

বাংলাদেশের উন্নয়নের স্বাধীন পর্যালোচনা

# State of the Bangladesh Economy in FY2017-18

## *First Reading*

Dhaka: 13 January 2018



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The CPD Team is grateful to all the participants at the consultation on 28 December 2017 for sharing their views, insights and comments on the study

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# SECTION I. INTRODUCTION

- ❑ The present report is the first reading of the State of the Bangladesh Economy in FY2018. This report has been prepared under the flagship programme of the CPD, titled *Independent Review of Bangladesh's Development* (IRBD)
- ❑ The principle of this report is to delineate an assessment of the key sectors of the Bangladesh economy and to trace out the trends in crucial macroeconomic correlates during the first half of FY2018
- ❑ The review scrutinises quality of macroeconomic management and identifies strengths and weaknesses of the economy, at the halfway mark of the ongoing fiscal year
- ❑ This report utilises latest available data and information from domestic and international sources. Insights from key informants are also taken into cognisance to strengthen the analyses further

## Section II. FY2017 Revisited

## 2.1 Economic Growth and Investment

- ❑ Considering the base year of 2005-06, the highest ever GDP growth (7.28%) was achieved in FY2017
  - 0.17 percentage point increase from FY2016
  - Exceeded the planned target of 7.2% (for second successive time)
- ❑ Growth was primarily driven by an increased contribution from the services sector
  - In particular, from the wholesale and retail trades sector
  - Contribution from financial intermediations also improved substantially despite deteriorating performance of the banking sector
- ❑ Industries' contribution dropped due to lower contribution by both manufacturing and electricity sectors
  - Contradicts the electricity production data from QIIP (11.0 % growth in FY17)
- ❑ Contribution of agriculture was lower than the provisional estimates
  - Indicative of the substantial loss of crop due to flash flood in *haor* areas in April 2017



## 2.1 Economic Growth and Investment

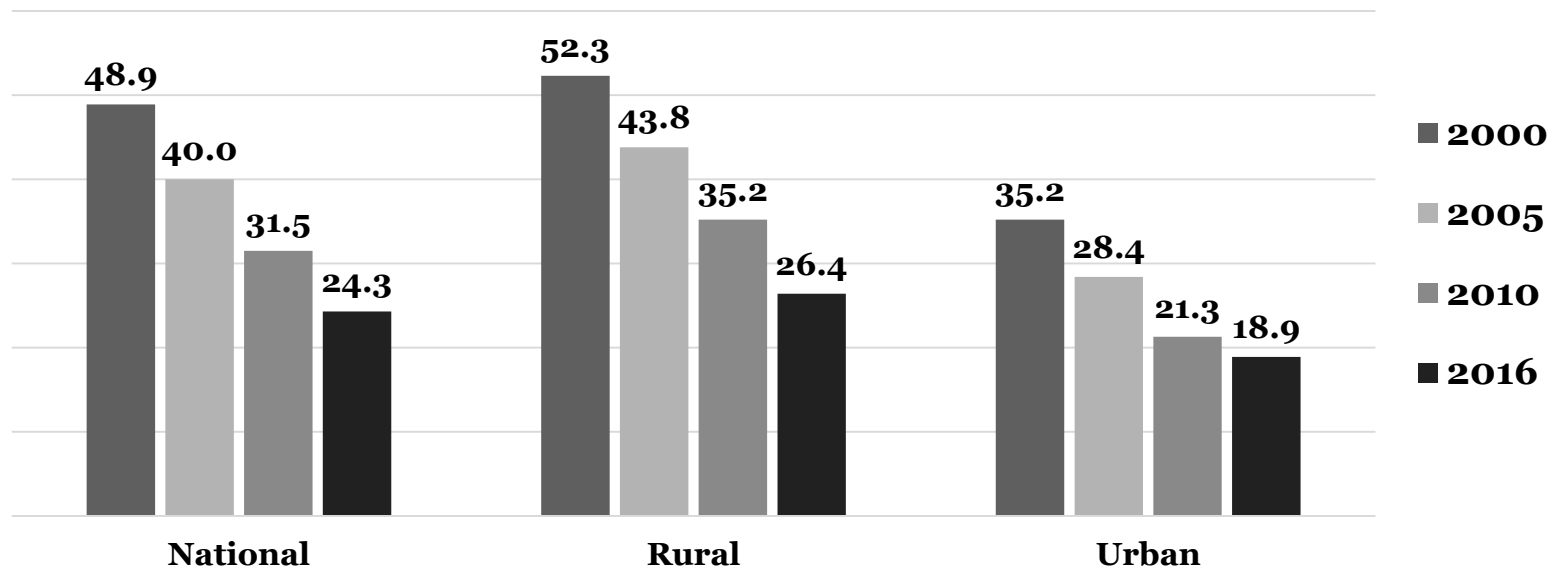
- ❑ BBS data showed, industries sector grew at double digit (10.2%)
  - Significant growth from the large and medium scale manufacturing industries (11.0%)
- ❑ QIIP data exhibits a number of large scale industries posting significant growth in FY2017
  - Leather and related products (53.4%), textile (21.2%), pharmaceuticals and medicinal chemical manufacturer (32.1%), and manufacture of other non-metallic mineral products (32.3%)
- ❑ This high growth recorded by large scale industries failed to get reflected in the export figures
  - Export earnings registered only 1.7% growth in FY2017
    - In particular the RMG exports posted only 0.2% growth, while leather and leather products grew by 6.3%
- ❑ The export figures corroborate the high growth of the manufacturing sub-sectors
  - Raises questions regarding the reliability of the production data
- ❑ Private investment remained stagnant as share of GDP (23.1%), on the other hand public investment increased marginally (0.7 percentage points)
- ❑ Gross national savings as a share of GDP (29.6%) declined compared to FY2016 (30.8%)
- ❑ Per capita GNI increased to USD 1,610 in FY2017 (9.9% growth over FY2016)

## 2.2 New Trends in Poverty and Inequality

❑ Poverty reduced in absolute level but pace of poverty reduction has slowed down

- During the 2010-16 period, national poverty rate declined by 1.2 percentage points per annum
- In contrast, the decline was 1.8 and 1.7 percentage points per annum respectively for the 2000-05 and 2005-10 periods

### Poverty Rate in Bangladesh Based on the Upper Poverty Line (%)



## 2.2 New Trends in Poverty and Inequality

- ❑ Poverty and employment estimates pose questions in context of the benefits of the attained economic growth
- ❑ It is perplexing that reduction in poverty level decelerated at a time when Bangladesh's GDP was growing at an annual average of 6.5 per cent

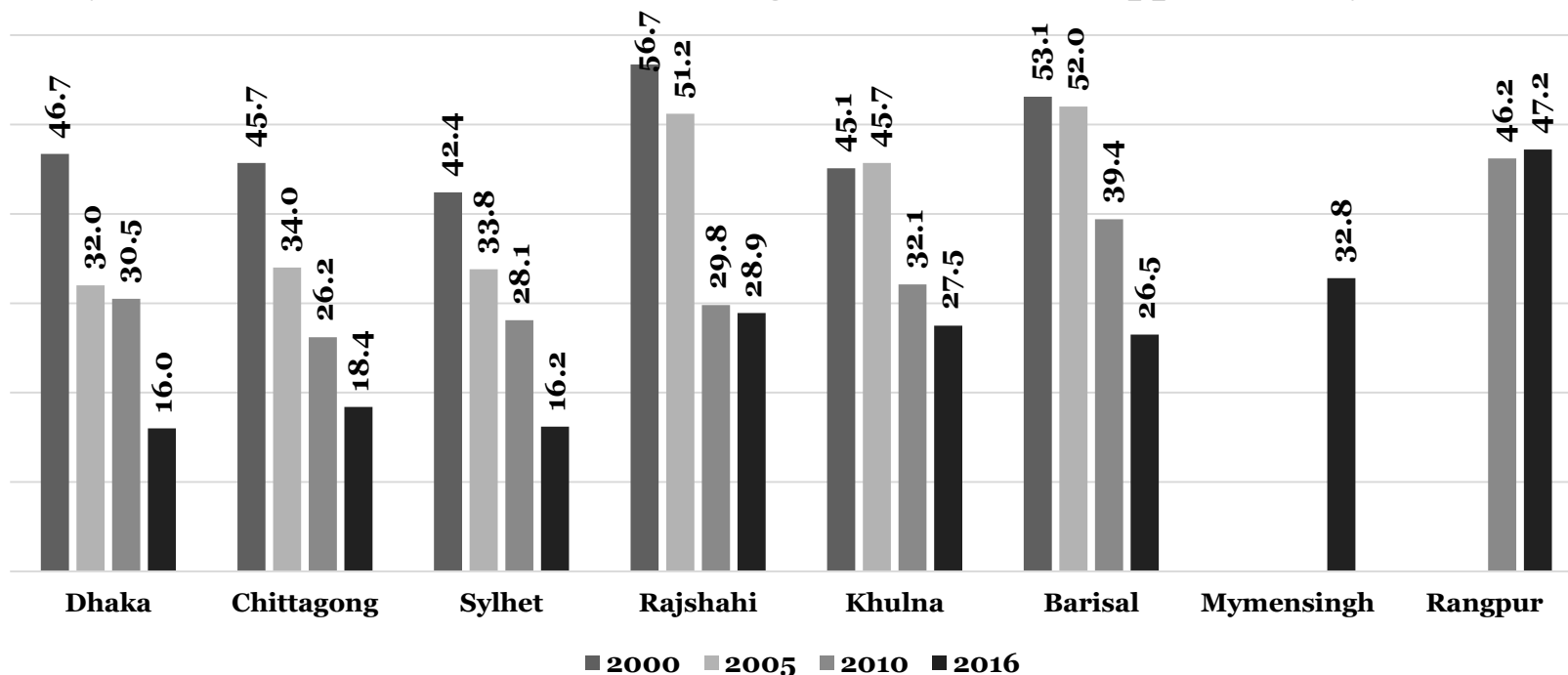
### **GDP Growth, Employment Growth, and Poverty Reduction Trends in Bangladesh**

<b>Average annual</b>	<b>2000-05</b>	<b>2005-10</b>	<b>2010-16</b>
GDP growth (%)	5.1	6.1	6.5
Employment growth (%)	3.3	2.7	1.9
Poverty reduction (percentage point)	1.8	1.7	1.2

## 2.2 New Trends in Poverty and Inequality

- ❑ The East-West divide in Bangladesh poverty scenario appears to have reappeared
  - The Eastern Divisions (Chittagong, Dhaka and Sylhet) have traditionally fared well compared to their Western counterparts (Barisal, Khulna, Rajshahi) in terms of poverty incidence
  - The scenario is about the same as regards the rate of poverty reduction
    - This is in stark contrast to the 2005-10 period

**Poverty Rates in Different Divisions of Bangladesh Based on Upper Poverty Line (%)**



## 2.2 New Trends in Poverty and Inequality

- ❑ The evidence of income concentration at the top is both disquieting and overwhelming
  - During the 2010-16 period, income inequality in Bangladesh was on the rise at national, rural and urban levels
  - Over the same time frame, consumption inequality was fairly constant
- ❑ The share of income of the lowest 5% households has dropped down to 0.23% in 2016 from 0.78% in 2010
- ❑ In contrast, the income share of the top 5% households has gone up to 27.89% in 2016 from 24.61% in 2010
  - This is another indication of income concentration at the top
- ❑ Ratio of income of top 5% and bottom 5% households increased from 31.6 in 2010 to 121.3 in 2016

## 2.2 New Trends in Poverty and Inequality

- ❑ If monthly (nominal) income per HH is considered, the bottom 5% and 10% HHs, at all levels, have suffered significant decline during 2010-16
- ❑ Meanwhile, the situation was favourable for households in other deciles - particularly in the top 5% and 10% levels
- ❑ It can be inferred that the rich are getting richer while the poor are getting poorer

**Decile Distribution of Average Monthly Household Income (Tk.)**

Household distribution	2005			2010			2016			Growth *(%)		
	N	R	U	N	R	U	N	R	U	N	R	U
Bottom 5%	1,109	1,073	1,402	1,791	1,698	2,504	733	668	1,219	-59.1	-60.7	-51.3
Decile-1	1,441	1,371	1,883	2,296	2,152	3,262	1,610	1,415	2,618	-29.9	-34.2	-19.7
Decile-2	2,348	2,212	3,160	3,696	3,406	5,091	4,512	4,006	6,747	22.1	17.6	32.5
Decile-3	2,953	2,767	4,049	4,706	4,332	6,508	6,442	5,782	9,432	36.9	33.5	44.9
Decile-4	3,602	3,303	4,823	5,740	5,239	8,254	8,180	7,304	11,260	42.5	39.4	36.4
Decile-5	4,293	3,919	5,922	6,899	6,204	10,396	9,934	8,853	13,336	44.0	42.7	28.3
Decile-6	5,165	4,650	7,094	8,403	7,381	12,587	11,975	10,616	16,179	42.5	43.8	28.5
Decile-7	6,288	5,650	8,925	10,400	8,982	15,322	14,542	12,605	18,842	39.8	40.3	23.0
Decile-8	7,967	7,003	10,651	13,201	11,095	19,556	17,747	15,730	23,671	34.4	41.8	21.0
Decile-9	10,855	9,405	15,150	18,298	14,993	26,492	23,662	20,684	30,034	29.3	38.0	13.4
Decile-10	27,112	20,674	42,982	41,141	32,697	57,284	60,846	46,522	93,509	47.9	42.3	63.2
Top 5%	38,795	28,074	63,552	56,500	44,246	77,070	88,941	64,762	144,958	57.4	46.4	88.1

## 2.2 New Trends in Poverty and Inequality

- ❑ Wealth inequality depicts an even more dire picture
  - Rich population's share in total wealth (in terms of value) surged from 2005 to 2010 at the country, rural and urban levels
  - The scenario was exactly the opposite for the poor

**Percentage Share of Wealth at Household Level (%), and Gini Coefficient**

Household distribution	National		Rural		Urban	
	2005	2010	2005	2010	2005	2010
Bottom 1%	0.00	0.00	0.00	0.00	0.00	0.00
Bottom 5%	0.06	0.04	0.01	0.08	0.02	0.02
Top 5%	47.99	51.32	35.24	35.75	51.67	53.64
Top 1%	24.00	28.87	13.63	16.22	24.32	30.09
Gini Coefficient	0.72	0.74	0.63	0.62	0.78	0.79

Source: Bhattacharya et al (2017)

## 2.3 Fiscal Framework

- ❑ Widening gap between planned and realised budget has become a common feature, and weakness, concerning the public finance framework

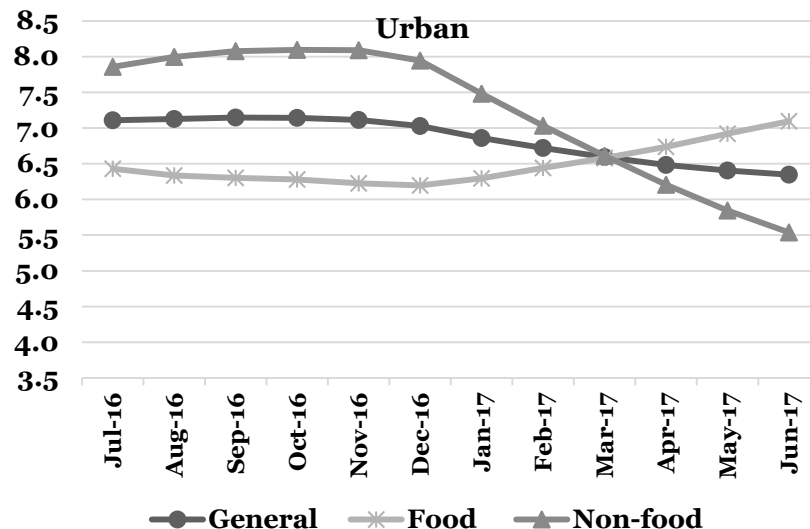
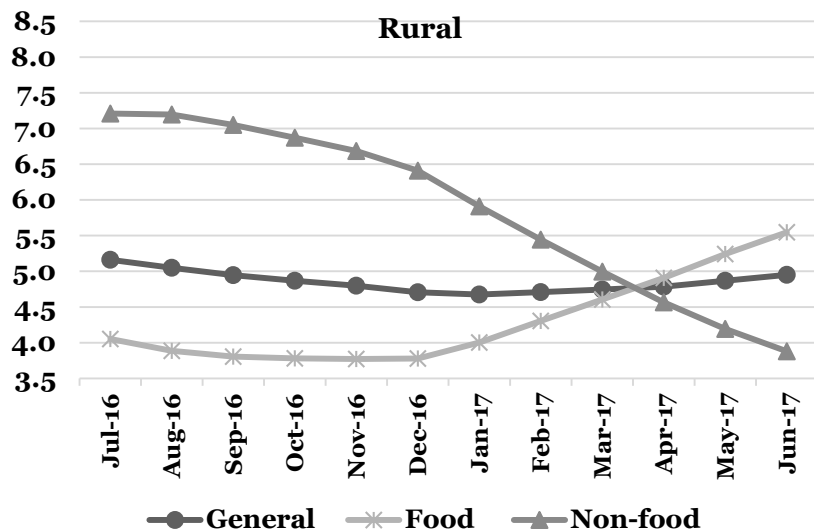
### Shifts in the Fiscal Framework: Growth Targets and Achievements in FY2017 (%)

Indicators	FY17B over FY16RB	FY17B over FY16A	FY17R B over FY16A	FY17A over FY16A	Attainment rate (%)	
					FY16	FY17
<b>Revenue collection</b>	<b>36.8</b>	<b>40.4</b>	<b>26.3</b>	<b>16.1</b>	<b>83.0</b>	<b>82.7</b>
NBR tax revenue	35.4	38.9	26.5	17.3	82.9	84.4
Non-NBR tax revenue	34.3	28.4	28.6	11.6	96.1	86.9
Non-tax revenue	47.0	53.6	24.6	9.0	80.4	71.0
<b>Total expenditure</b>	<b>28.7</b>	<b>42.4</b>	<b>32.6</b>	<b>9.3</b>	<b>81.1</b>	<b>76.8</b>
ADP	21.6	38.3	38.3	-3.5	82.5	69.8
Non-ADP	32.5	44.4	29.7	15.7	80.4	80.1
<i>Month when change reported</i>	<i>Jun'16</i>	<i>Sep'16</i>	<i>Mar'17</i>	<i>Sep'17</i>		



- ❑ The annual average inflation in June 2017 was 5.4% – well contained within the target of 5.8% envisaged in the MPS of Bangladesh Bank
  - Non-food inflation started to drop from 7.5% in September 2016 and stayed at 4.6% in June 2017
  - On the other hand, food inflation started to rise from 4.5% in December 2016 and reached 6.0% in June 2017
    - Primarily due to higher global food prices and various natural disasters

### Inflationary Trends in FY2017 (%)



## 2.5 Monetary Growth and Financial Institutions

- ❑ Growth rates of different monetary aggregates in FY2017 remained varied compared to their respective annual targets
  - Banking sector performance was a major disappointment

### Growth (%) of Monetary Aggregates in FY2017

Monetary Aggregates	Actual FY16	Target FY17	Actual FY17
<b>Net foreign assets</b>	<b>23.2</b>	<b>10.1</b>	<b>14.4</b>
Total domestic credit	14.2	16.4	11.2
Credit to public sector	2.6	NA	-12.0
Credit to private sector	16.8	16.5	15.7
Net other assets	14.4	NA	19.7
<b>Net domestic assets</b>	<b>14.2</b>	<b>17.3</b>	<b>9.7</b>
<b>Broad money</b>	<b>16.3</b>	<b>15.5</b>	<b>10.9</b>

## 2.6 External Sector Performance

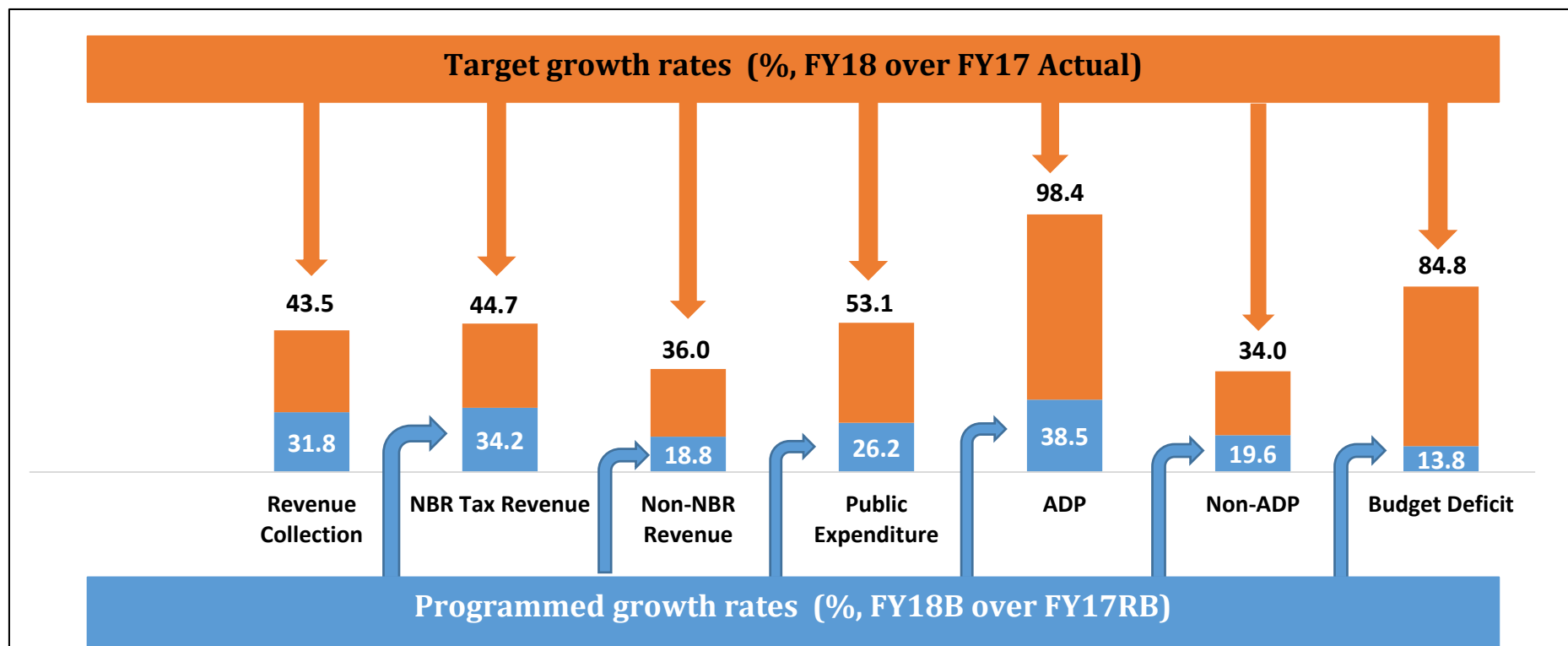
- ❑ Export performance was subdued throughout FY2017
  - Registering only 1.7% growth against the target of 8.0%
- ❑ Net foreign aid disbursement was about USD 2.6 billion in FY2017, posting a growth of 2.1% thanks to a late surge of inflows
- ❑ Inflow of remittance recorded a double digit negative growth for the first time in the history ((-) 14.5%) in FY2017
  - Curiously, during the same period overseas employment registered a strong 32.3% growth
- ❑ Import growth was relatively steady and posted 9.0% growth at the end of FY2017
- ❑ Current account balance entered into the negative terrain (USD (-) 1,480 million)
- ❑ Overall balance of payment managed to keep a surplus of USD 3,169 million in FY2017
- ❑ At the end of June 2017, forex reserves stood at USD 33.4 billion
- ❑ Exchange rate of BDT against USD crossed the 80 BDT/USD mark in May 2017, marking a depreciation of 2.8%

# SECTION III. MACROECONOMIC PERFORMANCE IN FY2018: EARLY SIGNALS

## 3.1 State of the Public Finance

**As apprehended during CPD's Analysis of the State of the Economy during the early months of FY18**

- ❑ For all indicators, except for net borrowing from non-bank sources, the actual growth targets for FY18 were found to be significantly higher than the targets set taking the revised budget for FY17 as reference point

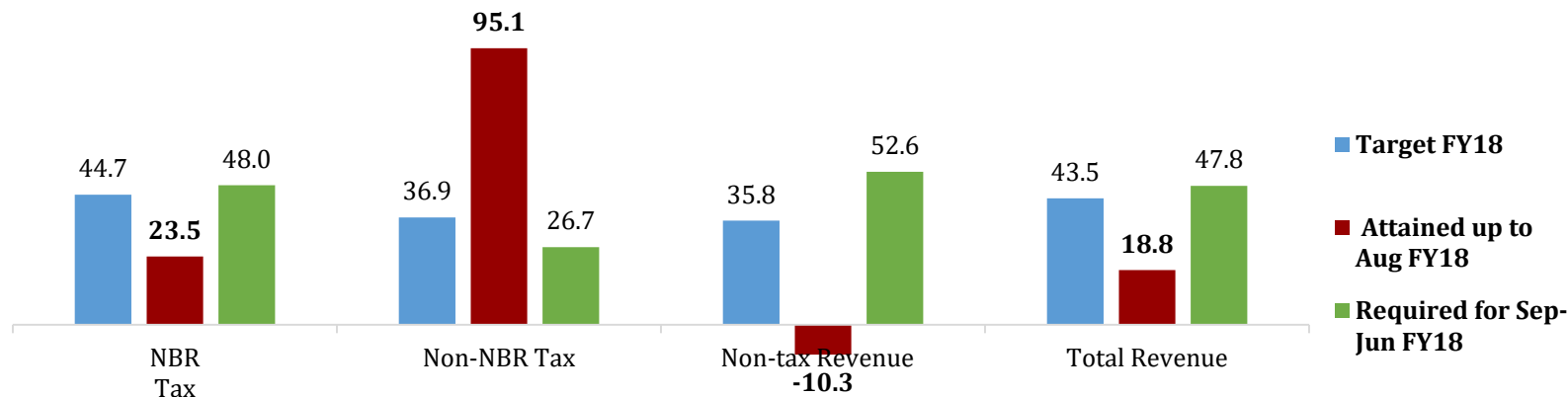


## 3.1 State of the Public Finance

### Revenue Scenario during early months of FY18

- ❑ Revenue mobilisation may fall short of target for the sixth consecutive year in FY18
  - CPD (2017) had earlier predicted that the revenue shortfall in FY18 could be between Tk. 43,000 crore and Tk. 55,000 crore
- ❑ Recently, the Hon'ble Finance Minister informed the Parliament that revenue collection during the Jul-Nov of FY18 increased by about 18%
  - To attain the annual growth target of 43.5%, total revenue will have to increase at a rate of 47.8% for the remainder of the FY18
- ❑ NBR achieved a growth of 23.5% during the Jul-Aug period of FY18 (24.1% in Jul-Aug of FY17)
  - The required growth of NBR collection for the rest of FY18 will have to be 48%
  - According to data available from NBR, during Jul-Oct period of FY18, revenue mobilised by NBR rose by 18.3% compared to the corresponding period of FY17

#### Growth Rates of Revenue Collection Components (%)



### **Reform agenda for revenue mobilisation in FY18 needs to be accelerated**

- ❑ The government should explore alternative avenues of revenue mobilisation:
  - The collection process of unpaid VAT accruing to the LTU of the NBR should be prioritised through using the ADR system
  - The forthcoming auction of 4G mobile telecommunications licence by the BTRC can be a potential source of revenue
- ❑ In view of the apprehended shortfall in revenue collection, a number of factors may put considerable stress in the fiscal management of FY18 from the expenditure side:
  - Rohingya rehabilitation expenditure
  - Flood and subsequent damage control measures
  - Public foodgrains import at higher cost from the international market in the backdrop of procurement failure

## 3.1 State of the Public Finance

### Discrepancies of statistics regarding fiscal parameters are remained pervasive

- ❑ Data discrepancy continues to hinder a proper assessment of the public finance management system mainly due to the divergence between data provided by several government agencies, viz. NBR, IMED, Bangladesh Bank, and the iBAS reported by the MoF
- ❑ Possible explanations behind this discrepancy in data could be because of the divergence in the data management and processing practices of different government agencies in terms of:
  - Methodology
  - Data collection tools and techniques
  - Accounting practices
- ❑ Implications of data discrepancies
  - Impedes budgetary monitoring and compromises the quality of fiscal and budgetary planning
  - Need a reconciliation and consolidation between these estimates for the sake of ensuring efficacy of public finance management

**Data Discrepancy (crore Tk.)**

Year	Difference		
	MRFP vs NBR (NBR Revenue Collection)	MRFP vs IMED (ADP Expenditure)	MRFP vs BB (Budget Deficit)
<b>FY13</b>	5,820	562	-3,969
<b>FY14</b>	9,397	1,586	-11,645
<b>FY15</b>	11,785	8,520	-8,904
<b>FY16</b>	9,279	3,539	-7,611
<b>FY17</b>	13,506 (7.9)	23,574 (30.5)	-3,667 (-6.0)
<b>Jul-Aug FY18</b>	-1,045	-449	14,219

*Figures in the parenthesis are departure from MRFP in %*



### Expenditure scenario during early months of FY18

- ❑ The total public expenditure (during Jul-Aug of FY18) increased by 29.7% compared to the corresponding period of FY17
  - This is well below the annual growth target of 53.1%
- ❑ The total Non-development expenditure increased by 31.7% (during Jul-Aug of FY18)
  - Pay and allowances' registered 53.4% growth
  - Domestic interest payments increased by 26.4%
  - Foreign interest payments decreased by (-) 7.9%
  - Subsidy and transfer expenditure increased by 18.7%

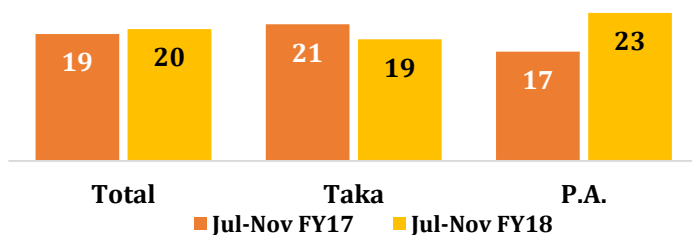
## 3.1 State of the Public Finance

### Expenditure scenario during early months of FY18

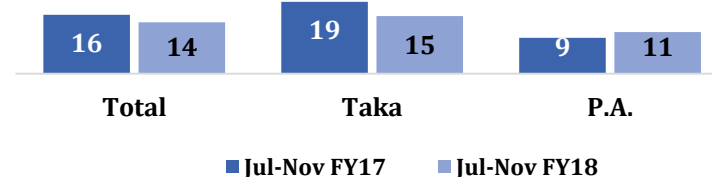
#### ❑ ADP expenditure

- Data by IMED indicates that expenditure for ADP showed signs of improvement during the first five months (Jul-Nov) of FY18
  - The actual ADP spending was 20.1% of the originally planned allocation of Tk. 155,931 crore during Jul-Nov of FY18
  - ADP expenditure was driven by the project aid utilisation of 22.6% (highest since FY10)
- The top 10 Ministries/Divisions which account for 73.3% of the total ADP allocation in FY18 spent 22.8% of their allocation during Jul-Nov of FY18 (highest in the last 5 fiscal years)
- ADP expenditure was mainly driven by the Power Sector (47.6%) without which project aid utilization and total ADP implementation rates would fall by 12 percentage points and 6 percentage points respectively

**Total ADP Implementation (%)**



**ADP Implementation without Power Division (%)**



### **A mismatch between financial and physical progress of ADP projects**

- ❑ High financial progress but low physical progress of the completed ADP projects is a disturbing feature of the ADP
  - In FY16, out of 258 completed ADP projects 123 were declared 'completed' despite failing to meet physical implementation target. Amongst these 123 projects:
    - 33 (26.8%) belonged to the Transportation sector
    - 20 (16.3%) belonged to the Agriculture sector
    - Three-fourths of the projects were Investment projects
    - The average completion period for these projects were 5.3 years
  - In FY16, a total of 134 ADP projects registered zero physical progress (out of 1,557 projects, i.e. 8.6%)
    - 48 of these projects belonged to the Transportation sector and 39 projects belonged to the Physical Planning, Water Supply and Housing sector
    - More than one-fourth of these projects have accounted for some amount of financial progress
    - A total of 29 of these ADP projects already spent more than 50% of their financial allocations amongst which 14 projects spent 100% of the allocated funds (e.g. 'Construction/Acquisition of 4 no. 108 TEU's Self /Propelled Cellular Container Vessel of 100 TEU's for BIWTC' project under the Ministry of Shipping)

### **Cost overrun of ADP projects lead to wastage of public resource**

- ❑ In order to find the cost escalation of projects, CPD conducted an exercise covering all the projects which were declared completed in FY06 and in FY16 and which had a financial progress of 80% or more
  - In FY16, total of 201 completed projects had more than 80% financial progress
  - 93 projects faced cost escalation with cumulative amount of Tk. 5,640 crore
  - This additional amount of Tk. 5,640 crore is equivalent to 13.1% of the costs of all the completed projects in FY16 which is an increase of 36.1% compared to FY06
  - Out of 24 Ministries and Divisions that faced cost escalation, the top 5 Ministries and Division that faced increased cost escalation in FY16 as compared to FY06 are:
    - Local Government Division (Tk. 1,868 crore)
    - Ministry of Communication (Tk. 1,073 crore)
    - Energy and Mineral Resources Division (Tk. 921 crore)
    - Ministry of Food and Disaster Management (Tk. 661 crore)
    - Ministry of Primary and Mass Education (Tk. 356 crore)
    - On a positive note, the Power Division could minimised the escalated cost of its completed projects in FY16 compared to FY06

## 3.1 State of the Public Finance

### Budget Financing of FY18

- ❑ Budget deficit was well within the projected limit during the first two months of FY18
  - Deficit financing was primarily driven by sale of NSD certificates which accounted for Tk. 9,045 crore (Jul-Aug of FY18).
  - It is 30% of the annual target of Tk. 30,150 crore
  - Foreign financing gained significant momentum during Jul-Aug of FY18
  - Higher interest rates than bank deposits induced the savers to invest more in the NSD certificates:

**Incremental Share of Selected NSD Certificate Sale & their Interest Rates**

- ❑ Most of the sales increase occurred in instruments with higher interest rates from amongst the 19 types available
- ❑ From the fiscal management perspective this could become a pressure point in the context of debt servicing liability in the medium term

Name of Scheme	Incremental Share of Sales (%)				Interest Rate (%)
	FY14	FY15	FY16	FY17	
5-year Bangladesh Savings Certificate	10.99	10.70	14.92	6.64	9.35-11.28
Family Savings Certificate	7.05	39.30	13.30	33.44	9.50-11.52
3 Monthly Profit Bearing Savings Certificate	63.15	33.71	0.68	32.18	10.00-11.04
Pensioner Savings Certificate	1.49	3.24	29.43	12.72	9.70-11-76
Post Office Savings Bank - Ordinary account	0.07	0.50	3.80	0.63	7.50
Post Office Savings Bank - Fixed deposit account	10.99	10.34	25.28	14.87	10.20-11.28
Wage Earner Development Bond	1.88	1.75	12.06	-0.58	12.00

## 3.2 Inflation and Monetary Sector Scenarios

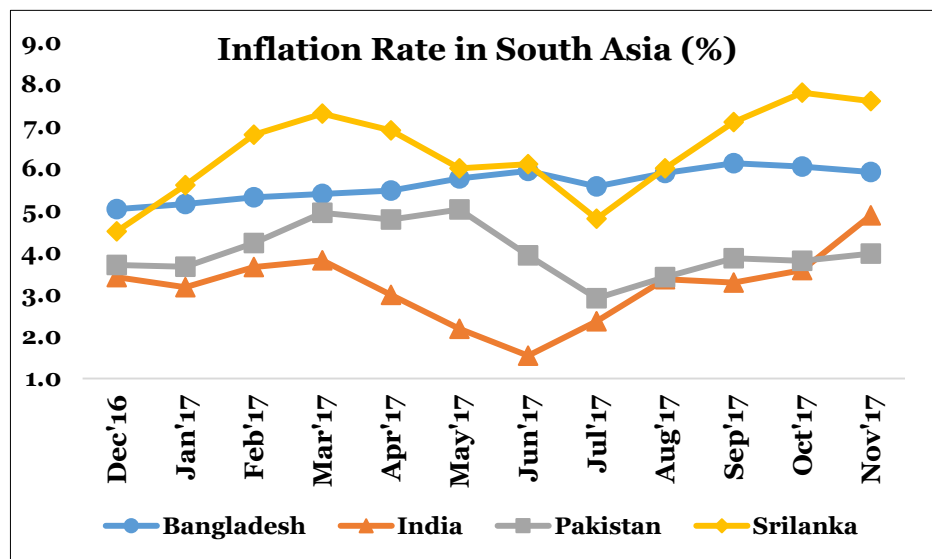
### Inflation in Bangladesh and South Asian countries

❑ Since mid-2017, Bangladesh, along with other South Asian countries, has experienced a rise in inflation

- Reason: consecutive floods in Bangladesh, and other natural disasters across the region

❑ In Bangladesh, food inflation increased significantly during this period (7.13% in Dec, 2017 *vis-à-vis* 5.38% in Dec, 2016)

- The rise in food inflation across the region did not have a strong relationship with the global food market



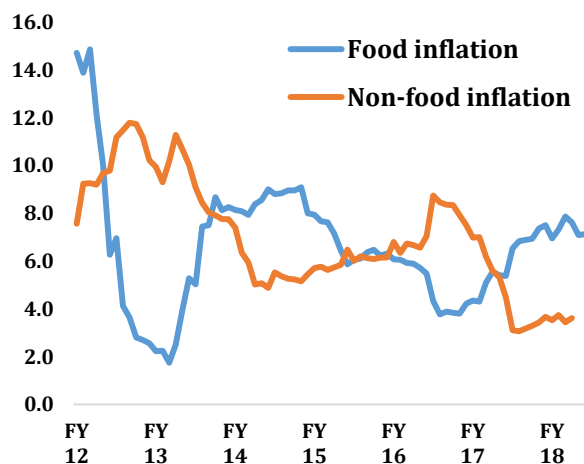
Correlation between Global Food Price Index and Local Food Price Index		
	Food Price Index (Global vs Local)	Rice Price Index (Global-Rice vs Local-Food)
Bangladesh	-0.71	-0.83
India	-0.82	-0.8
Pakistan	-0.71	-0.91
Sri Lanka	-0.43	-0.26

## 3.2 Inflation and Monetary Sector Scenarios

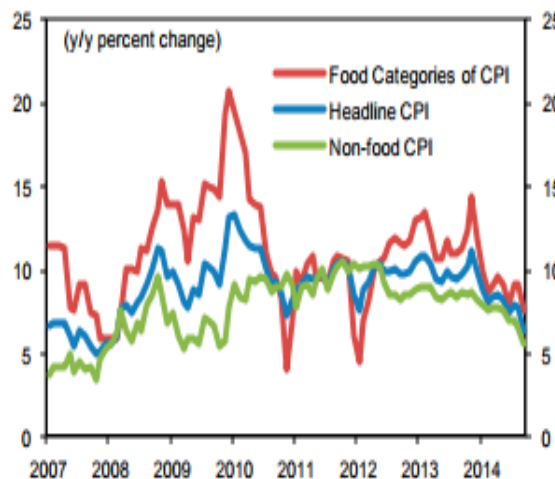
### Relation between food and non-food inflation

- ❑ Bangladesh's food and non-food inflation, unlike those of other South Asian countries, evince a peculiar trend

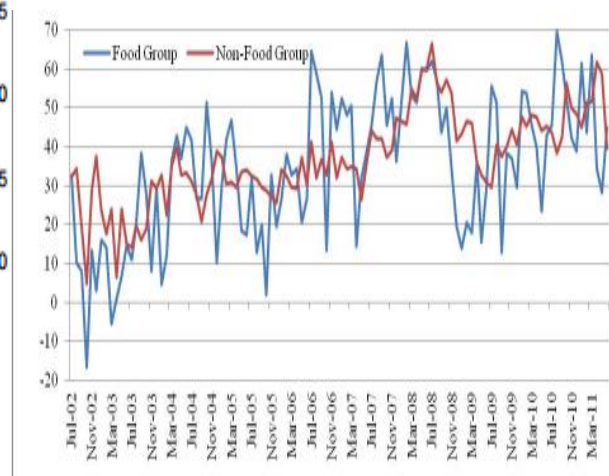
**Trends of Food and Non-Food Inflation: Bangladesh, India and Pakistan**



Bangladesh



India



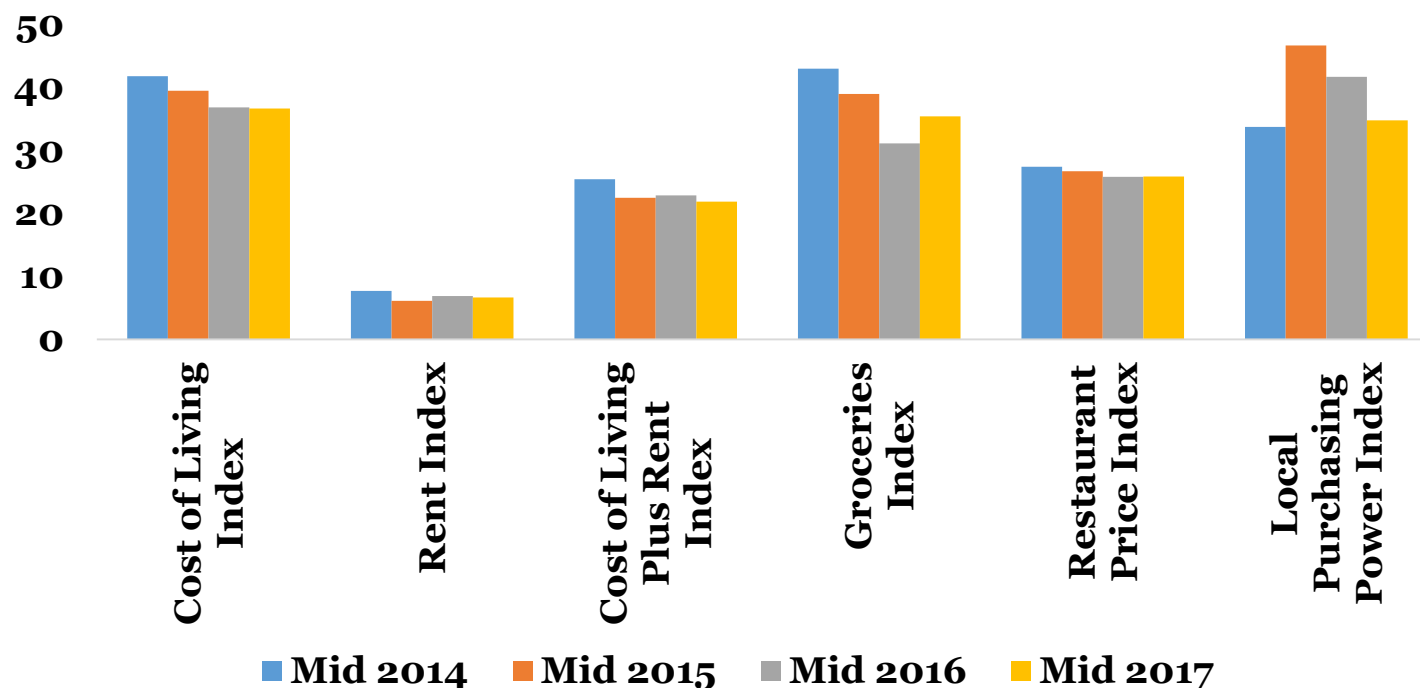
Pakistan

- In Bangladesh, food and non-food inflation maintain a negative correlation (-0.32)
  - This remains negative even in the lagged periods
  - Relationship appears to be different for other countries

## 3.2 Inflation and Monetary Sector Scenarios

- ❑ Since July 2016, prices of most of the components of non-food inflation have gradually reduced around the time when the food inflation had started to rise.
  - Difficult to match with other available information ( e.g. cost of living index of Dhaka, available at <https://www.numbeo.com/cost-of-living/rankings.jsp>)

**Dhaka: Cost of Living Index**

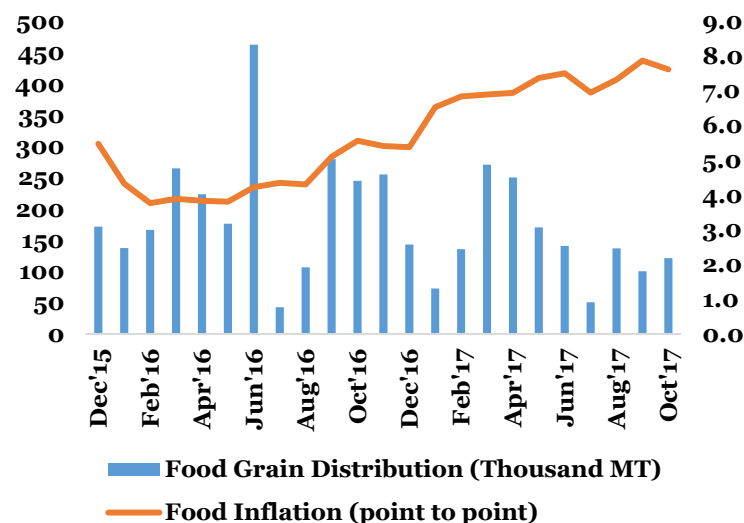




## 3.2 Inflation and Monetary Sector Scenarios

### Impact of inflation on households and government's initiatives

- ❑ Between October 2016 and October 2017, wage indices for major economic activities experienced a rise between 6.1 per cent and 7.5 per cent
  - Slower growth rate in wage indices were observed for construction (6.1%) and services (6.4%) while higher growth rates were seen for fishery (7.1%) and production (7.5 %)
- ❑ Slower growth in wages alongside the increase in inflation left workers of some sectors (such as construction and services) with just enough to meet the bare minimum requirement of household expenses
- ❑ Government's distribution of foodgrains was 28.8% less (1.68 million MT vs 2.36 million MT) compared to the same period of the previous year
- ❑ The food distribution was at the lowest level when the inflationary pressure was at its peak
  - Further adverse impact on the purchasing power of low income households
  - With consequent implications for poverty and food insecurity



## 3.2 Inflation and Monetary Sector Scenarios

- ❑ Inadequate stock is the major reason behind the failure to ensure required foodgrain supply under the PFDS
  - High food inflation is likely to continue in the coming months
  - Public procurement may be affected because of lower production of Aman
- ❑ A possible shortfall of foodgrains for PFDS during H2 FY18 could be between 2.44-3.47 lakh MT
  - Needs to be imported through public channel (without depending on purchase from the private sector from the local market).
  - An additional food budget will be required (Tk.700 crore to Tk.1,152 crore)

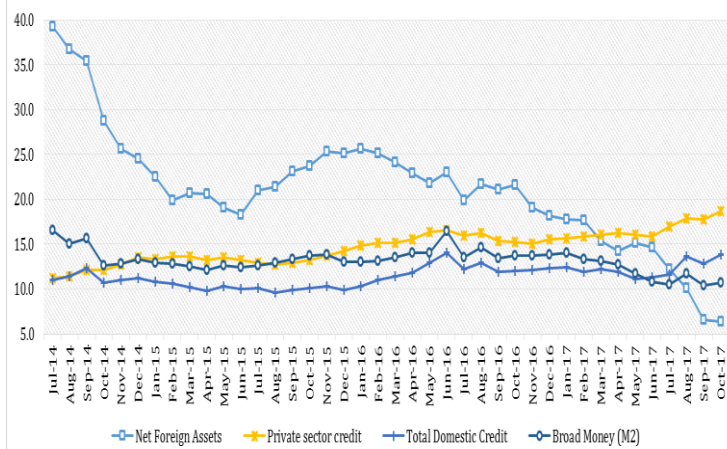
**Requirement of Food to Replenish PFDS Stock during H2 of FY2018 (in million m. ton)**

Items	FY18 (Target)	FY 18 (as of 21 Dec., 2017)	Differences	
			Actual (as of 21 Dec, 2017)	If procurement target is met
<b>1. Food distribution</b>	2.44	0.66	1.78	1.78
<b>Rice</b>	1.86	0.5199	1.34	1.34
<b>Wheat</b>	0.58	0.1445	0.43	0.43
<b>2. Requirement of food</b>			0.35	0.21
<b>Rice</b>			0.31	
<b>Wheat</b>			0.04	
<b>3. Cost of Import (BDT)</b>			1152 cr.	702.1 cr

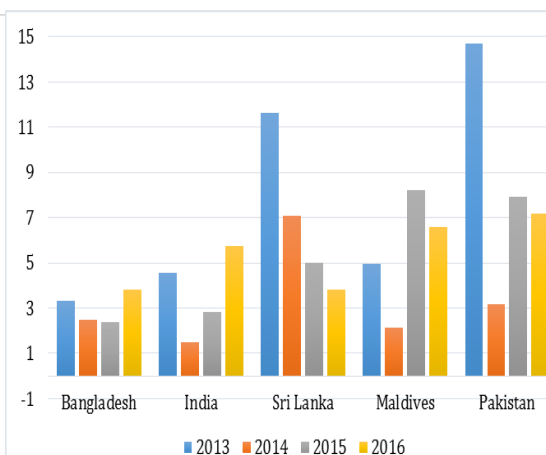
## 3.2 Inflation and Monetary Sector Scenarios

- ❑ In recent years, growth of broad money was significantly influenced by one or two components instead of the balanced growth of the involved components.
  - Growth of net foreign assets decelerated and public sector credit had significantly declined
  - Credit to the private sector had experienced considerably high growth which was even higher than the MPS target for H1 of FY18
- ❑ This is happening at a time when performance of its financial sector has weakened.
- ❑ Quality of private sector credit growth in Bangladesh is a major concern

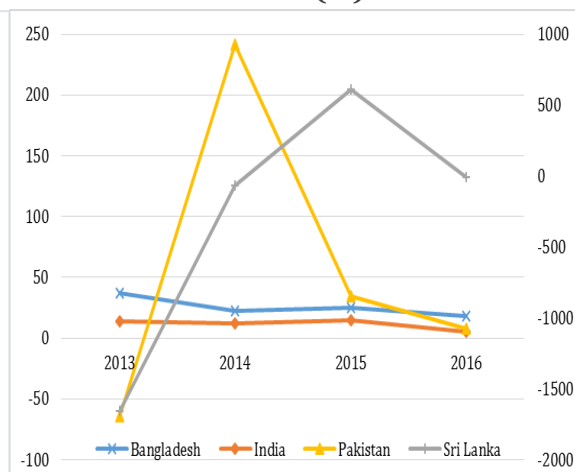
**Growth of Monetary Aggregates (%):  
FY15 to FY18 (up to October)**



**Government Claims as % of M2**

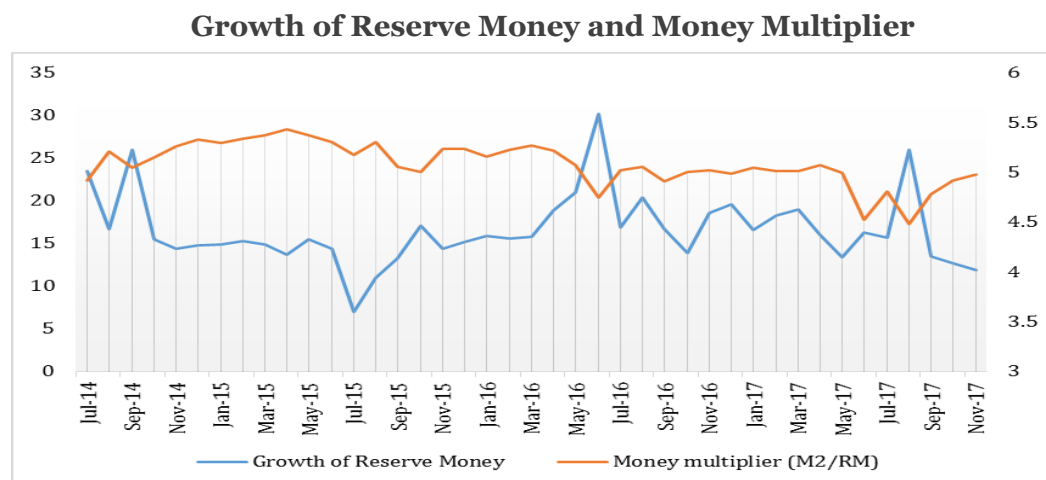
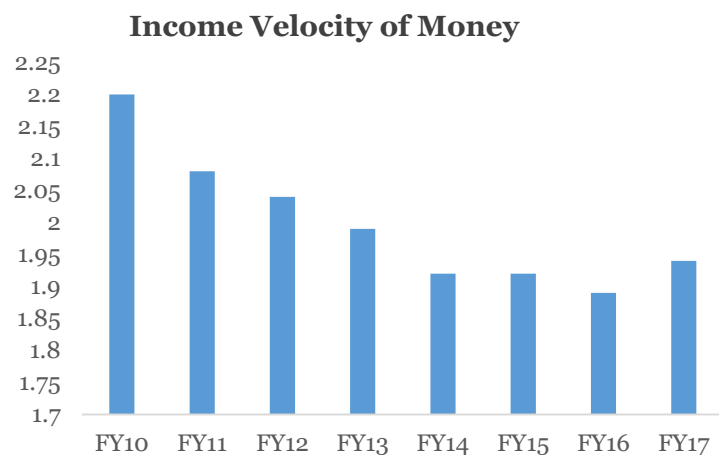


**South Asia: Growth of Net Foreign Assets (%)**



## 3.2 Inflation and Monetary Sector Scenarios

- ❑ Quality of broad money growth can be examined through various indicators:
  - The income velocity of money followed a declining trend over the past several years apart from FY17 when there was a rise – from 1.89 in FY16 to 1.94 in FY17
  - Given the sluggish growth of M2 in FY18 with a possible high growth in GDP, velocity of money may experience a further slowdown in FY18
  - This would have further adverse effect on transactions in the real sector
  - Money multiplier decreased from 5.02 in November, 2016 to 4.98 in November, 2017 which pushed banks to maintain higher reserve money

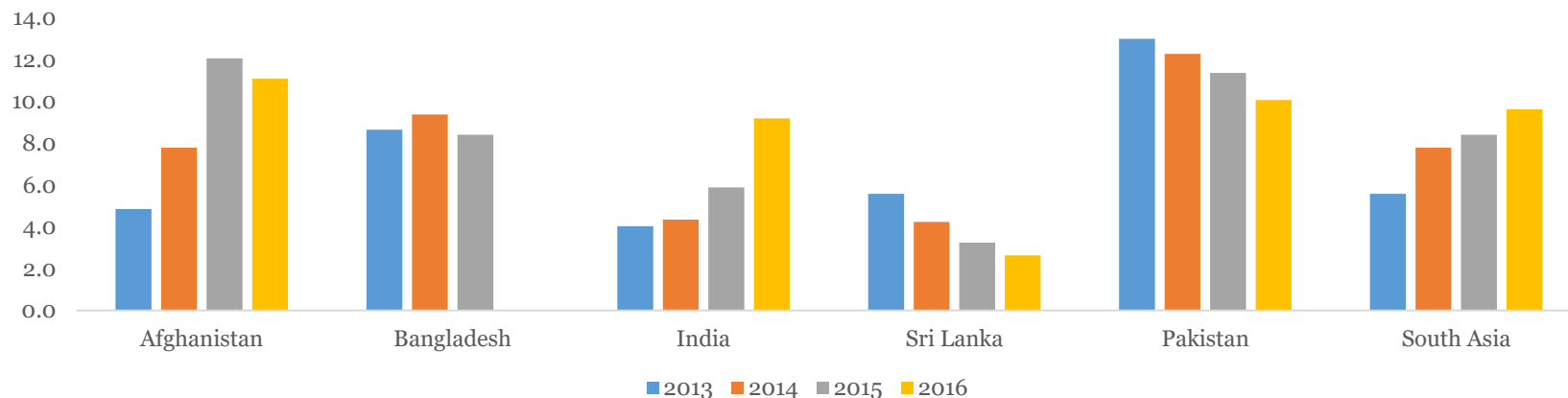


## 3.2 Inflation and Monetary Sector Scenarios

### Private sector credit

- ❑ Share of advances to some traditional sectors such as trade and commerce (35.6%) was overtaken by the industrial sector (38.9%)- apparently good sign!
  - Rise in share in advances was observed in case of term loan and working capital distributed to large, medium and small industries and construction sectors
  - Such a compositional change is likely to help industrial growth
- ❑ High share of NPL (close to the South Asian average), mostly attributed to industrial sector, has put the quality of private sector credit under scrutiny

NPL (as % of Gross Loans): 2013-16



## 3.2 Inflation and Monetary Sector Scenarios

- ❑ Excess liquidity in the banking sector contributed to pushing down both deposit and lending rates
  - Lending rate declined at a slower pace compared to that of deposit rate
- ❑ Decline in lending rates is not at same level in all sectors
  - High lending rates prevailed in case of advances through credit cards (36%), term loan to small industries (18%), working capital to large and small industries (18-19%) and housing loan (17.8%)
  - In each sector the gap between 'max' and 'min' lending rates are still quite high
  - Despite a decline in the interest rate, high rates of lending continued to prevail in key sectors, discouraging investors

## 3.2 Inflation and Monetary Sector Scenarios

- ❑ There is a growing concentration of bank lending to limited number of borrowers of large and medium scale industries
  - The stress test and resilience test indicate that having a default incurred by 3, 7 and 10 largest borrowers in each bank, the number of banks which could become non-compliant was 25, 38 and 4 respectively (Bangladesh Bank, 2017)
- ❑ The quality of private sector credit needs to be monitored very closely by the central bank and the commercial banks

### **Public Sector Credit**

- ❑ GoB's dependence on non-bank financial instruments continued in FY18
  - During Jul-Oct, 2017 net borrowing from non-bank sources was 9.7% higher than the comparable period of 2016
  - During this period, government repaid interest payment of Tk. 6,732 crore against the principal amount of Tk. 9,468 crore
- ❑ CPD in its earlier IRBD reports argued for putting a lower ceiling on NSD sales and a downward review of the interest rates
  - If GoB could borrow more from the banking system, it would reduce the pressure of excess liquidity




### Growth in Exports and Imports

- ❑ Export sector of Bangladesh evinced positive signals during the 1st half of FY18
  - Export growth rate **has bounced back**
  - Total export earnings during the first half of FY18 was **USD 17.9 billion**
  - The recorded growth rate was **7.1%** (against 4% in 1st half of FY17)
  - A period-on-period growth of **9.2%** will be required in the remaining half (January-June) of FY18 to reach the export target of USD 37.5 billion
- ❑ RMG recorded a growth of 7.8% - Knit (11.5%) and woven (4.1%)
  - Non-RMG export growth (4.4%) was unable to keep pace
- ❑ Export growth in the traditional markets was 9% - **gained some momentum**
  - 11.3% in the EU market, 9.2% in Canada and 1.6% in the US market
- ❑ LDC graduation: future trade negotiations will determine the scale of preferential margins received by Bangladesh in the key markets, and consequently the export competitiveness
- ❑ The Export Policy 2015-2018: will **phase out** in 2018
  - ❑ **Next export policy** must take note of the developments in the key markets (e.g. Brexit), competing economies and the shift of trade arrangements post to LDC-graduation



- ❑ US imports of RMG products from Bangladesh and China is decreasing
  - There are growing signs that it is Vietnam is being more able to take the advantage of China's displacement from the US market

**Analysis of RMG Imports in the US Market**

Countries	2011	2013	2015	2017	2011	2013	2015	2017
	July - October				July - October			
	Period-on-period growth				Compositional share			
Bangladesh	8.7	17.9	11.9	-5.1	4.9	5.5	5.7	 5.5
Cambodia	17.4	-48.0	2.7	5.2	3.2	3.0	2.8	2.8
China	2.9	2.9	1.5	-3.8	42.8	42.1	40.5	 37.3
India	4.4	16.5	3.1	7.5	3.3	3.4	3.5	3.9
Vietnam	13.7	13.6	11.2	7.8	8.2	9.8	11.9	 14.0

- ❑ In both the US and the EU markets, the price effects and volume effects (within the export value growth) experienced pulls in opposite direction
  - Growth in the value of exports in these markets are **mostly volume-driven**
    - The average prices of RMG products from Bangladesh in both the EU and the US markets have been **falling** in the year 2017 (continuation of the trend from 2014)
    - Vietnam experienced an increase in prices of woven products in the US market
  - Since even for items at disaggregated level, Bangladesh's price was somewhat lower than key competitors, it is possible that there is scope for Bangladesh to **negotiate better prices** though improvement in quality and design of the same items

- ❑ Significant import payments growth: **28.7%**; but L/C settlement growth don't commensurate (only 8.3%)
- ❑ Rice Import: USD 623 million; mainly because of production shortage due to flood
  - Import of rice is likely to continue: in view of higher domestic retail prices, lower public stock and reduced tariff
- ❑ Suspicious import growth of raw cotton: 75% (upturn since Nov. 2016)
  - Cotton price was stable; unmatched RMG export growth; no strong indication of sudden spurt in investment in spinning
  - NBR and the Bangladesh Bank should increase scrutiny to identify cases of over-invoicing and capital flight
- ❑ High import growth for sugar (50%) and edible oil (39%) – likely to continue
- ❑ Import growth of capital machinery: 43.9%; public-sector-led infrastructure projects contributed
- ❑ Bangladesh may face additional burden of import payments in the 2nd half of FY18 as price of crude oil evinced signs of rise
- ❑ ToT has worsened: In October 2016 import payments for 1 barrel of crude oil was costing the equivalent of earnings from exports of 3.7 kg of knitwear products in the US; to contrast, the corresponding figure for October 2017 was 4.3 kg, an increase of 17.3%

### ❑ Terms of Trade has worsened

Terms of Trade against RMG Exports in the US and EU Market (Base = October 2016)

<i>the US market</i>						
Products	KG of knit (61)			KG of woven (62)		
<b>Selected Major import products</b>	<b>Oct-17</b>	<b>Oct-16</b>	<b>Increase (in %)</b>	<b>Oct-17</b>	<b>Oct-16</b>	<b>Increase (in %)</b>
1 barrel of crude oil	4.3	3.7	17.3	3.4	2.4	42.0
1 MT of rice	30.7	27.3	12.5	24.7	18.2	36.1
1 kg of Cotton	0.1	0.1	5.3	0.1	0.1	27.5
Fertilizer(index)	6.1	5.3	14.9	4.9	3.5	39.0
<i>the EU market</i>						
Products	KG of knit (61)			KG of woven (62)		
<b>Selected Major import products</b>	<b>Sep-17</b>	<b>Sep-16</b>	<b>Increase (in %)</b>	<b>Sep-17</b>	<b>Sep-16</b>	<b>Increase (in %)</b>
1 barrel of crude oil	3.8	3.6	5.0	3.2	2.9	7.4
1 MT of rice	28.7	30.7	-6.5	24.0	25.1	-4.3
1 kg of Cotton	0.1	0.1	-7.5	0.1	0.1	-5.4
Fertilizer(index)	5.3	5.7	-6.9	4.4	4.6	-4.8

### Remittance and Migration

- ❑ Remittance growth for (Jul-Dec) FY18: **12.5%**; but, **(-) 7.4%** below than FY15
  - Exchange rate depreciation and upturn of oil price helped the slow recovery of remittance growth
- ❑ Migration growth for (Jul-Dec) FY18: **26.8%**; but, **(-) 20.0%** if excludes KSA
- ❑ A review of past record evince the followings:
  - Concentration of migrants in the Middle East
  - Migration in Malaysia and Italy had declined while stagnated in South Korea and Singapore
  - Remittance from the Middle East was on relative consistent decline – one of the reasons is felt to be greater movement through informal channels
  - Share of remittance from non-traditional markets increased to 33.2% from 30% over last three fiscal years (FY2015 to FY2017) compared to the earlier six fiscal years (FY2009-FY2014)

- ❑ Shares of remittance channeled through SOBs and IBBL have declined since January 2017 while non-resident Bangladeshi commercial banks are not performing well
- ❑ CPD's earlier claim of digital hundi - proved to be a real factor behind remittance diversion
  - Interventions made by BB (e.g. BFIU ordered bKash to suspend activities of 2,887 agents for breaching the laws in September 2017; 8 agents were arrested in January 2018 ) followed by an investigation **may have helped** to:
    - improve remittance earnings
    - bring more transparency in the mobile banking transfers

### Exchange Rate Dynamics

- ❑ BDT started to experience some depreciation since second quarter of FY17 continuing to the early months of FY18
  - Monthly average nominal exchange rate (NER) in the first half of FY2018 was USD/BDT 82.6 (December 2017) –same as in 2012
  - Real effective exchange rate (REER), has declined in the first 5 months of FY18 from 153.4 in July to 150.7 in November 2017 (Source: Bruegel Database)
- ❑ Analysis of the cross-currency rate with Bangladesh's major trade competitors reveals that BDT is **reaching to pre-appreciation level**
  - one can expect the **exports to benefit** from REER movement in the coming months

**Cross-currency Comparison with Trade Competitors** for the period FY2013 – FY2018 (first half, up to December 2017)

Competitor	Currency rate	Current NER*	Same level previously**	Current REER	Same level previously**
Cambodia	KHD/BDT	0.02002	July 2012	0.8911	March 2015
China	CHN/BDT	12.52	March 2013	0.8828	May 2016
India	INR/BDT	1.25	January 2015	0.8000	April 2015
Vietnam	Dong/BDT	0.003640	August 2014	0.9329	March 2016

Note: \*As of December 2017 for China and Vietnam, as of November 2017 for India and as of October 2017 for Cambodia

\*\*The time has been noted for which the exchange rate was approximately similar to the current rate

### Foreign loans availed by private sector

- ❑ Total number of foreign loans has increased dramatically over the years (2011-2017)

Analysis of Foreign Loans availed by the local companies (2011 to 2017)

Year	Total No. of Loans	Share of No of Loans from OBUs (%)	No. of Hard loans	No. of Soft Loans	Average Maturity Period (Years)	Average Interest rate (%)	Total Amount of Foreign Loans (USD million)
2011	24	29.2	7	14	5.2	4.6	909.3
2012	62	32.3	5	50	5.1	4.2	1466.2
2013	103	49.5	1	100	5.2	4.2	1182.3
2014	129	52.7	6	99	4.5	4.7	1771.1
2015	129	52.7	3	98	5.0	3.1	1930.2
2016	148	61.5	11	108	5.0	3.3	1386.5
2017	134	59.0	40	67	5.5	3.6	1494.3

- ❑ RMG sector dominated (60.2% of the total number of foreign loans)
  - Followed by power sector with a share of 11.4%
- ❑ Higher payment obligations in foreign currency over the coming years
- ❑ Depreciation of BDT in the recent past will put further pressure on debt servicing liabilities
- ❑ Current policy of allowing foreign loans, on a case by case basis, **should be re-evaluated** - justified on account of falling interest rate in the domestic market and the need to bring back good investors within the fold of domestic financial system

### Balance of Payments

- ❑ Foreign exchange reserve has declined to USD 32.0 billion as of January 2018
- ❑ Current account balance: USD (-) 3,311 million for Jul-Oct FY2018
  - Mainly driven by the negative trade balance of USD (-) 5,791 million
- ❑ The overall balance of payments: USD (-) 225 million for the Jul-Oct FY18
  - ❑ Thankfully, medium and long-term (MLT) foreign loans doubled
- ❑ Trade deficit may continue to rise in the 2<sup>nd</sup> half of the FY18 despite signs of improved export and remittance performance
  - Foreign exchange reserve to come under pressure
  - Central bank needs to take cautious approach in pursuing its monetary policy
  - Stimulate export earnings and remittance flows
  - Maintain exchange rate stability
  - Rein in imports



## SECTION IV. SELECTED ISSUES FOR FY2018

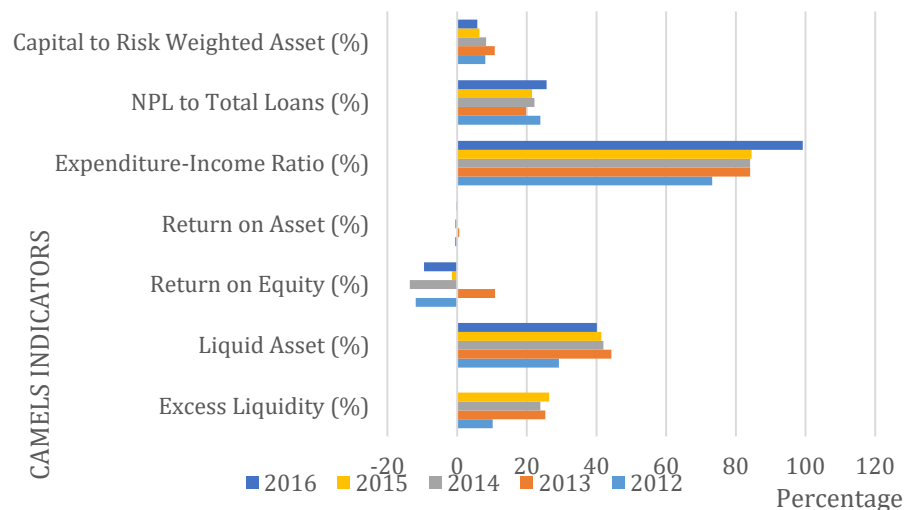
## 4.1 Crisis in the Banking Sector

### **Performance of the banking sector of Bangladesh has been disappointing in recent times**

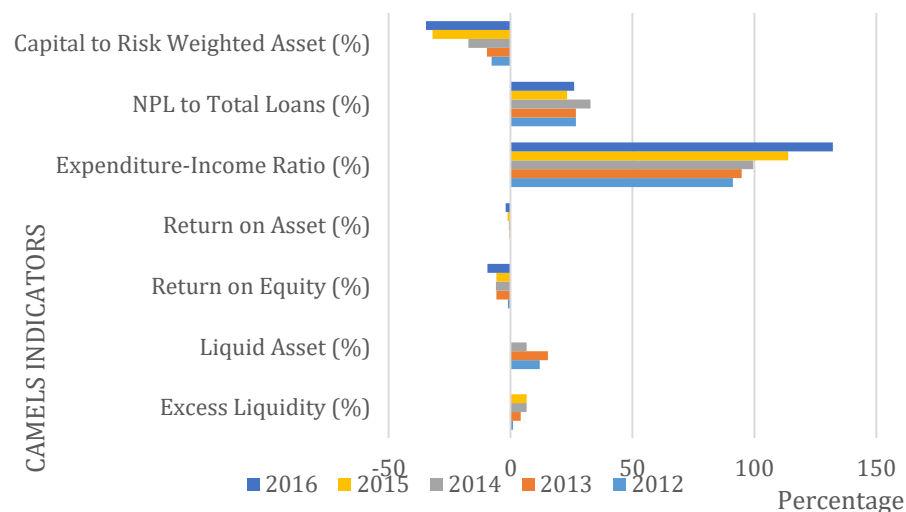
- ❑ The banking sector has been plagued by
  - financial scams
  - non-performing loans
  - inefficiency
  - slack monitoring and supervision
- ❑ 65% of banks faced financial crimes during the years 2014-2016 (Habib 2017)
- ❑ Financial statements of borrowers was always available to the banks only 17% of the time (Siddique 2017)
- ❑ Two detrimental amendments of dubious nature have been proposed to the Banking Company Act
  - tenure of board of directors is proposed to increase from 6 years to 9 years
  - up to four family members would be allowed to be on the Board, instead of the earlier two per family

# 4.1 Crisis in the Banking Sector

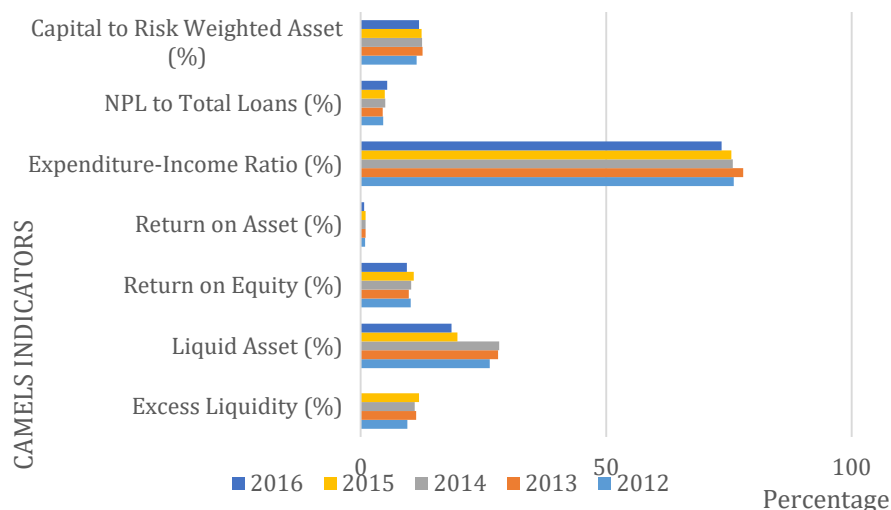
Performance of State Owned Commercial Banks 2016-2012



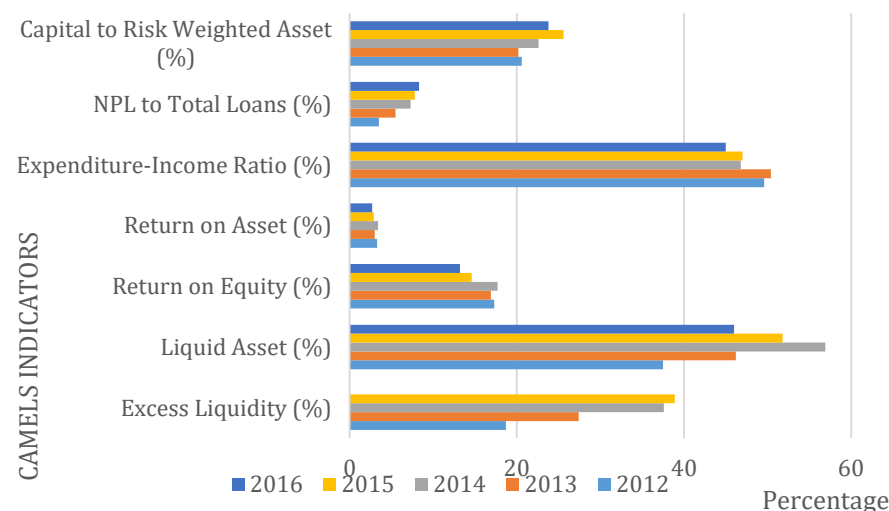
Performance of Development Finance Institutions 2016-2012



Performance of Private Commercial Banks 2016-2012



Performance of Foreign Commercial Banks 2016-2012



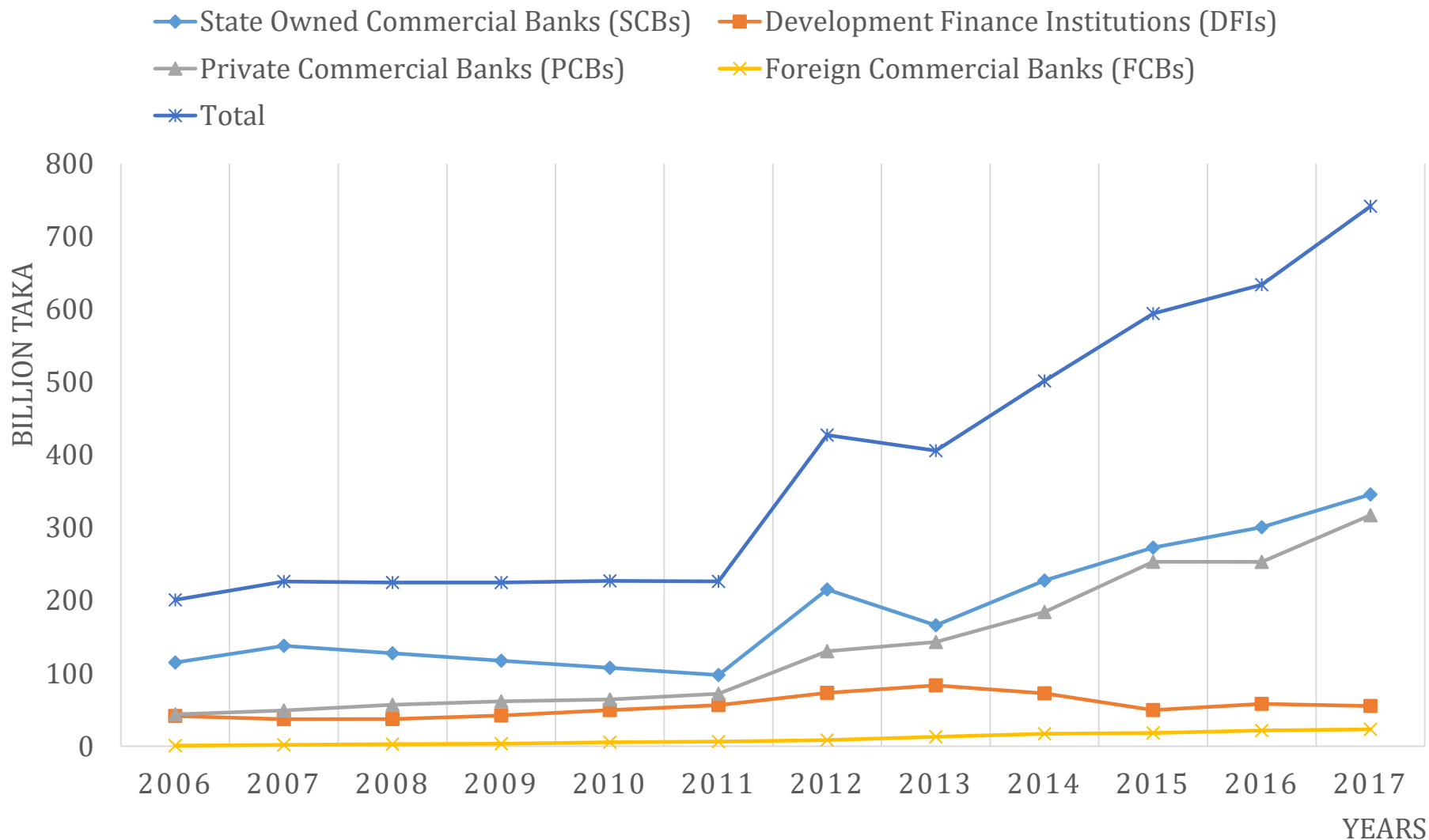
## 4.1 Crisis in the Banking Sector

- ❑ 95% bankers believed that the new banks were redundant (Nabi 2016)
- ❑ Instead of opening new banks,
  - new branches could also be opened by the existing banks
  - banking and financial services could be provided digitally
    - Index of Financial Inclusion (IFI) in Bangladesh had increased from 27.5% in 2010 to 65.5% in 2014, mainly due to the opening of a large number of mobile banking accounts (Rabbi 2016)
- ❑ Farmers Bank is now on the verge of collapse after being hit by scams and scandals
  - Due to acute liquidity crisis, the bank is unable to pay its depositors
    - This is creating panic amongst the depositors should are desperately trying to take their savings out of the bank
  - Bangladesh Bank has
    - Allowed Farmers Bank to float subordinated bonds worth Tk. 500 crore
    - Provided short term loan of Tk. 96 crore
  - However, the situation in Farmers Bank is getting worse every day and may soon be as bad as Oriental Bank

## 4.1 Crisis in the Banking Sector

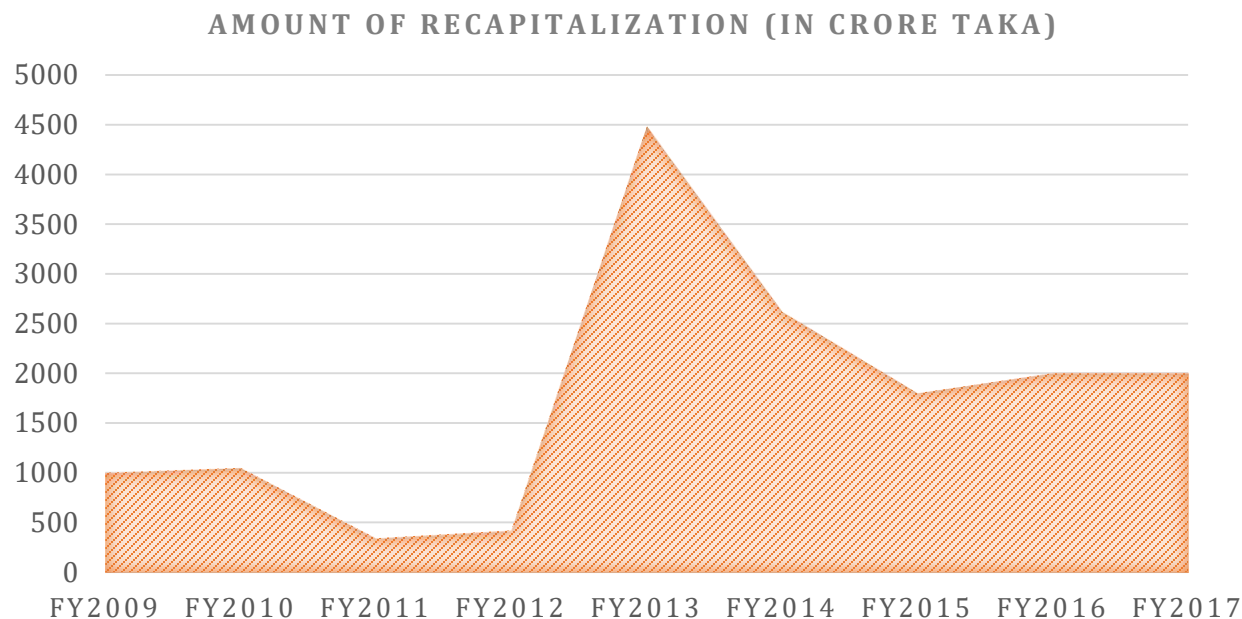
- ❑ In general, high interest rates are not causally related to high level of NPLs in Bangladesh (Ahmed 2006) (Mujeri 2009, Hossain 2012)
  - Exception is small and medium enterprises (SMEs)
    - For SMEs high interest rates could be a reason behind NPLs (Jahan 2016)
- ❑ Reasons behind high amount of NPLs in Bangladesh include political instability, corruption, poor governance, and weak rule of law (Banerjee 2017; Alam 2015)
- ❑ During the years 2011-2014,
  - On average only 33% of first time rescheduled loans, and 30% of third time rescheduled loans were recovered (Chowdhury 2017)
  - Loans worth Tk. 45,527.4 crore were written off by the banking as of 30 June 2017
- ❑ Only 14% of bankers considered the borrower selection process to be extremely effective (Habib 2017)

## 4.1 Crisis in the Banking Sector



## 4.1 Crisis in the Banking Sector

- ❑ Tk. 15,705 crore spent in recapitalising the banks during the period FY2009-FY2017.
- ❑ This amount is roughly half the cost of the construction of the Padma Bridge.
- ❑ Instead of government-funded recapitalisation, banks should
  - use revenue to increase capital
  - search for investors to buy bank shares
  - merge with other commercial banks



## 4.1 Crisis in the Banking Sector

- ❑ Embezzlement of public money by a handful of corrupt people and escalation of financial crimes in Bangladesh indicate that the banking sector is in dire straits
- ❑ Immediate attention and decisive actions are required on the part of the government to rescue the banking sector from this dire situation.
  - Immediate Measures for the Failed Banks
    - Bangladesh Bank should appoint administrators immediately to oversee the operation of the banks
  - Implementing Risk Management Guidelines
    - The central bank outlined six core risks, and requested banks to adopt appropriate measures to address them in 2012 – needs to ensure enforcement
  - Improving Internal Control
    - The internal control department of state owned commercial banks is in need of a serious overhaul
  - Combating Cronyism in Banking
    - Financial reporting fraud in banks is more likely if the Board of Directors is dominated by insiders (Beasley 1996; Dechow 1996; Farber 2005; Song 2004; Uzun 2004)
    - Despite being cautioned by the central bank in 2014, two private commercial banks still had four or more members from the same family in their Board of Directors, as of 12<sup>th</sup> January 2018
  - Upholding Central Bank's Independence
    - Interference in Bangladesh Bank's activities goes against the spirit of Bangladesh Bank Amendment Bill 2003 which was geared to guarantee the central bank with autonomy
  - Refrain from providing licenses to new banks under “political consideration”



### Key Short Term Recommendations

- A special financing scheme should be considered for rural (affected) people to get access to low cost formal credit
- Adequacy and coverage of agricultural rehabilitation programmes can be extended through better use of agriculture subsidy budget
- Government should make use of the NGO networks to reach the remotest and farthest flood-affected areas
- Adoption of digital tools may help the government to improve the efficiency and efficacy of flood relief activities by reducing misidentification, overlaps and by helping to put in place improved monitoring system

### Key Medium Term Recommendations

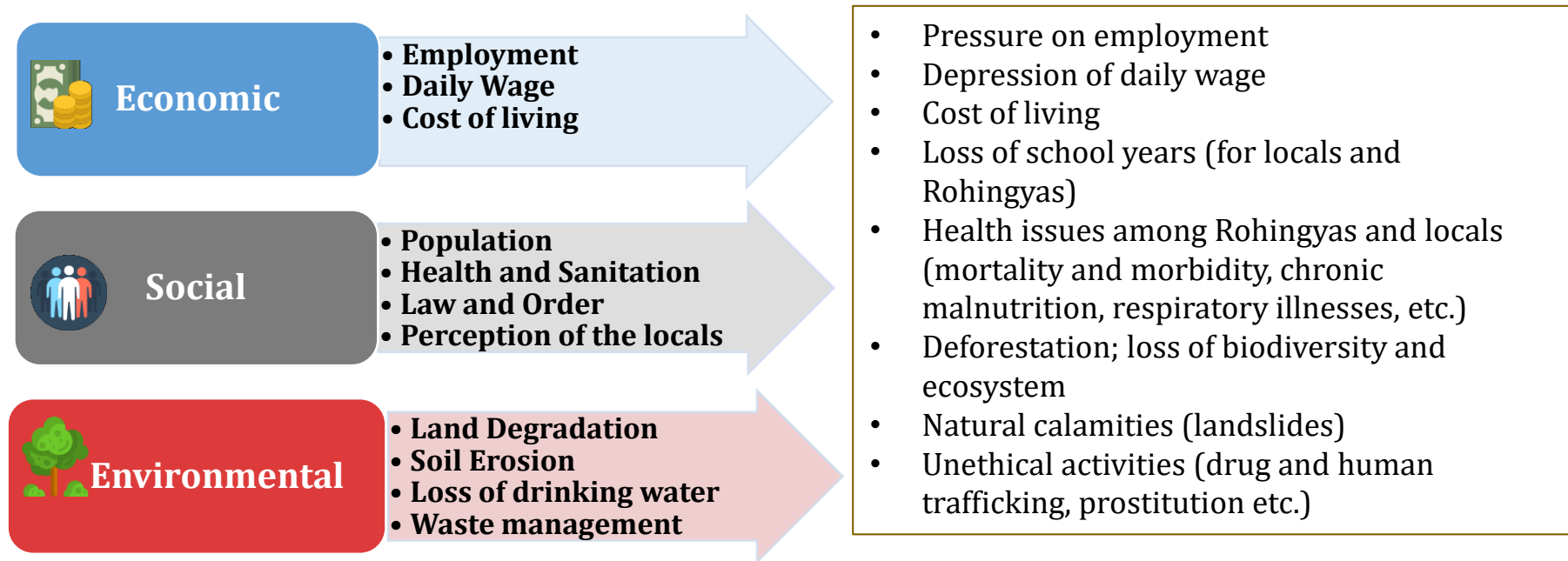
- Rebuilding and repairing of embankments and dams need to be carried out in a timely and coordinated manner
- Projects need to be undertaken as part of integrated flood management framework on a priority basis to repair damaged road networks
- Structural flaws of road, bridge and culvert networks in many rural areas adjacent to farm lands, which cause water logging, need to be remedied
- Need to undertake a project to establish protection walls at *haor* areas after proper technical and feasibility assessment
- Periodic dredging of various canals and rivers linked to *haors* is a must to protect the ecosystem of the *haor* wetlands
- Good governance in the flood (disaster) management and strengthening institutional capacity in implementing the projects ought to be seen as priorities by policymakers

## 4.3 Implications of Rohingya Crisis for Bangladesh

- ❑ Between 25 August 2017 and 7 January 2018, about 655,500 Rohingyas have arrived in Bangladesh
- ❑ CPD undertook a study to understand the economic implications of the Rohingya crisis
  - The findings were presented at a dialogue on 11 November 2017.
- ❑ A Memorandum of Understanding was signed on 23 November 2017 between Bangladesh and Myanmar for the repatriation of Rohingyas
- ❑ Myanmar State Counsellor said they would take back daily maximum 300 Rohingyas
- ❑ Bangladesh and Myanmar formed a joint working group (JWG) in December 2017
- ❑ The “physical arrangement” regarding repatriation will be finalized on 15 January 2018
- ❑ Rohingya repatriation is planned to start from 23 December 2017

## 4.3 Implications of Rohingya Crisis for Bangladesh

- ❑ Bangladesh will face several challenges due to the unfolding crisis of the Rohingya influx
- ❑ These will have three dimensions- economic, social and environmental



- **6,000 acres** of land was deforested by the Rohingya camps
- According to CPD estimates, this is equivalent to **Tk. 741.3 crore** or **USD 86.7 million**

## 4.3 Implications of Rohingya Crisis for Bangladesh

- ❑ According to OCHA and UNHCR, total fund requirement for the September 2017 – February 2018 would be USD 517.8 million (USD 434 million + USD 83.8 million additional funds)
- ❑ CPD estimated that USD 882 million will be required for the period September 2017 - June 2018
- ❑ Recent bilateral and political developments have indicated towards Rohingya repatriation
- ❑ In this context, CPD has estimated the cost of hosting the Rohingyas based on three scenarios

### Description of hypothetical scenarios and their underlying assumptions

<b>Scenario 1: Assuming 300 Rohingyas are repatriated every day, without incorporating population growth and inflation</b>	<b>Common Assumptions:</b> <ul style="list-style-type: none"> <li>➤ Total Rohingyas: 860,000               <ul style="list-style-type: none"> <li>• Previous Rohingyas: 205,000</li> <li>• New Rohingyas: 655,000</li> </ul> </li> <li>➤ Working days: 25 days per month</li> <li>➤ Inflation rate: 6% every year</li> <li>➤ Population growth rate: 1.5%</li> <li>➤ Estimates indicate only direct costs to be incurred for the Rohingyas</li> <li>➤ Implicit costs for the environmental degradation and morbidity and mortality can be large</li> <li>➤ Repatriation and relocation costs not included</li> </ul>
<b>Scenario 2: First scenario repeated by incorporating population growth and inflation</b>	
<b>Scenario 3: Assuming 200 Rohingyas are repatriated every day by incorporating population growth and inflation rate</b>	

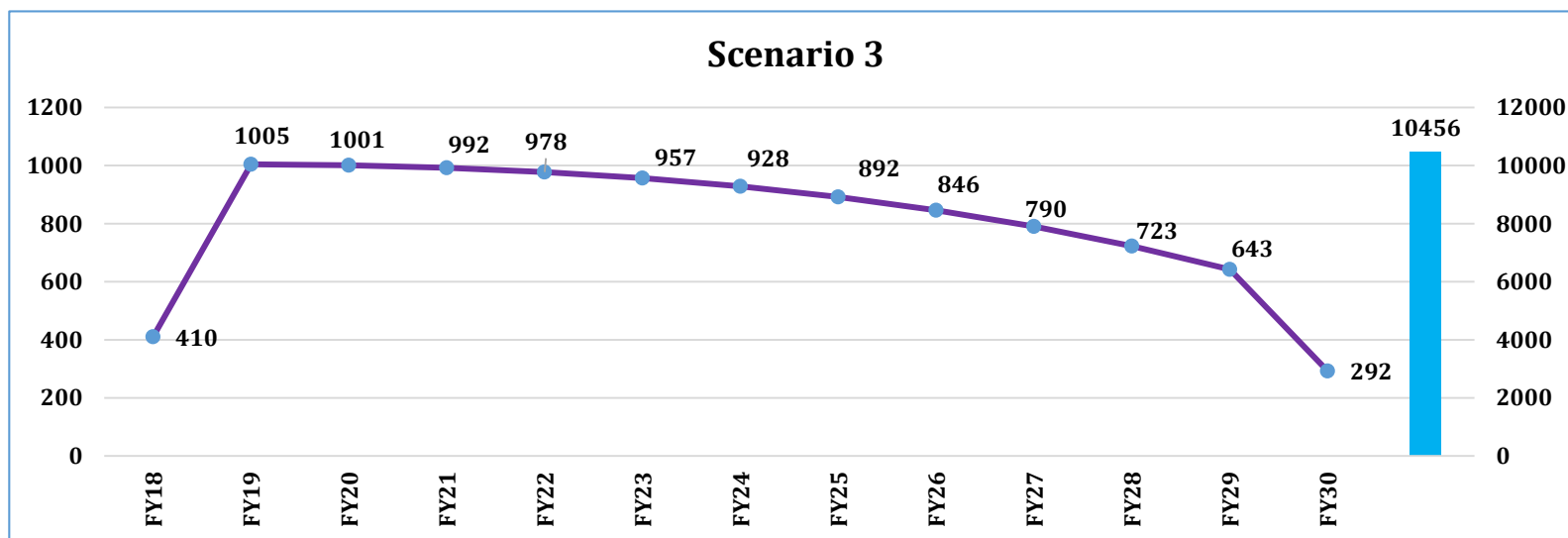
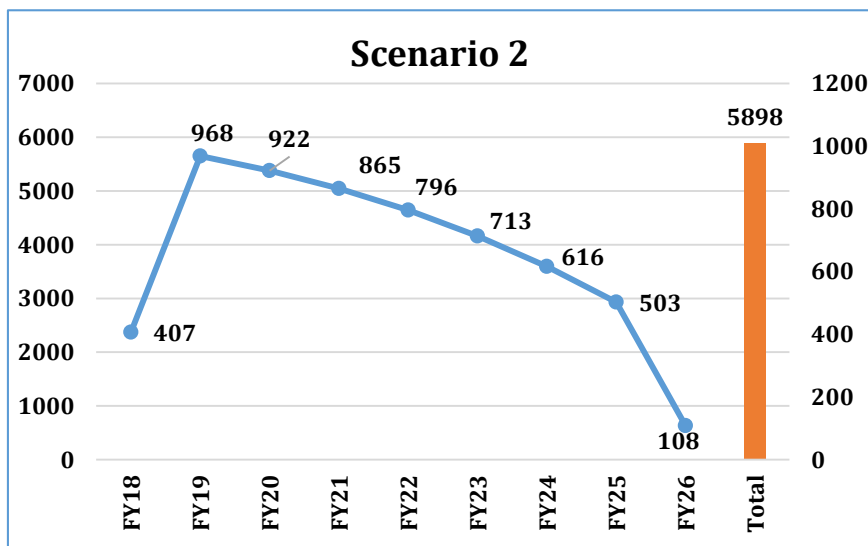
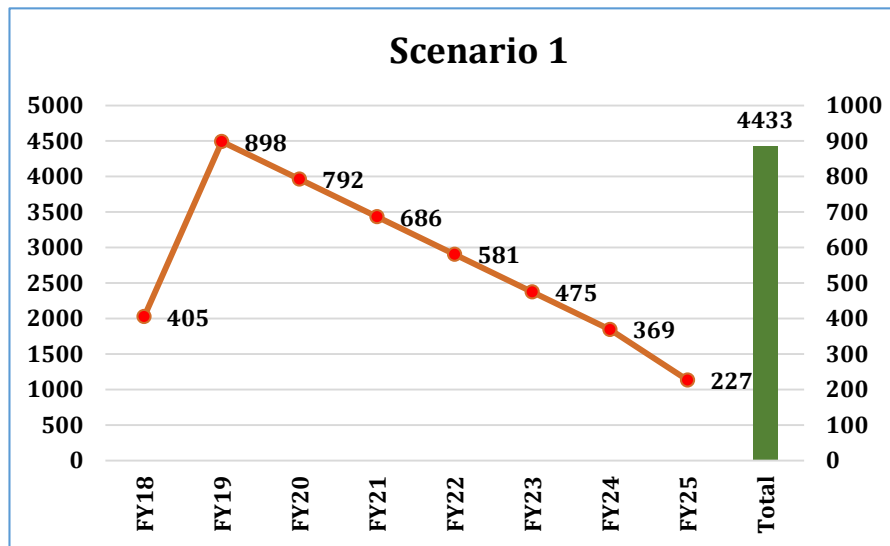
## 4.3 Implications of Rohingya Crisis for Bangladesh

### Summary Findings on Repatriation Time and Cost of Hosting Rohingyas

Scenarios	Assumptions	Required years for repatriation	Cost of hosting Rohingyas (USD mln)	Previous Rohingya entrants	
				Remaining after repatriation	Cost of hosting in the following period (USD mln)
<b>Scenario 1</b>	-300 Rohingyas per day -no inflation or population growth	<b>7</b> <i>(up to FY25)</i>	<b>4,433</b> <i>(up to FY25)</i>	<b>205,000</b> <i>(up to FY25)</i>	<b>384</b> <i>(in FY26)</i>
<b>Scenario 2</b>	-300 Rohingyas per day -population growth and inflation rates included)	<b>8</b> <i>(up to FY26)</i>	<b>5,898</b> <i>(up to FY26)</i>	<b>231,000</b> <i>(up to FY26)</i>	<b>466</b> <i>(in FY27)</i>
<b>Scenario 3</b>	-200 Rohingyas per day -population growth and inflation rates included	<b>12</b> <i>(up to FY30)</i>	<b>10,456</b> <i>(up to FY30)</i>	<b>245,000</b> <i>(up to FY30)</i>	<b>625</b> <i>(in FY31)</i>

# 4.3 Implications of Rohingya Crisis for Bangladesh

Cost of hosting the Rohingyas throughout the repatriation period in million USD (Three Scenarios)



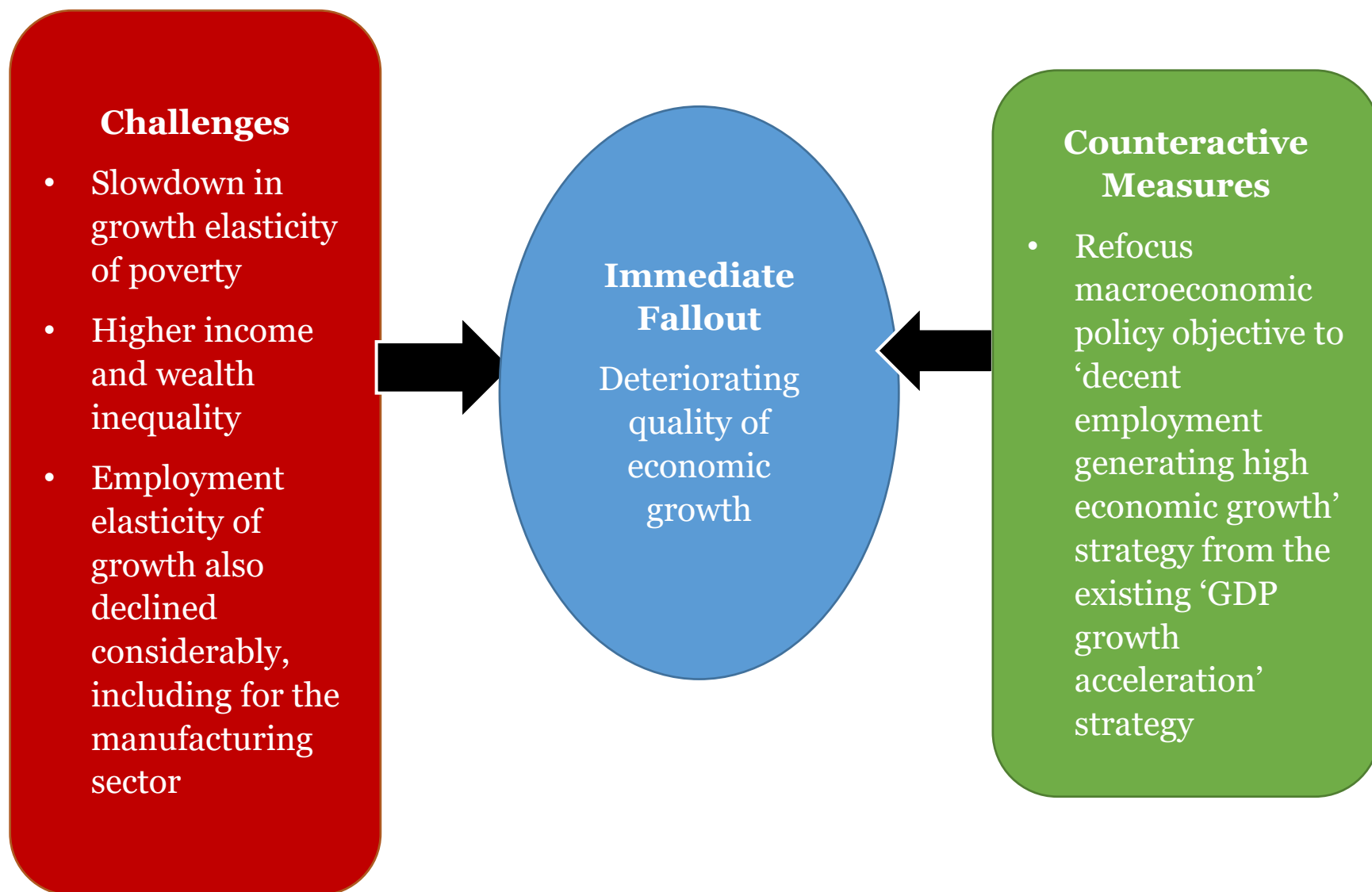
## 4.3 Implications of Rohingya Crisis for Bangladesh

- ❑ Ensure smooth repatriation process of the Rohingyas as agreed between the governments of Bangladesh and Myanmar
- ❑ Preparedness on the part of Bangladesh will also be critical
- ❑ Preparation for post-Geneva follow-up meeting for resource mobilisation has to begin now
- ❑ Support for the Rohingyas from the donors should in the form of grants only
- ❑ Continue energetic diplomacy to accelerate the repatriation process

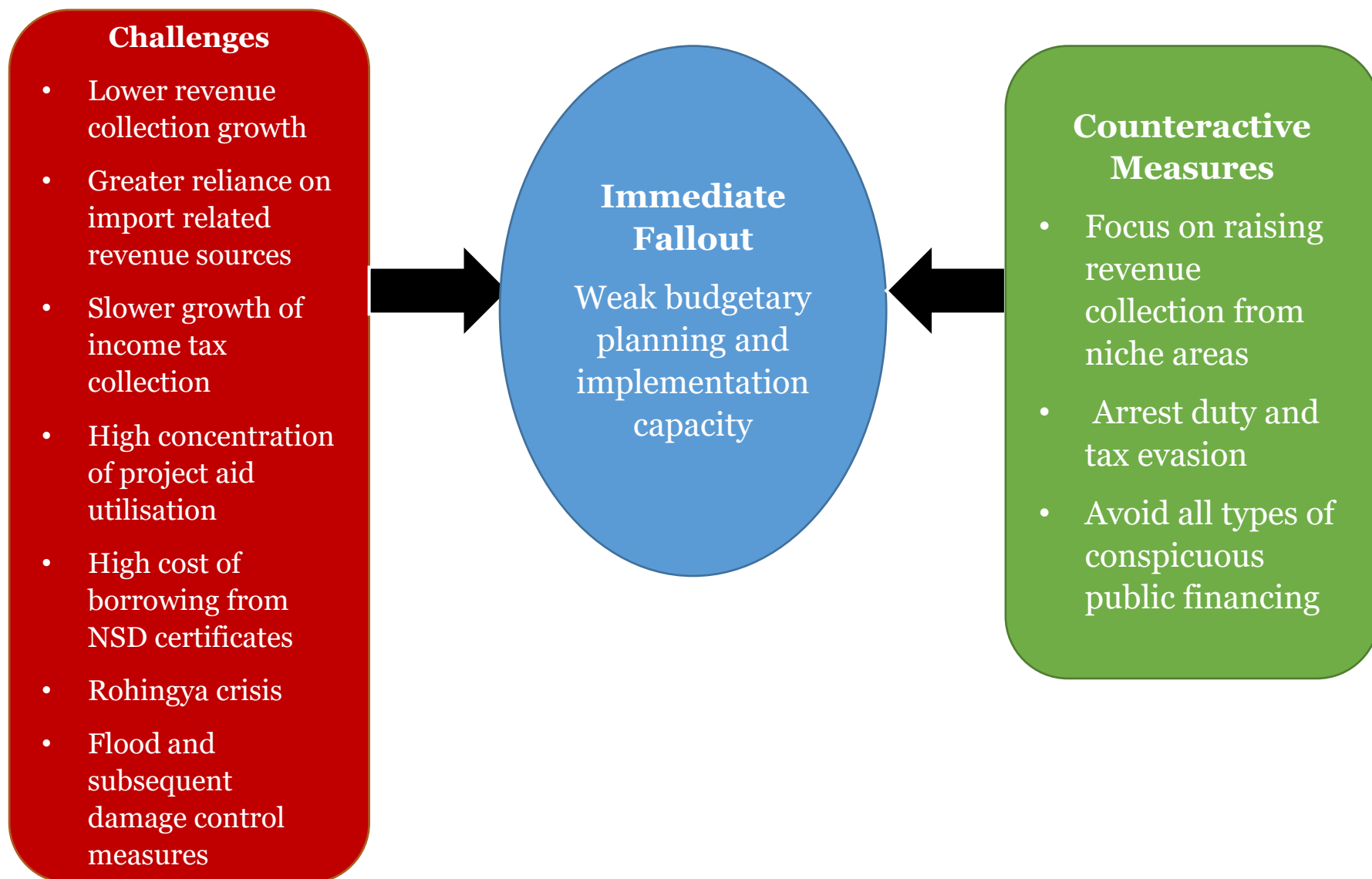


## SECTION V. CONCLUDING REMARKS

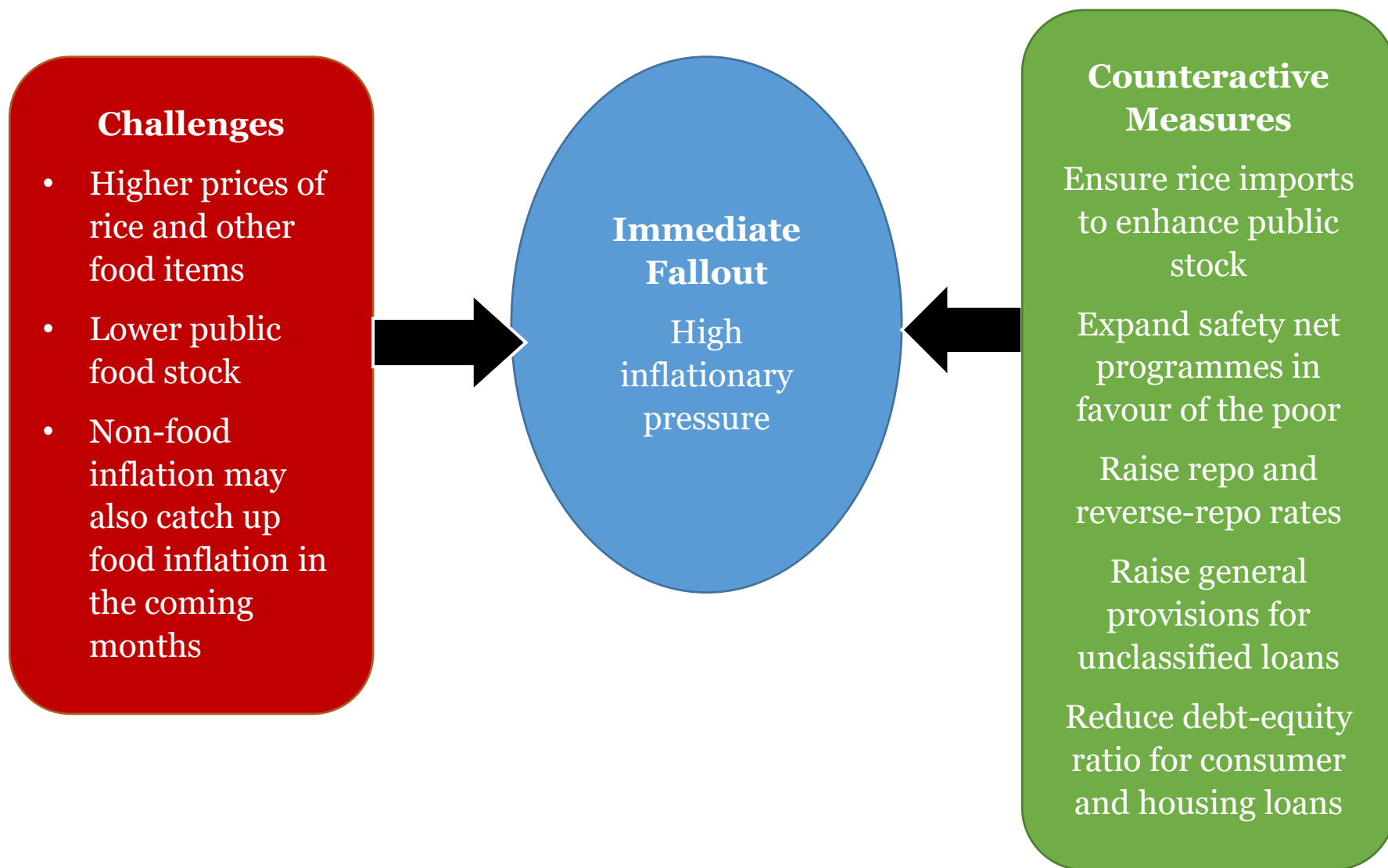
## 5. Concluding Remarks



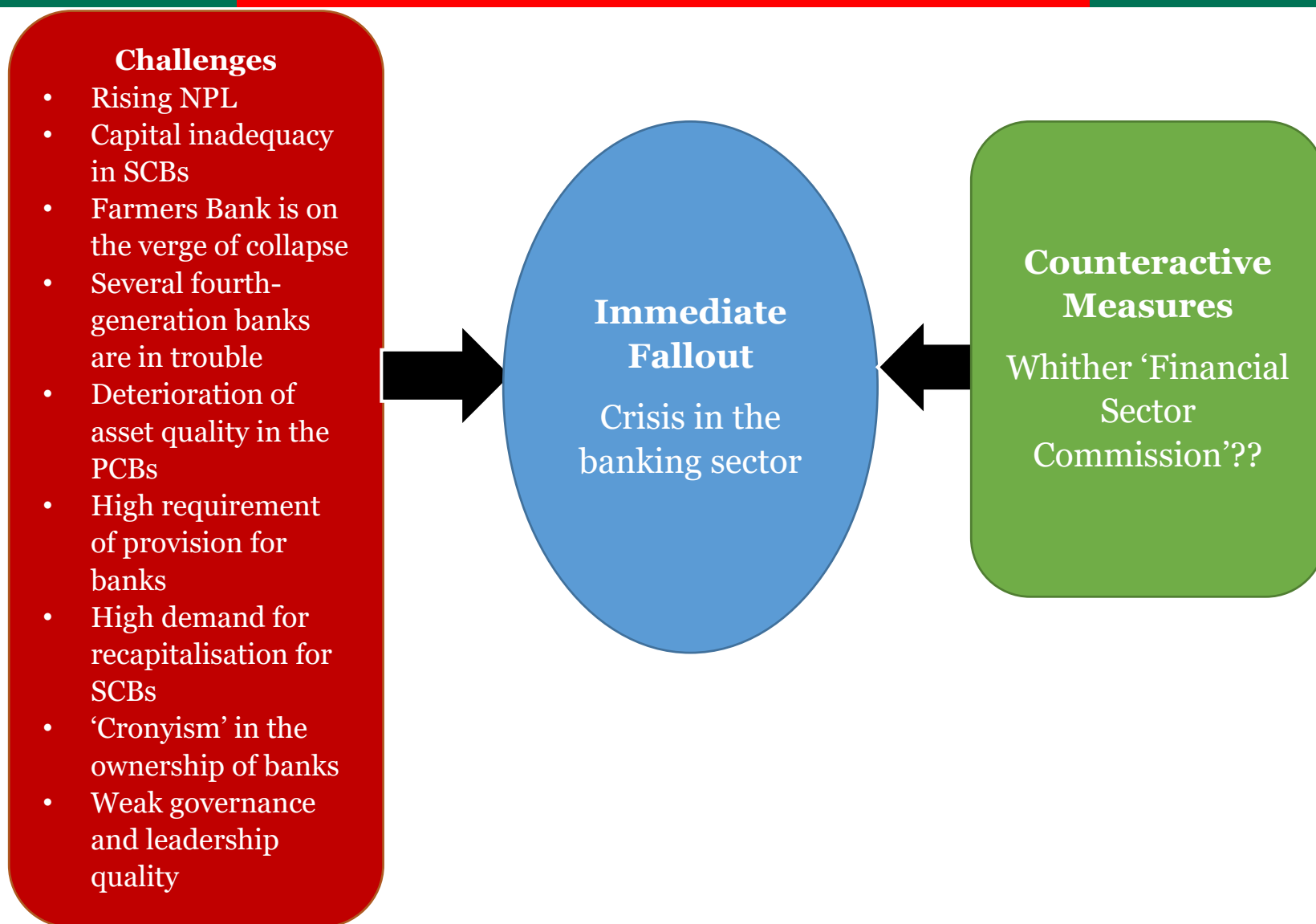
## 5. Concluding Remarks



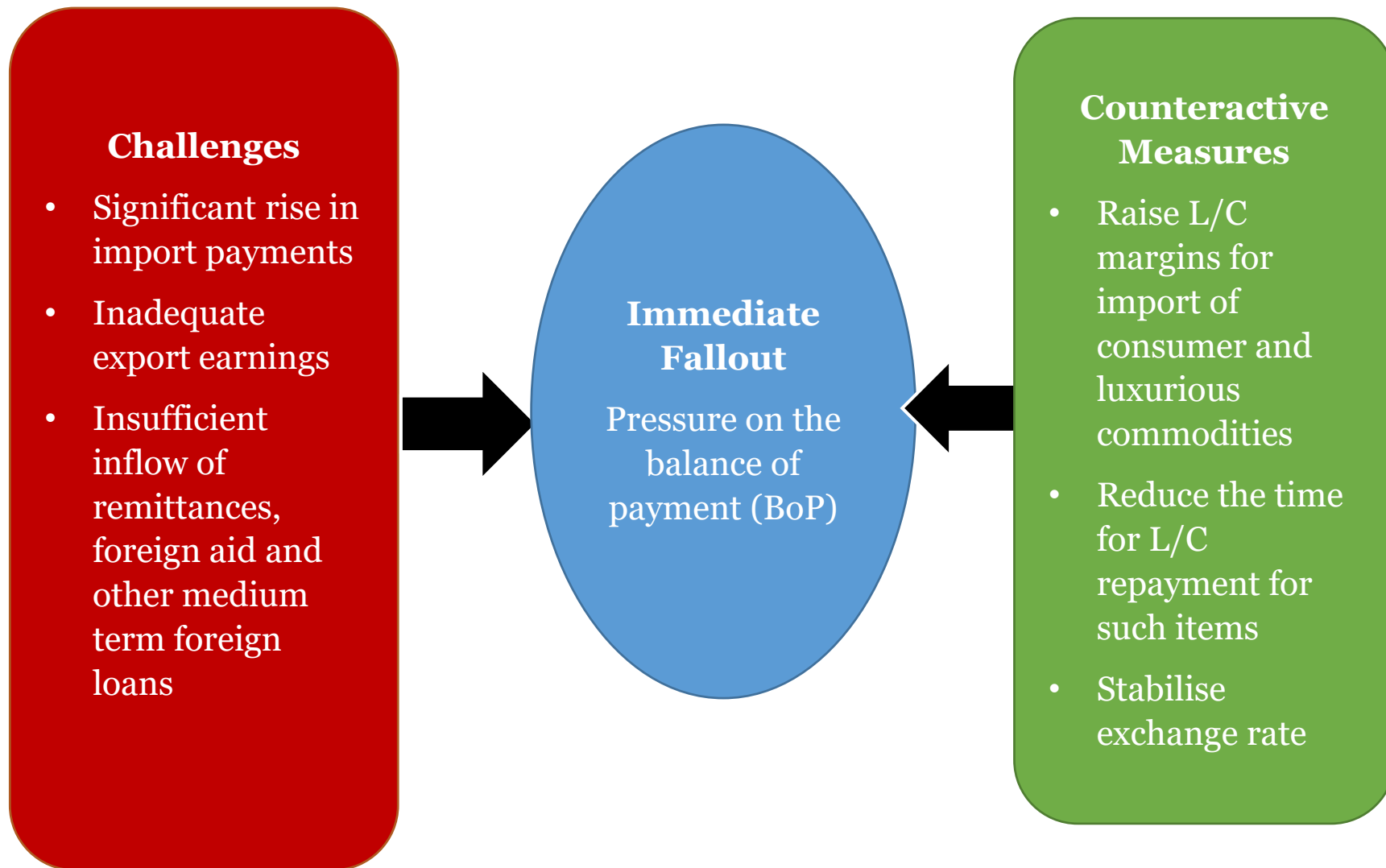
## 5. Concluding Remarks



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- ❑ Macroeconomic stability has come under considerable pressure
- ❑ Improve the quality of macroeconomic management
- ❑ Regrettably, reform agenda of the incumbent government will not see much light till the upcoming national election
- ❑ One only hopes that the reform issues will find place in the ensuing electoral debates macroeconomic policy stance in the upcoming months should be conservative
- ❑ It may be tempting for the government to go for a greater cause of maintaining macroeconomic stability should be the guiding principle for the government
- ❑ It is to be seen how the incumbent government manages the economy during the upcoming political transition

# Thank You