPP, privatisation etc.) by taking bold steps, to yield the aspired results
- In the coming days, success in the economic arena will also hinge on the state of political predictability and effectiveness in addressing the overall public safety and security concerns in the country

Independent Review of iRBD Bangladesh's Development

Thank You