Bangladesh Development Update

Poverty Reduction and Economic Management, South Asia Region

The World Bank
Table of Contents

Summary ........................................................................................................................................... 1
Recent Economic Developments ...................................................................................................... 3
Structural Policies ............................................................................................................................ 15
Short to Medium Term Development Challenges .............................................................................. 17
Short and Medium Term Outlook ..................................................................................................... 19
Bank Support and Activities ............................................................................................................. 21
Special Focus ..................................................................................................................................... 22
    The Power Sector: Key Issues and Policy Priorities ...................................................................... 22
    An Overview of the Sector ............................................................................................................. 22
    Key Issues ...................................................................................................................................... 23
Annex A .............................................................................................................................................. 27

The preparation of this report was led by Zahid Hussain (Lead Economist, SASEP). The core team included Nadeem Rizwan and Adiba Sanjana (SASEP). Valuable inputs were received from Shah Nur Quayyum and A. K. M. Abdullah (SASFP). The team acknowledges comments from Vinaya Swaroop (Sector Manager, SASEP) and Sereen Juma (Country Program Coordinator). Mehar Akhter Khan and Kamrun Nahar formatted the document.
List of Figures

Figure 1: GDP Growth and Sector Growth Rates (%) .......................................................... 3
Figure 2: Recent Trends in Growth Related Indicator .......................................................... 5
Figure 4: Net Foreign Asset (Y-o-Y, %) .......................................................................... 9
Figure 3: Inflation (2005-06, y-o-y,%) ............................................................................ 9
Figure 5: Broad Money and Reserve Money Growth (y-o-y, %) ........................................... 9
Figure 6: Foreign Exchange Reserves .............................................................................. 11
Figure 7: Exchange Rate (Taka per USD) ........................................................................ 11
Figure 8: Lending & Deposit Rate (%) ............................................................................. 12
Figure 9: Govt. Revenue and Expenditure (% of GDP) ...................................................... 14
Figure 10: NBR Revenue Growth (y-o-y,%) ...................................................................... 14
Figure 11: ADP Utilization Rate ........................................................................................ 15
Figure 12: Quarterly Growth Rate of LC Opening for Capital Machinery (%) .................. 19
Figure 14: Quarterly Growth Rate of LC Opening for Intermediate Inputs (%) ............... 19
Figure 13: Quarterly Growth Rate of LC Opening for Industrial Raw Materials (%) ....... 19

List of Tables

Table 1: Rising Unit Cost of Power .................................................................................... 24
Table 2: Energy Subsidies in Bangladesh ($ million) ......................................................... 24
Table 3: Power Tariff in South Asia ................................................................................... 25

List of Boxes

Box- 1: Costs of Political Turmoil ....................................................................................... 4
Box- 2: State of FDI .......................................................................................................... 7
Box- 3: Explaining the decline in tax revenue growth ....................................................... 15
Box- 4: Impact of Fed Tapering ......................................................................................... 20
Bangladesh moved closer to achieving the Sixth Five Year Plan target of reducing extreme poverty to 22.5 percent by 2015 as it sustained healthy GDP growth and moderate single digit inflation in FY14. However, growth this year slowed relative to last year with declining remittances and losses due to political turmoil. Sound macroeconomic management kept inflation in check, although it increased somewhat due to the one-off effects of supply disruptions and wage increases. Official foreign exchange reserves increased to an adequate level as Bangladesh Bank intervened to keep the exchange rate stable. Weak demand for credit reduced interest rates. Monetary policy remained prudent while fiscal management challenged by shortfall in tax revenue, demand for support from sectors adversely affected by the political turmoil, and under-utilization of development budget. The Fund’s ECF is on track. Immediate challenges are to boost investments in power and roads; manage the transition in readymade garments; and stem the decline in remittances.

Summary

1. **Economic activities recovered in the second half of FY14, driven by resilient exports and domestic demand, following setback suffered in the first half due to political uncertainty and turmoil.** Recovery in export growth and increases in public expenditure are likely to help achieve 5.4 percent GDP growth in FY14, slightly higher than the average for developing countries but lower than last year’s 6 percent. The political turmoil in the last quarter of 2013 inflicted a value added loss of about $1.4 billion, of which 86 percent was in services, 11 percent in industry and the remaining 3 percent in agriculture. Business and consumer confidence in general suffered through decline in rate of return on investment perceived by domestic and foreign investors, and by reduced remittances and demand for labor. Bangladesh is likely to have achieved the MDG goal of halving poverty, and to accelerate progress towards the post-2015 goal of eliminating extreme poverty, it will need to sustain higher growth rates.

2. **Sound macroeconomic management helped maintain inflation at a moderate single digit level.** Inflation increased in recent months due to cost push from supply disruptions and wage increases. The political disturbances obstructed food distribution channels, resulting in constrained supplies and higher food prices. Stability in international commodity prices, weak domestic demand, and some appreciation of the nominal exchange rate combined with a restrained monetary policy to moderate the recent increase in prices. Average headline inflation may reach 7.5 percent this year, compared with 6.8 percent last year, largely due to increased food prices.

3. **External balances have remained comfortable due to strong export growth and weak imports which more than offset the decline in the level of workers’ remittances.** Large surplus in the overall balance of payments, driven primarily by increased surplus in the current account, and BB’s frequent intervention to prevent an appreciation of the nominal exchange rate led to further accumulation of official reserves to over 5 months of GNFS import cover.

4. **Monetary policy pursued a restrained path achieving broadly the targets for the first half of FY14.** Implementation of monetary policy benefited from slowdown in private credit growth. This contributed to increase in excess liquidity despite stepped up sterilization operations by BB in response to overshooting of the target for growth of net foreign assets.

5. **The financial sector has been stressed with deteriorating fundamentals of the banking sector exacerbated by rise in default risk across the board due to losses inflicted by prolonged disruption in production and trade.** The state-owned banks were already negatively impacted by the earlier financial scams. The growing nonperforming loans of private commercial banks are also a matter of concern. Capital market turnover has been increasing in the post-election period.
6. **Fiscal deficit and financing continue to remain within sustainable thresholds.** Fiscal management this year is facing challenges because of a large and growing shortfall in NBR tax revenue, demand for fiscal support from sectors adversely affected by the political turmoil and slower utilization of ADP. Tax revenue growth in the first seven months of FY14 was barely 10 percent. Usual shortfalls in public investment spending are unlikely to be enough to keep deviation from FY14 budget deficit target within a reasonable limit. Government bank borrowing so far has been contained, while net nonbank borrowing has increased.

7. **The structural reform agenda came to a near standstill during the political crisis and is still to regain its normal momentum.** However, the Fund’s ECF program remained on track as all end-June 2013 performance criteria and structural benchmarks were met. Bangladesh is well poised to take advantage of the current favorable external environment to advance structural reforms and consolidate macroeconomic stability.

8. **The momentum of GDP growth acceleration has been deflated in recent years as a result of lingering uncertainties around the modality of political transition, slow pace of structural reforms and the inability to begin a building transformative infrastructure.** In the immediate future, Bangladesh faces three sets of formidable challenges: (i) maintaining stability and resolving the remaining political uncertainties while boosting investment in power and roads; (ii) managing well the transition in the readymade garment industry; and (iii) stemming the decline in remittances.

9. **The medium-term development challenges include re-invigorating structural reforms that boost supply capacity and productivity by investing in transformative infrastructure, energy and streamlining trade and investment regulations.** Growth in Bangladesh—which is currently below potential—may rise to potential capacity within a couple of years if stability prevails. But it is unlikely to accelerate much further without hitting capacity constraints and generating overheating pressures in the absence of continuing structural reforms and upgraded infrastructure.

10. **Bangladesh has made good progress in addressing electricity shortage.** The liquid fuel based high cost generation plants bought much needed breathing space. A multi-pronged strategy is needed to address the remaining demand-supply imbalance and to ensure the sustainability of adequate and reliable power. The policy priorities are to boost base-load supply, promote efficiency across the value chain, diversify fuel mix, and reduce the fiscal burden through better alignment of retail prices with unit costs.

11. **External balance may erode from the current level, but not too far beyond comfort.** As the RMG industry upgrades both factory and labor standards, export growth will likely recover after moderating in FY15. Remittances are expected to normalize from FY15 assuming improved demand for Bangladeshi labor with the relaxation of restrictions in KSA, UAE and Kuwait made possible by intensified economic diplomacy. Import growth can be expected to rise with a pick-up in private investment demand. However, reserves may still rise supported by stronger inflow of FDI and public external borrowing for infrastructure.

12. **If stability is sustained, confidence and economic activity will improve in the near and medium-term.** Growth is likely to strengthen back to over 6 percent from FY15, supported by the demand and supply effects of enhanced public investment in infrastructure, harnessing of demographic dividend, fostering human capital accumulation, and structural reforms to revamp the climate for domestic as well as foreign private investment. With continuation of prudent macroeconomic management, inflation should approach around 6 percent, below the threshold where it begins to hurt growth.
Recent Economic Developments

Slowling growth trend has been exacerbated by the costs of political turmoil, stagnating private investment and declining remittances. Resilient export growth and increases in public expenditure helped maintain growth around the average for developing countries. Progress on reducing extreme poverty and boosting shared prosperity is likely to have been slowed by disruptive politics.

13. Economic growth in FY14 is projected to decline to 5.4 percent, compared with 6 percent the previous year (Figure 1). Deep and pervasive political unrest throughout the country took a heavy toll on domestic activity (Box-1), causing large and partially irreversible output, employment, and asset losses. Private investments were depressed any way. Its impact on aggregate demand was compounded by the political turmoil and decline in remittances as they weakened private consumption expenditures, notwithstanding wage increases in the public and private sectors. Strong export demand and restoration of political stability since the January 5, 2014 elections has revived economic activity. However, investments remain weak in general due to continued uncertainty with regard to the stability of the political climate over the medium-term and garments exports remain subject to the risk of GSP removal in Europe.

14. The economic costs of the political turmoil: With frequent non-stop general strikes and blockades to cut off Dhaka from the rest of Bangladesh, production and distribution chains suffered prolonged disruption. The opposition parties enforced 85 days of nation-wide general strikes (hartals) and blockades since January 2013, of which 45 days were in July-January, FY14. Unlike in the past, this time the political agitations were not only limited to Dhaka and a few major cities. They have been as, if not more, intense in smaller cities and towns across Bangladesh. The hartals lasted not for 12 or 24 hours at a time but often for a whole week and blockades for indefinite periods. The transport blockades, suspension of operations of Chittagong port, disruptions due to strikes and sieges and uncertainties surrounding the elections and its aftermath is likely to have had serious adverse effects on economic activity in all key sectors already and in the immediate future.

15. From an economic point of view, the impact of such an intense and prolonged political impasse can be conceived as the composite of a supply shock and an adverse shift in expectations/confidence. Disruptions caused by the turmoil reduced the economy’s ability to produce from a given level of inputs. A permanent supply shock of this type lowers growth and increases inflation. The turmoil also made consumers and businesses more worried about the future. As a result, consumers tended to consume less and save more at a given level of disposable income than before and businesses tended more to wait and see in executing their investment decisions while foreign buyers sought alternative sources of supply. These resulted in a decrease in aggregate demand leading to further lower growth while muting the impact of the supply shock on inflation, other things equal.

16. It seems reasonable to assume that the adverse productivity effect of the turmoil is likely to be irreversible at least partially. The disruptions lasted long enough to make it impossible for firms and workers to make up all the losses suffered. Although many businesses worked weekends and nights to make-up the loss of working days, but there were just too many days lost to be fully made up. Note that because of political uncertainties, image crisis of garments, slowdown in manpower exports and associated problems in GCC markets facing Bangladeshi workers, growing gas shortage, improving yet
persisting power deficit, and growing congestions in the critical road networks, growth was projected to slow further, following two consecutive years of decline, even before the political impasse turned into prolonged hartal and blockades as well as street violence (Figure-2 provides evidence on some proxy indicators of production, consumption and investment). The growth projection revised to factor in the impact of the political turmoil is discussed below.

**Box-1: Costs of Political Turmoil**

*Media reports are filled with stories on the extent and variety of economic damages purportedly caused by the political agitation. One of the worst hit was the RMG sector, the major export earner, with delivery schedules going haywire and new orders drying up, due to growing uncertainties with respect to the industry’s ability to deliver on time. The Center for Policy Dialogue (CPD) collated information from a number of sources covering 4 sectors—agriculture, RMG, transport and tourism and estimated the loss to these sectors at Tk. 490 billion (4.7 percent of GDP). No such estimates are available for losses incurred by other sectors such as retail, wholesale, hotels and restaurants, non-RMG manufacturing; construction and real estate development; financial sector and numerous other services. Many business and professional bodies have come up with estimated costs of Tk. 1000 billion (9.6 percent of GDP) for the economy as a whole. In most cases the losses include gross sales or loss of sales due to cancellation of orders (in the case of RMG exports) and loss of assets (burning of trucks and buses, power stations, schools).

The potential loss of value addition is only a fraction of this estimated gross loss. To get a sense of the magnitude of lost value added, we estimated the benchmark GDP at current prices for FY14 using the projected sub-sectoral growth rates. Loss per day was calculated by dividing the FY14 benchmark GDP by the number of days in a year. While the number of formal productive days varies from sector to sector, the historical experience on the work culture in Bangladesh shows time is indeed fungible. Weekends become working days when working days cannot be used for work. By using 365 we err on the conservative side in estimating value added per day which is the most critical determinant of the estimated loss in growth and value added.

The loss per day is multiplied by the number of lost days not made up by sectors to estimate the total loss of value added in each sector. The estimated losses are subtracted from the benchmark, added the resultant sectoral value added to get nominal GDP that takes into account the impact of political turmoil and then deflated the result to get the projected real GDP for FY14.

This produces a total value added loss of about $1.4 billion, of which 86 percent was in services, 11 percent in industry and the remaining 3 percent in agriculture. This loss reduces the growth rate from the 6.2 percent benchmark to 5.4 percent.*

**17. Projections from the production side:** *Growth performance in all the major sectors is projected to be worse than would have been the case in the absence of hartals and blockades.*

**18. Agriculture was affected least severely.** In agriculture, crop value addition growth in FY13 was already very low at 0.15 percent. Despite a bumper aman crop the situation is not likely to improve much this year. Problems with input availability disabled boro transplantation during the political turmoil, but this may be largely made up because of prevailing high rice prices which should induce the farmers to increase boro acreage. Farmers have already suffered from loss of income from winter crops and from fresh dairy products due to transportation disruptions. Poultry has been significantly affected due to weak domestic demand resulting from cancellation of cultural and entertainment activities. Much of these activities in the peak winter season either got cancelled or downsized due to political agitation. Overall the combined agriculture value addition growth may not exceed 1.6 percent in FY14.

**19. Manufacturing coped, but at a high cost.** Manufacturing growth will be lower than in recent years despite stronger export growth relative to last year. Even before the political crisis, the RMG sector has been facing the challenge of coping with the impact of Tazreen fire, Rana Plaza collapse, and labor
unrest. Political disturbances added fuel to the pre-existing fire. Buyers were unable to visit Dhaka during November and December and shifted sizable amounts of orders to other competing countries like Pakistan, India, Myanmar, Indonesia, and Viet Nam. Despite these odds, the RMG 17.7 percent export growth through the first seven months of FY14 once again demonstrated their resilience in coping with adversities.

20. Given that RMG accounts for almost 40 percent of manufacturing, this sector will help pull up the overall manufacturing growth but not to the extent implied by the rate of growth realized. The increase in RMG export proceeds may not correspondingly increase value addition because the entrepreneurs had to incur huge cost escalations for making air shipments instead of sea shipments (a tenfold increase in shipment cost), a fivefold increase in transportation of goods from Dhaka to

**Figure 2: Recent Trends in Growth Related Indicator**

<table>
<thead>
<tr>
<th>Export Growth (%)</th>
<th>Remittances Growth (y-o-y, %)</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="source" alt="Graph" /></td>
<td><img src="source" alt="Graph" /></td>
</tr>
</tbody>
</table>

Source: Export Promotion Bureau

<table>
<thead>
<tr>
<th>Growth Rate of LC Settlement for Capital Machinery (%)</th>
<th>Private Credit Growth (Y-O-Y, %)</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="source" alt="Graph" /></td>
<td><img src="source" alt="Graph" /></td>
</tr>
</tbody>
</table>

Source: Bangladesh Bank

<table>
<thead>
<tr>
<th>Quarterly Growth Rate of import of Petroleum Oil &amp; Lubricants (%)</th>
<th>Average Monthly Power Generation (MKWH)</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="source" alt="Graph" /></td>
<td><img src="source" alt="Graph" /></td>
</tr>
</tbody>
</table>

Source: Bangladesh Bank

Source: Bangladesh Power Development Board
Chittagong\textsuperscript{1} and penalties/discounts incurred on account of delays in making shipments.\textsuperscript{2} The non-RMG manufacturing sector, accounting for about 60 percent of manufacturing, has been significantly impacted by the subdued domestic demand during most of the first half of FY14. Non-RMG export growth in the first seven months was just 4.9 percent relative to the same period last year.

21. **Construction and real estate sectors were hurt badly.** Because of a sharp drop in housing demand sales of newly constructed apartments (according to REHAB) has dropped by almost 60 percent and unsold inventories of new apartments have increased to about 23,000 units and growing. Sales of land for residential, business, and industrial units have also reportedly declined by 80 percent with many housing projects around Dhaka and other big cities facing liquidity problem. Implementation of government financed construction projects also suffered. The pace of implementation of publicly financed infrastructure projects may regain the lost ground in the second half of the fiscal year, when much of actual project implementation takes place. However, private sector construction activity is not likely to recover soon before the unsold inventories of apartments and plots decline to more reasonable levels.

22. Based on above considerations, the industrial sector growth is projected at 7.9 percent, compared with last year’s 9 percent.

23. **Service sector suffered the most.** Service sector accounts for more than 54 percent of GDP. Its performance is linked to the performance of the agriculture and industrial sector as well as the volume of international trade. The most adversely impacted sectors are: transport (road and rail in particular), wholesale and retail trades; domestic tourism and entertainment; and hospitality sector (hotels, restaurants and decorators). Activity on inter-district or cross country road network was in a standstill due to nationwide blockade with enormous loss of income for a couple of months. The financial sector (banks in particular) also took hits as many of the affected entrepreneurs would not be able to service their debt and are seeking special financial arrangements to survive. Credit demand has collapsed to historic lows. Against this background, service sector, which was expected to surpass last year’s performance by a significant margin, is projected to grow at 5.3 percent in FY14.

24. **Projection from the expenditure side:** The political impasse and subsequent turmoil contributed to decline in business and consumer confidence in general through decline in rate of return on investment perceived by domestic and foreign investors and a decline in demand for labor.

25. **Growth in private consumption demand slackened considerably.** Private consumption accounts for 75 percent of GDP. Domestic consumers could not spend as much as they would under normal circumstances as streets became unsafe and shops and restaurants could not stay open. Demand for consumer goods including durable consumer goods (TV sets, refrigerators, air conditioners, cars and motor cycles) suffered badly during the prolonged political unrest. Most people postponed purchases of these items, hurting their domestic production, import, distribution and marketing. Sales of consumer goods like clothing, shoes, cosmetic, personal hygiene products, packaged foods and drinks were also badly hurt in the first half of FY14. Consumption demand deficiency is a new phenomenon for Bangladesh. It slowed across the board starting with transportation, construction and other service related activities like hotels and restaurants and wholesale and retail trade. In part, consumers faced a suppressed demand situation where services were just not available due to blockades and hartal. The 7 percent drop in workers’ remittances during the first eight months also contributed to the softening of domestic demand.

\textsuperscript{1} From a normal rate of Tk. 20,000 per container to Tk. 1,00,000 per container.

\textsuperscript{2} According to BGMEA, average losses per factory due to the turmoil was about $ 0.6 million.
26. **Animal spirits remained deflated.** Political uncertainties and lack of progress in improving the investment climate combined with disruptions due to political turmoil choked private investments. This is evident from various indicators such as disbursement of industrial term loans for large, medium and small industries, advances other than working capital financing for the manufacturing sector, import of capital goods, FDI (Box-2) and trends in new real estate projects.

<table>
<thead>
<tr>
<th>Box-2: State of FDI</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bangladesh has the potential to attract significantly higher levels of FDI by positioning itself as a competitive center for labor-intensive manufacturing, and attract efficiency-seeking FDI.</strong> Its attractions include abundant labor supply, a mastery of large-scale labor-intensive manufacturing in garments and to some extent footwear, a favorable location between two large and dynamic economies, India and China, as well as wide understanding of the English language. Preferential access to key consumer markets in developed countries makes it an attractive platform for export-seeking FDI. Its entrepreneurial private sector is another important asset that could be exploited further with a business-enabling regulatory framework in place. In addition, if Bangladesh is able to stay on its current growth path, its market size could increase quickly and attract a wave of market-seeking FDI. However, to make good this potential, Bangladesh would have to address some critical constraints to FDI including availability of serviced land, the asymmetry between local and foreign firms, and also adopt a more welcoming and more pro-active stance towards FDI.</td>
</tr>
<tr>
<td>There was no significant breakthrough in the inflow of FDI during the first half of FY2014. Overall FDI flow during July-December 2013 was US$ 840 million, compared with US$797 million in the first half of FY13. A large part of FDI, amounting to US$369 million, was targeted to different EPZs. A significant part of this investment is likely to be reinvestment by existing companies. Despite this, all the EPZs have experienced negative growth in terms of investment during the period of September-December, 2013 over the corresponding period of the previous year. A similar situation has prevailed in registration of FDI. The number of jointly owned and 100 percent foreign owned firms registered with BOI during October-December, 2013 was only 21 with a proposed investment of about US$101 million. This was very low compared to that of the previous year (47 and 152.5 million respectively). A Russian telecom company was set to invest $2 billion and a German airline company $660 million, but the political unrest held them back. A good number of investors could not invest in shipping, airlines, logistics, travel and some other sectors in last 18 months as they failed to get licenses.</td>
</tr>
</tbody>
</table>

- Industrial term loan disbursement during July-September, 2013 declined by 8.6 percent relative to the previous year.³
- Import of capital goods during July-November, 2013 experienced growth of about 5.5 percent over the same period of the previous year. Capital machineries import, which constitute about 30 percent of total capital goods imports, declined during this period while other capital goods which comprise the remaining 70 per cent, grew by 7.9 percent.
- Import of capital machineries for most of the industries such as leather, jute, pharmaceuticals and packing have registered either low or negative growth both in the settlement and opening of LCs during July-October 2013.
- The number of new projects started by real estate developers declined by 75 percent in 2013 relative to the previous year.⁴

27. **Public expenditure may provide some boost.** ADP implementation during first half of the fiscal year generally tends to be slack because of the time-consuming processes in completing tender related activities, acquisition of land (if necessary), disbursement of funds against work orders and procurement

---
³ The decline encompassed large and medium scale industries at varying rates. Borrowing by small scale industries during this period was, however, exceptionally high (37.5 per cent).
of construction materials. Only 33.2 percent of the FY14 ADP was spent in the first seven months, compared with 38.3 percent during the same period the previous year. The utilization rate is likely to improve significantly in the second half of the year, although it may fall 10 to 15 percentage points short of the 90 percent average utilization rate achieved in last three years (relative to the original size). Public consumption expenditures may be higher than anticipated in the budget. This is because of 20 percent Dearness Allowance given to all public sector employees later in the year.

28. **Net exports are expected to be the savior.** Increase in net exports is projected as the major driver of FY14 growth from the demand side. Export performance remained resilient to a series of adverse developments on the domestic front. Total exports in the first eight months of FY14 increased by 14 percent. The European Union continues to remain the largest destination of Bangladeshi exports, primarily due to RMG products.\(^5\) Imports have remained fragile. Following less than 1 percent growth in FY13, GNFS import payments increased by 2.4 percent in the first half of FY14 over the corresponding period in FY13. Consequently, net export growth is likely to exceed last year’s pace.

29. **Bangladesh is likely to have achieved the MDG goal of halving poverty, and to accelerate progress towards the post-2015 goal of eliminating extreme poverty, it will need to sustain higher growth rates.** With the economy growing on average 6.3 percent since 2010 when poverty rate was 31.5 percent, just 2.5 percentage points short of the MDG target, poverty incidence is likely to have declined by over 8.6 percentage points during FY11-13.\(^6\) Had the economy grown at the benchmark rate of 6.2 percent, poverty would have declined further by 2.7 percentage points in FY14. Instead, because of the costs of political turmoil, the economy is likely to grow by 5.4 percent. This is likely to have reduced the pace of poverty reduction by 0.4 percentage points (from 2.7 to 2.3 percentage points). Assuming higher economic growth better sustain improvement in the share of total income going to wages (as opposed to capital) and therefore make societies more equal, slower growth is likely to have dragged progress on boosting shared prosperity (measured as the income of the bottom 40 percent in any given country) as well by depressing both employment and real wage growth.

**Inflation has remained at a moderate single digit level despite recent rise due to cost push from supply disruptions and wage increases.** The political disturbances obstructed food distribution channels, resulting in constrained supplies and higher food prices. Stability in international commodity prices, weak domestic demand, and some appreciation of the nominal exchange rate combined with a restrained monetary policy to moderate the rise in inflation.

30. **Cost push led inflation has resurfaced.** Following some deceleration in the first four months, inflation has been moving in a relatively narrow range of 7-7.5 percent in recent months, higher than the 6-6.5 percent target (using the 2005/06 base). Inflation has increased since November, with large wage increases expected across all sectors of the economy and supply disruptions caused by political agitation and violence. Food inflation (y-o-y) has risen from 8.1 percent in July 2013 to 8.8 percent in February 2014 (Figure-3). Higher distribution costs due to the frequent nationwide strikes and rise in food prices in India (which is correlated with Bangladesh food prices) contributed to this increase. Non-food inflation declined in the first four months to 5 percent and then rose back, reaching 5.4 percent in February 2014. Cost push from supply disruptions and demand pull from expected wage increases are likely to have driven up the non-food prices. These overpowered the impact of decline in international commodity

---

5 In the initial months of FY14 Bangladesh’s market share in the EU increased further to 13.4 percent. Bangladesh now occupies the second highest position in the EU market with double digits market share, although somewhat remotely to the first place holder China with a share of 40 percent.

6 Based on poverty elasticity reported in the World Bank, Bangladesh Poverty assessment, June 2013, page 18.
prices\(^7\) and appreciation of the real exchange rate. Average headline inflation may rise to 7.5 percent this year.

31. **Acceleration of food prices dominated the rise in inflation.** Increased food prices appear to be primarily the result of supply disruptions caused by political unrest, although the increase in rice prices may not be reversed.\(^8\) Rice millers could not operate at their normal pace as shipments of rice from the major rice producing belts to the large cities were disrupted. Volatility in the prices of some other food products like onions, vegetables and imported food items because of supply disruptions also fuelled food price increases in recent months.

32. **Non-food inflation has been decelerating steadily.** Restricted movement and store openings, a sense of insecurity, and concerns about the near-term outlook have dampened demand for non-essential products, thereby helping the reduction of non-food inflation. The stance of monetary policy and the continued exchange rate stability have also played important supporting roles.

*Monetary policy pursued a restrained path achieving broadly the targets for the first half of FY14. Implementation of monetary policy benefited from slowdown in private credit growth. This contributed to increase in excess liquidity despite stepped up sterilization operations by BB in response to overshooting of the target for growth of net foreign assets.*

33. **Monetary restraint is firmly in place.** Bangladesh Bank (BB) made a decisive shift in its policy stance in January 2012 towards “a restrained monetary growth path consistent with curbing inflationary and external sector pressures, while ensuring adequate private sector credit to stimulate inclusive growth.” Since then BB started effective implementation of monetary tightening measures and broadly achieved the operating and intermediate targets for FY12 and FY13 (Figure-4). The MPS of July 2013 continued the same stance, aiming to bring average

\(^7\) Prices of internationally traded food commodities declined by 3 percent between October 2013 and January 2014, adding another quarter to previously observed price declines since the August 2012 historical high. See The World Bank Group, Food price Watch, Year 4, Issue 16, February 2014.

\(^8\) The retail prices of essential food items such as rice, wholemeal wheat flour (atta), and palm oil increased throughout the period of October 2013 to January 2014 in all divisions. Compared to the high food prices of 2008, the retail price of rice is close to the peak price of 2008.
inflation down to 7 percent (using the 1995/96 base) or 6-6.5 percent using the 2005/06 base.

34. **Monetary program is broadly on track.** All major monetary aggregates have remained within the targets established under the MPS in FY14 so far. Monetary management was challenged by a rapid buildup of foreign exchange reserves (NFA) of the banking system due to a large surplus in the overall balance of payments. Compared with the program target of 19.3 percent increase by end-December 2013, the actual expansion in the NFA through end-December was 35.2 percent (Figure-5). Yet Bangladesh Bank managed to contain reserve money growth below target at 13.6 percent through December. Consequently, broad money expansion has also remained below the target at 15.6 percent. In line with the increase in NFA, BB undertook sizable sterilization operations to mop up the excess liquidity injected into the economy by issuing 30-day BB bills.9

35. **Declining private credit growth helped contain growth of domestic credit.** Private sector credit growth declined to 10.6 percent in December. Borrowing by corporates overseas partly made up for this.10 Government borrowing (net) from the banking system through December 2013 was also significantly lower than projected. Central government borrowing (net) amounted to Tk 46 billion in the first half of FY14 against a budget target of Tk 260 billion for FY14.11 Consequently domestic credit growth slowed to 10.8 percent. These combined with sterilization operations helped offset the impact of surging net foreign asset on domestic monetary growth.

36. **The MPS for the last half of FY14 continues the policy stance maintained in the first half.**12 Policy rates remain unchanged. Excess liquidity in the banking system made easing of reserve requirement ratios unnecessary. The program framework limits reserve money growth to 16.2 percent and broad money growth to 17 percent by June 2014. BB will have a ceiling on net domestic assets as a key operating target. The ceiling for private sector credit growth of 16.5 percent has been kept well in line with economic growth targets.13 This is sufficient to accommodate any substantial rise in investment and trade-finance over the next six months. There is enough liquidity in the money market to support a pickup in the post-election economic rebound in demand for credit in the private sector. The MPS has correctly maintained government borrowing from the banking system within the original FY14 budget target. Thus, the envisaged stance does not accommodate potential inflationary pressures.

External balances have remained comfortable due to strong export growth and weak imports which more than offset the decline in the level of workers’ remittances. Rising surplus in the overall balance of payments, driven primarily by increased surplus in the current account, and BB’s frequent intervention to prevent an appreciation of the nominal exchange rate led to further accumulation of official reserves.

---

9 Net domestic assets of Bangladesh Bank turned declined to negative Tk 22 billion, by end-December 2013, compared with Tk 92.43 billion at end-June 2013. Sterilization operations and the associated quasi-fiscal costs will of course adversely affect BB’s profit transfers to the budget.

10 Borrowing for term credit purposes with most having a maturity beyond five years was US $534 million in H1FY14, compared with US $1.82 billion approved in FY13 and US $1 billion in FY12.

11 The relatively low borrowing is due to the slow pace of ADP implementation and sharp rise in proceeds from the sales of National Savings Certificates as the differential between their returns and that of bank fixed deposit rates has grown. Savings certificates sales between July-November 2013 of Tk 33.7 billion compares with Tk 7.72 billion for the whole of FY13.


13 Achieving this will require net private credit increase of about Tk 480 billion in the last six months of FY14, constituting 10 percent of the outstanding stock of private credit at end-December 2013.
37. **Trade deficit has declined while financial-cum-capital account surplus narrowed.** Due to strong export growth and flat import payments, external trade deficit declined to $2.8 billion in the July-January of FY14 from $4.3 billion during the corresponding period of the previous year. The decline in trade deficit contributed to increase in current account surplus from $1.4 billion in July-January of FY13 to $2.1 billion in the same period of FY14 despite 7.8 percent decline in remittances. Financial and capital accounts maintained surplus, reflecting pickup in Foreign Direct Investment (FDI) and other short-term loans. However, the size of the surplus shrank to $144 million during July-January, compared with $2.6 billion surplus recorded during the same period of the preceding year. The lower surplus is primarily attributable to $1.6 billion outflow on account of trade credit (net) in July-January of FY14, compared with $133 million inflow during the same period the previous year. This may be reflecting credits or payment delays allowed by exporters as a way of compensating for shipment delays or delivery failures due to disruptions caused by the political turmoil.

38. **Reserve build up continued.** The combination of a sizable current account surplus and a moderate surplus in the financial and capital account contributed to maintaining a still large, though smaller relative to last year, surplus in the overall BOP position and a consequent build-up of external foreign exchange reserves. Gross foreign exchange reserves of Bangladesh Bank increased by $5 billion over the 12-month period through end-December 2013 to $18 billion, rising further to $19 billion by end-February, equivalent to 6.4 months of prospective FY14 merchandise imports (Figure-6). This is a good cushion to have against the possibility of yet another round of political instability. The high level of reserves helped Bangladesh’s sovereign rating needed to catalyze higher foreign direct investment (FDI).

39. **Exchange rate management has remained sound.** Bangladesh Bank’s exchange rate policy contributed to the reserves buildup as well as protecting the competitiveness of exports. Higher inflows associated with buoyant export receipts and weak import demand resulted in excess supply of foreign exchange in the interbank market leading to over 5 percent nominal appreciation of Taka against the US dollar in FY13 despite BB’s purchase of $4.5 billion (Figure-7). The nominal exchange rate would have appreciated further in the absence of $3.3 billion BB purchase of foreign exchange in the first ten months of FY14. The nominal exchange rate has been stable at around Tk 77-78 per US$ in recent months through end-February, 2014.

40. **Real exchange rate appreciated.** Export competitiveness depends on the real exchange rate on which BB has no direct control. Bangladesh’s inflation rate is different from its trading partners. The Real Effective Exchange Rate (REER) appreciated significantly due to inflation.
differentials with trading partners, although so far that appreciation appears to have no major negative impact on Bangladesh’s export performance. The REER already increased to 99.7 in FY13 from a recent low of 89.42 in FY11 following the nominal depreciation of the currency in that year. The exchange rate based on REER varied between Tk 78-79 per US$ and the unofficial market rate was around Tk 78.1 per US$ in February. If export growth continues to decline and remittances do not recover, BB should consider letting the taka depreciate over time in line with inflation differential. BB has room to scale back foreign exchange intervention without giving rise to excess volatility in the foreign exchange market.

The financial sector has been stressed with deteriorating fundamentals of the banking sector exacerbated by rise in default risk across the board due to losses inflicted by prolonged disruption in production and trade. The state-owned banks were already negatively impacted by the earlier financial scams. The growing nonperforming loans of private commercial banks are also a matter of concern. Capital market turnover has been increasing in the post-election period.

41. Profitability in banking has declined. Financial health of the banking industry has been deteriorating over time due to various irregularities and scams. Credit and risk management status is unsatisfactory. The net aggregate profits of banks are likely to shrink mainly due to fall in their interest income and difficulties in repayments of loan installments by their clients, amid disrupted economic activities during the last few months of 2013. Among the profitability measures, return on asset (ROA) in the banking sector declined marginally from 0.64 percent at the end of December 2012 to 0.61 percent at the end of June 2013 primarily due to the higher interest expenditure than interest income. However, return on equity (ROE) of the banking industry remained virtually unchanged at 8.2 percent at the end of December 2012 and 8.21 percent at the end of June 2013.

42. Nonperforming loans have increased. Public and private commercial banks are suffering from increase in nonperforming loans due to deteriorating economic condition, exposure to the stock market and strengthening of provisioning requirements by Bangladesh Bank. Since December 2011, the health of public sector banks has deteriorated at a faster rate compared to the private sector banks. The situation is likely to have deteriorated further by end-December 2013 due to the impact of political turbulence on business borrowers and the response to call for relief from the business community. Bangladesh Bank has relaxed the loan loss provisioning requirement until end-2014. This will window-dress the real situation and may even allow the banks to declare dividends to shareholders while in reality their financial condition may not necessarily warrant such a decision.

43. Capital inadequacy in SoCBs remains. The capital-to-asset ratio dropped for the State owned Commercial Banks from 11.68 percent in December 2011 to 8.13 percent in December 2012, and thereafter to almost zero by March 2013. This is attributable primarily to their gross non-performing loan (NPL) ratio, which deteriorated at a much faster rate than the overall all banking sector NPL ratio, increasing from 11.27 percent in December 2011 to almost 28 percent in March 2013. The capital to asset ratio for the state owned banks is likely to have improved at end-December 2013 due to Tk 41 billion capital injection

---

14 Despite appreciating, the real effective exchange rate is assessed by the IMF to be close to equilibrium, with the garment sector remaining competitive. See IMF Staff Report for the 2013 Article IV Consultation, November 2013.
from the government budget. However, this injection is unlikely to have met even nearly the entire capital shortfall of the state-owned banks.\textsuperscript{15}

44. **These developments have heightened the risk facing the banking sector.** With over 70 percent of financial system assets in the banking system, banking assets to GDP at 77 percent and deposits to GDP at 60 percent, risks in the SCBs are systemically significant. Disruptions in the banking sector can have a negative impact on the real economy; lead to a credit squeeze; cause a ‘flight to safety’ of deposits; and enhance the risk of contagion from the SCBs to the rest of the banking system. Most merchant banks are operational because of financial support from their parent banks. The margin loans stuck with the commercial/merchant banks are reported to be in excess of Tk. 150 billion.\textsuperscript{16} Unless the stock market rebounds very strongly, loan loss provisions and profitability of commercial banks will deteriorate further in the coming months. Banks also have large direct and indirect exposures to the land and real estate sectors in Bangladesh. With the declining trend in land and real estate prices much of the land-based investments and land-based collaterals may become illiquid or worth much less with distressed sales posing further downside risks for the banking system.

45. **Weak demand for credit pushed interest rates down.** Weak demand for credit is reflected in loan to deposit ratios well below historical norms, leading to ample liquidity. Call money rates have declined from their 20 percent peak in early 2012 to around 7 percent in June 2013. They have since been stable in the 7-8 percent range. Both deposit and lending rates fell in the first half of FY14. Average lending rates declined from 13.67 percent in June 2013 to 13.45 percent in December while average deposit rate declined from 8.54 percent to 8.39 percent during the same period (Figure-8). Fall in domestic lending rates is attributable to weak demand for credit, lower cost of funds and increased competition from overseas lenders.

46. **Capital market regained some vibrancy.** Most market participants and analysts have been concerned about the sharp fall in daily turnover to less than Tk. 2 billion in April 2013 compared with the all-time peak of Tk. 30 billion in late 2010. The daily turnover increased to a range of Tk. 6-8 billion after the election in January. However, the trade volume demonstrated high degree of volatility, as evident from the wide range between the highest and the lowest single day trade volume in the year.\textsuperscript{17} The market capitalization increased from 12 percent of GDP to 20 percent. A number of incentives in the FY14 budget and the inflow of foreign capital, together with a respite from the political violence, have helped the stock market rebound strongly in recent weeks. Several steps were taken during the year to increase market discipline and strengthen market monitoring by the Securities and Exchange Commission (SEC). SEC enhanced surveillance on the brokerage houses and merchant banks for compliance to SEC rules. The Dhaka and Chittagong stock exchanges, whose demutualization plans were approved in September 2013, selected new boards in February 2014. The behavior of Bangladesh capital market has been in line with many of its much more dynamic regional markets.

*While fiscal balances remain within sustainable limits, fiscal management is facing challenges because of a large and growing shortfall in NBR tax revenue, demand for fiscal support from sectors adversely affected by the political turmoil and slower utilization of ADP. Spending cuts are on the cards to keep deviation from FY14 budget deficit target within a reasonable limit. Government bank borrowing so far has been contained, while net nonbank borrowing has increased.*

\textsuperscript{15} The four SoCBs had a total capital shortfall of Tk 86 billion as of end-September 2013.

\textsuperscript{16} These long overdue loans are not counted under classified loans and provisioned for under a special dispensation from Bangladesh Bank.

\textsuperscript{17} Single day trade volume was as low as Tk 200 million and as high as Tk 1.95 billion during the year.
47. **Fiscal outcomes are likely to deviate from the budget, primarily because of the sizable revenue shortfall and slower pace of ADP implementation.** Fiscal deficit may remain around the budget target if there are some significant cuts in spending in response to the emerging large and growing revenue shortfalls. The overall government spending level may not increase as much as envisaged in the budget because of significant shortfall in development spending relative to the original budget target. However, NBR revenue shortfall is likely to be in the range of Tk. 140-160 billion and non-NBR revenue shortfall at around Tk. 10 billion. Even if the government cuts the ADP by Tk. 100-110 billion, there still would be a need for some cuts in current outlays to keep the deficit within the original budget target. Absent such adjustments, the deficit could rise to 5.1 percent (Figure-9) and domestic financing to 3.8 percent of GDP, compared with the budget target of 4.6 percent and 2.9 percent respectively.

48. **Domestic financing is still on track.** Domestic financing of the fiscal deficit has remained below budget target for the first half of FY14. However, domestic financing of the budget increased to Tk. 99.74 billion in the first half of FY14, compared with Tk. 64.9 billion in the corresponding period of the preceding year. This reflects a surge in non-bank borrowing due to 42 percent decline in the encashment of National Savings Certificates. Net foreign financing for the budget declined to only Tk.55.9 billion, compared with Tk. 84.51 billion in the first half of FY13. The public debt to GDP continued to decline below 40 percent, with the share of external debt declining to one half.

49. **Revenue growth is off track.** In the FY14 budget, the government had set an ambitious NBR revenue target of Tk. 1,360 billion which was 25.2 higher than the FY13 actual. Achieving this would have been very challenging even under normal circumstances. Economic slowdown exacerbated by shutdowns and strikes has made its achievement even more difficult. The revenue collected between July and January 2014 grew by 10.1 percent (Figure-10), falling short of budget target by about Tk. 82 billion. The revenue growth slowed across the board, although the deceleration was dominated by trade based taxes which declined by 0.8 percent. Both VAT (domestic) and income tax revenue growth have been well below the rates of growth required to achieve their respective budget targets (Box-3).

Public expenditure in the first five months of FY14 has remained below target, constituting only 27 percent of the total budget, compared with 28.1 percent during the same period in FY13.\(^{18}\)

50. **One major reason is the subsidy bill.** This was budgeted to decline in the FY14 to Tk 309 billion, reversing the increasing trend observed in recent years. Actual expenditure on subsidies in the first five months constituted only 27 percent of the subsidy budget for FY14, compared with 90.8 percent during the same period in FY13. Subsidies are likely to fall short of the budget target because of a number of factors: (i) decline in domestic demand for petroleum products due to disruptions to the transportation system during the prolonged political turmoil; (ii) decline in international prices of petroleum products; and (iii) decline in international price of fertilizers along with the general decline in hydro-carbon based products.\(^{19}\)

51. **A second reason is decline in ADP utilization rate.** Only 33.2 percent of the budgeted ADP was implemented in the first half of FY14, compared with 38.3 percent during the same period the previous year (Figure-11). Infrastructure projects like roads and bridges, including Padma Bridge related work have suffered the most during the political turmoil. Past implementation record shows that more than 40-50 percent of the ADP implementation happens in the final quarter of the fiscal year. There is still enough time for the government to regain the momentum.

---

**Box-3: Explaining the decline in tax revenue growth**

The slack in revenue collection cannot all be attributed to disruptions caused by the political turmoil. The fiscal measures in the FY14 budget introduced a number of revenue reducing fiscal incentives including increase in the threshold for non-taxable income limits for individuals; reduction and exemption of a number of tax rates; raising the limit for investment for tax rebate and also enhancing the related tax exemption margin. NBR extended the deadline for submission of income tax return by three months as tax returns filed by end-September 2013 was one hundred thousand lower than that of FY13. The government decided to provide a number of fiscal incentives to exporters to help them recover losses arising from the prolonged political turmoil. The revenue foregone from reduction of advanced income tax (AIT) on apparel exports alone could be worth more than Tk. 8.7 billion. The composition of import growth in the first half was not tax revenue friendly as a significant part of the import growth came from duty exempted goods (food grains, RMG export related imports and capital machineries). Also, global commodity prices were stable and taka appreciated against US dollar.

---

**Structural Policies**

*The structural reform agenda came to a near standstill during the political crisis and is still to regain its normal momentum. However, the Fund’s ECF program remained on track.*

52. **On November 27, 2013, the Executive Board of the IMF concluded the Article IV consultation, completed the third review under the ECF with Bangladesh, and approved US$140.4 million disbursement.** The Fund’s ECF program has remained on track in the post third review period.

\(^{19}\) However, the reduction of urea price by the government in FY14 would limit the potential for reducing agriculture sector subsidy as envisaged in the budget.
All performance criteria for December 2013 and most indicative targets were met. The structural benchmarks for December 2013 were also completed.

53. **Government announced a number of policy support for the real sector to compensate losses due to the prolonged political disruptions.** It has reduced advanced income tax (AIT) for apparel exporters to 0.3 percent from 0.8 percent. In addition, apparel exporters are eligible to receive a 5 percent cash incentive against export payments made through advance Telegraphic Transfer (TT). Interest rate on input procurement loans from the Export Development Fund (EDF) has been reduced temporarily by 1 percent for exporters to USD LIBOR +1.5 percent for the second half of FY14. Furthermore, the EDF facility has been extended to leather and ceramic sectors. Down payment requirement for loan rescheduling and fixing duration for the rescheduled loans has been relaxed till the end of FY14 for all sectors. New refinance lines are being introduced to support lending to new entrepreneurs including low-income individuals holding no-frills bank accounts opened with Tk 10 deposits.20

54. **The government has revised the minimum wage for garment workers effective from 1st December, 2013.** Under the new scale, the minimum wage for the workers working in the lowest grade (Grade 7) has been raised to Tk 5300 (US$ 68) per month from the previous wage of Tk 3000 (US$ 38) per month representing an increase of 76.7 percent. This wage is higher than the proposed Tk 4500 (US$58) by the owner’s and lower than the Tk 8114 (US$ 104) demanded by the workers. Two new components, transport allowance of Tk 200 (US$ 2.5) and food allowance of Tk 650 (US$ 8), were added to the minimum wage calculation. In addition, the workers will get five percent increment over basic salary each year. The seven grade system remains with the average wage increase of 60 percent in the top six grades.

55. **Bangladesh Energy Regulatory Commission (BERC) increased the power tariff by 6.96 (weighted average) percent.** The average tariff at consumer level increased from Tk 5.75 per Kwh to Tk 6.15 per Kwh. Average retail tariff for residential consumers, small industries and commercial users increased by 6.97 percent, 8.14 percent and 6.49 percent respectively. Tariff for irrigation and ‘life-line’ (less than 50 kWh per household per month) residential users remain unchanged. However, the users using more than 50 units will not get the benefits of ‘life-line' tariff. The new tariff is effective from March 1, 2014.

56. **Bangladesh and the United States signed the Trade and Investment Cooperation Forum Agreement (TICFA).** This agreement creates a mechanism for further dialogue on initiatives for expanding trade and investment between the two countries. Ministry of Commerce will represent Bangladesh while the Office of the United States Trade Representative will chair the United States side in this forum. Under this framework, the countries will monitor trade and investment relations, identify opportunities and constraints and will work to remove the constraints. The representatives will meet at least once a year. Either party may terminate the agreement providing a written notification with a notice period of 180 days.

57. **Bangladesh Bank (BB) has limited the total investment of commercial banks in capital market on consolidated basis along with the existing solo one to minimize investment risk.** The market value of total investment of a banking group in the capital market on a consolidated basis will not exceed 50 percent of its consolidated paid up capital, balance in share premium account, statutory reserve, and retained earnings as stated in the latest audited statement. The existing rule issued previously on 26th September 2013 said that banks can invest up to 25 percent of their core capital in the capital market on standalone basis. The banks have been asked to take measures to bring down their excess investment in the capital market by July 21, 2016 on both solo and consolidated basis. All investments of the banks,

---

excepting inter-company transactions, subscription to any fund intended to the capital market investment, market value of all capital market leaning securities including shares, margin loans and bridge loans provided by the subsidiaries will be counted while calculating the banks’ total capital market investment on a consolidated basis.

58. **Annual foreign exchange quota for business travel increased from $6,000 to $10,000 subject to limit of $4,000 per trip.** BB in a circular on March 10, 2014 said exporters, importers, and producers for the local market are entitled to this quota. Exporters will also be entitled to use the balance in their foreign currency retention quota account for business visits abroad. “Genuine requirements” beyond the above will be accommodated by BB upon establishing bona fides of the additional requirements.

59. **The Anti-Corruption Commission (amendment) Bill, 2013 was passed by the parliament.** The bill introduced a controversial new provision in the section 32 of the Anti-Corruption Commission (ACC) Act 2004 under which it makes mandatory for the ACC to follow section 197 of the Criminal Procedure Code that requires the ACC to secure prior government permission before filing any case against civil servants, judges and magistrates for alleged corruption. However, the High Court has declared this provision unconstitutional and illegal. The amendment also made graft offences non-bailable and introduced a provision for punishment up to five years’ imprisonment for supplying false information to influence investigation and trial. Some other features of the amendment are: mandatory disclosure of corruption related information by such bodies as NBR, law enforcement agencies, CAG and Bangladesh Bank upon ACC’s request; retaining the appointment of the secretary in ACC’s jurisdiction; confidentiality of information provider and empowering the police to investigate the graft allegations.\footnote{ACC Toothless, The Daily Star, 11 November, 2013.}

60. **Ministry of Posts and Telecommunications and the Ministry of Information and Communication has been merged into Ministry of Posts, Telecommunications and Information technology.** The rationale behind this merger is to ensure better coordination and reduce bureaucracy. The ministry will now have two divisions-Posts and Telecommunication division and Information and Communication Technology division. The Minister of Posts and Telecommunication will be in charge of this newly formed ministry.

**Short to Medium Term Development Challenges**

61. **Growth momentum needs immediate boosting.** The momentum of GDP growth acceleration, so critical to realizing Bangladesh’s aspiration of becoming a middle income country and graduating from LDC status, has faltered in recent years as a result of lingering uncertainties around the modality of political transition, slow pace of structural reforms and the inability to get started on building transformative infrastructure. Growth in manufacturing should benefit from stronger demand in high income countries, but growth in services is likely to suffer (especially in 2014) because of decline in domestic demand due to employment losses and decreased remittance flows.

62. **Bangladesh faces three sets of formidable challenges in the immediate future:** (i) maintaining stability and resolving the remaining political uncertainties while boosting investments in power and roads; (ii) managing well the transition in the readymade garment industry; and (iii) stemming the decline in remittances. While the return of stability will help focus on addressing these challenges, the loss of time in taking decisive actions could be very costly for the Bangladesh economy.

63. **Prioritized attention on resolving supply side constraints could produce quick results.** Apart from addressing the root causes of political instability, the first requires alleviation of supply side constraints by making progress on ongoing projects on a fast track in power and transport. There is huge
need for upgrading the power plants to increase fuel efficiency in electricity production and to upgrade and maintain roads, railways and waterways for efficient and safe movement of passengers and cargo along trade corridors to strengthen the economy’s competitiveness.

64. **Managing the transition in garments will be critical.** In garments, minimum wages are being increased, but the industry coverage is still well behind target. The Bangladesh government, garment associations, workers organizations, and international stakeholders have put in place several initiatives to improve working conditions and factory safety standards. When implemented, these will increase operating costs which, combined with some likely displacement of external demand, may constrain expansion of the garment industry if an environment enabling productivity increasing investment and industrial reorganization is not created.

65. **Stemming remittance decline will require rejuvenating manpower exports** by finding new markets and addressing Bangladesh specific issues in existing markets so as to reduce the number of returnees and unemployment of workers abroad. The UAE, Saudi Arabia and Kuwait continue to keep their doors shut for Bangladeshi labor because of the alleged involvement of some Bangladeshi workers in smuggling, visa forgery, swindling and other crimes. These countries have continued to recruit workers from India, Pakistan and Sri Lanka. Strengthening of the institutional capacity is needed for speeding up the issuing of machine readable passports (MRP) for migrant workers. Migrant workers are experiencing difficulties in renewing work permits without MRPs. Saudi Arabia has initiated the practice of signing Standard Employment Contract with sending countries. India, Philippines and Sri Lanka have signed such contracts with Saudi Arabia to ensure safety and rights of migrant workers. Bangladesh should pursue proactive diplomatic efforts in this regard. Bangladesh should also take an active part in the negotiations in the WTO in the context of operationalization of the service waiver, as was agreed in Bali during Ministerial Conference-9.22

66. **Accelerating the growth rate to 8 percent is the most critical medium-term challenge.** The medium-term development challenges include re-invigorating structural reforms that boost supply capacity and productivity by investing in transformative infrastructure, energy and streamlining trade and investment regulations. Growth in Bangladesh—which is currently below potential—may rise to potential capacity within a couple of years if stability prevails. But it is unlikely to accelerate much further without hitting capacity constraints and generating overheating pressures in the absence of restoring the international image of the garment industry, regaining the manpower export momentum, continuing structural reforms and upgrading infrastructure. Rise in public investment in transformative infrastructure will be critical to boosting private investment and capacity creation. Other things equal, increasing the potential growth rate to a new normal of about 8 percent from the current potential of 6.5 percent could be achieved by a combination of annual average 14 percent export growth, 13 percent remittance growth and 15 percent growth in public investment, compared respectively with 11.6 percent, 13.3 percent and 8.5 percent average growth rates achieved in last ten years.

---

67. **The world economy is showing signs of rebound this year.** Global GDP is projected to grow from 2.4 percent in 2013 to 3.2 percent this year, stabilizing at 3.4 percent and 3.5 percent in 2015 and 2016, respectively. Much of the initial acceleration reflects a pick-up in high-income economies where the drag on growth from fiscal consolidation and policy uncertainty will continue to ease, accelerating economic growth from 1.3 percent in 2013 to 2.2 percent this year, and stabilizing at 2.4 percent in 2015 and 2016.

68. **The recovery is most advanced in the US.** Notwithstanding Fed’s tapering (Box-4), the US economy is projected to grow by 2.8 percent this year (from 1.8 percent in 2013), firming to 2.9 and 3.0 percent in 2015 and 2016, respectively. Growth in the Euro Area, after two years of contraction, is projected to be 1.1 percent this year, and 1.4 and 1.5 percent in 2015 and 2016, respectively. The recovery is supported by a pick-up in private domestic demand leading to rising import demand in high income economies. This is proving to be a significant tailwind for developing country exports that are rebounding strongly. Global trade volumes rose at a 12.1 percent annualized pace (3m/3m saar) in December, up from a low of -1.4 percent last August, with developing country exports expanding at a 21.1 percent pace, the fastest in 9 months.\(^{23}\)

69. **Bangladesh’s external balance may erode from the current comfortable level, but stability is likely to continue.** Export growth may moderate reflecting supply disruptions and some weakening in demand for Bangladeshi garments due to inadequate improvements in labor standards. Remittances are expected to remain weak while imports are likely to pick up, leading to narrowing of the current account surplus. These could lead to slower accumulation of foreign exchange reserves during the rest of FY14.

70. **The RMG industry is likely to consolidate due to acquisition of smaller firms by large ones with stronger capacity to upgrade both factory and labor standards.** As a result, export growth may recover after moderating in FY15 as the demand

response to upgrading start flowing in and the rise in operating costs is counterbalanced by the lagged effects of improved power, gas and transport infrastructure. If the relaxation of the GSP’s rules of origin made by EU in favor of Bangladesh in January 2011 is reversed on grounds of compliance inadequacies, the impact on external balance will be sizable, weakening both the current account and the reserve cover. This may be partially alleviated if remittances normalize from FY15 assuming improved demand for Bangladeshi labor with the relaxation of restrictions in KSA, UAE and Kuwait made possible by intensified economic diplomacy. Import growth can be expected to rise with a pick up private investment demand. However, reserves may still rise supported by stronger inflow of FDI and public external borrowing for infrastructure.

71. **Internal balance is expected to improve in the medium-term.** LC opening data provide mixed indications of an imminent growth recovery (Figure 12-14). Growth is likely to strengthen gradually from FY15, supported by the demand and supply effects of enhanced public investment in infrastructure, harnessing of demographic dividend, and structural reforms to revamp the investment climate and

---

**Box-4: Impact of Fed Tapering**

In May 2013, the former Chairman of the Federal Reserve Bank of the US Ben Bernanke stated Fed may soon taper the size of its bond-buying program – known as Quantitative Easing (QE) – by reducing its asset purchases from the US$85 billion per month level. The reason for this move was that the US economy had become strong enough for the Fed to feel confident in reducing the level of stimulus. The Fed first reduced the asset purchase by $10 billion to $75 billion per month in December 2013. On January 29, 2014, Fed policy makers trimmed bond buying for the second time by cutting monthly purchases by $10 billion to $65 billion. Currently, the consensus estimate is that the Fed will continue to reduce the size of its QE program through 2014 and ultimately wind it up by the end of the year.

The impact of Fed’s tapering decision was felt most in Argentina and Turkey, where the currencies came under pressure. However, in the coming weeks and months any other adverse event or expectations regarding growth (in the US and China, but also among the emerging market Fragile Five—Brazil, India, Indonesia, Turkey and South Africa) and perceptions that policy reforms and financial/institutional buffers are inadequate, could trigger increased volatility in currency, commodity and financial markets. What effects could it have on Bangladesh?

The main transmission mechanism through which Fed tapering could impact Bangladesh’s trading partners is increase in interest rates which could dampen growth in consumer spending in those economies. However, this is unlikely to impact demand for Bangladeshi exports, which are concentrated in low-end garments, agro-processed products, footwear, and non-perishable consumables such as ceramic and light engineering products. Demand for these products is not interest sensitive.

Fed tapering is likely to raise the six-month LIBOR. This in turn could raise the cost of borrowing by Bangladeshi firms from foreign sources. There are two new channels through which Bangladeshi entrepreneurs have been recently accessing overseas lenders, who offer lower cost financing relative to domestic bank lending rates. One channel is borrowing by corporates for term credit purposes most with a maturity over five years. Interest payments on these loans are based on six-month LIBOR plus a premium of 4.5 percent. The second channel is private capital flows to local corporates which have also grown due to the addition of short term foreign currency loans for working capital purposes in the form of ‘buyers credit’ (which importers avail with a tenure of up to one year) and ‘discounted export bills’. Cost of these loans may also rise as a result of Fed tapering.

Tapering could also adversely affect FDI flows into Bangladesh if the international capital flows are redirected to the US or to developed economies which are doing better. Historically, FDI inflows into Bangladesh have been relatively small, but are consistently rising. From $276 million in FY04, it increased to $1.3 billion in FY13. This increase indicates the global shift taking place with a re-allocation of efficiency-seeking FDI away from China and other emerging markets and towards frontier markets such as Bangladesh with their vast untapped labor pools, low costs and market opportunities.
increase human capital. The effect of an adverse export shock from EU on income from the export sector may dampen private consumption and investment, resulting in a negative impact on growth spread over a couple of years.

72. *The extreme shortage of power faced by the country a few years ago, which threatened to derail economic growth, have been partially mitigated.* The high cost liquid fuel based generation plants bought much-needed breathing space. Bangladesh now needs to address the remaining demand supply imbalance by pursuing a multi-pronged strategy to ensure the sustainable availability of adequate and reliable power. The policy priorities are to boost new base-load supply, promote efficiency across the value chain, diversify fuel mix to enhance energy security, and reduce the fiscal burden through better alignment of retail prices with unit costs (See the Special Focus section for more details).

73. *Adhering to the macroeconomic policy stance envisaged in the government's Medium-Term Macroeconomic Policy Framework underpinning the FY14 budget will contribute to external and internal economic stability.* Monetary aggregates should remain restrained while providing room for a recovery in private credit growth to support the likely increase in private investment. Fiscal policy should allow continued rise in public investment spending while restraining growth in recurrent expenditures, particularly untargeted subsidies and non-ADP capital spending. Over the medium-term, a moderate consolidation path anchored on stronger tax collection effort should continue to be pursued.

74. *With continuation of prudent macroeconomic management, inflation should approach the normal 6 percent over the medium-term.* This of course assumes stable international commodity prices. In the case of a sustained trade shock, the exchange rate could be allowed to adjust with its pass-through to inflation contained by monetary tightening, while ensuring an adequate supply of liquidity to the markets. At the same time, some fiscal easing in the form of additional public investment and expansion of well-targeted safety nets to protect the poor and the vulnerable will help sustain growth without risking price stability.

**Bank Support and Activities**

*Lending commitments have been on track to achieving targets envisaged in the CAS Progress Report endorsed by the Board in January, 2014.*

75. On Jan. 14, the IDA Board discussed the Country Assistance Strategy Progress Report on Bangladesh. EDs welcomed the progress Bangladesh has achieved in sustaining economic growth, reducing poverty and improving social indicators and strongly supported the Progress Report’s proposal to put more emphasis, in the remainder of the extended CAS period, on enhancing WBG financing for key infrastructure (including energy) and mainstreaming governance, noting that governance challenges will remain the key obstacles to sustaining economic and social progress.

76. New commitments in FY14 have increased. The IDA Board so far has approved five projects for Bangladesh in FY14, for a total new commitment of $1.75 billion. We expect to commit another $125 million, for a total commitment of $1.875 billion in FY14. The most recent approval came on Feb. 27, when the Board considered the $600 million Rural Electricity Transmission and Distribution project. The $60 million VAT Improvement project is expected to go to the Board in May and an additional financing will be prepared for the ongoing Rural Electrification and Renewable Energy project, home to the successful IDCOL-implemented Solar Home Systems program, to absorb any additional IDA16 resources that are made available to Bangladesh, through exchange rate variation, cancellation, or cross-country reallocation.
77. Bangladesh made sufficient progress in combating money laundering and terror financing to exit the monitoring process undertaken by the Financial Action Task Force (FATF), the international standard setter on Anti-Money Laundering/Counter Financing of Terrorism (AML/CFT). The Bank's Financial Market Integrity Unit (FFSFI) has been supporting the Bangladesh Bank and the Financial Intelligence Unit (FIU) in its endeavor to implement an AML/CFT system consistent with FATF standards. Support was also provided by a JOTAP child Trust Fund and a Canadian Trust fund (Cantech). The TA Program was closely coordinated with the Central Bank Strengthening Project (CBSP) which included funding of a new IT database, training and recruitment of a long-term mentor to assist the Bangladesh authorities in improving their AML/CFT regime.

**Special Focus**

**The Power Sector: Key Issues and Policy Priorities**

*The Government took action to address the extreme shortage of power faced by the country a few years ago, which threatened to derail economic growth. The solution adopted - high cost “quick rental” generation plants - bought much-needed breathing space. Bangladesh now needs to address the remaining demand supply imbalance in power by pursuing a multi-pronged strategy to ensure the sustainable availability of adequate and reliable power to support the country’s development. The policy priorities are to boost new base-load supply, promote efficiency across the value chain, diversify fuel mix to enhance energy security, and reduce the fiscal burden through better alignment of retail prices with unit costs.*

**An Overview of the Sector**

78. Electricity is the major source of power for country's most of the economic activities. The country's generation plants have been unable to meet system demand over the past decade. Bridging the demand-supply gap in electricity is a major challenge. Bangladesh ranked 133 out of 148 countries in the Global Competitiveness Index 2013-14 for quality of electricity supply. The power deficit rises to around 30 percent of demand (2000 MW) during peak periods. In generating and distributing electricity, the failure to adequately manage the load leads to extensive load shedding which results in severe disruption in the industrial production and other economic activities. Surveys revealed that power outages reduce GDP growth by about half a percentage point in Bangladesh.

79. Bangladesh is steadily climbing up the development ladder. Energy and power needs to act as a key catalyst in helping the country move further up. Industries are being automated, moving gradually from a labor-intensive economy to a relative more capital intensive one. Electricity is vital at such a stage. Bangladesh has a vast market as far as power and electricity is concerned. As of FY13, only 55 percent of the population had access to electricity with annual per capita consumption of 213 kWh.\(^\text{24}\) Good prospects for constructing power generation plants exist in terms of resources available and government policies. The government plans to address the power deficit through a set of interventions that include supply and demand side efficiency measures; investment in generation, transmission and distribution to raise electrification rates to 68 percent by 2015; and reforms to improve efficiency, accountability, and effectiveness of sector institutions.

\(^{24}\) BPDB, Annual Report 2012-2013.
80. **Market Structure and Concentration**: Bangladesh Power Development Board (BPDB) is responsible for the major portion of electricity generation in the country. Transmission is vertically separated as a subsidiary of BPDB to Power Grid Company of Bangladesh (PGCB) and distribution is horizontally separated in the capital city (Dhaka Electric Supply Co. Ltd and Dhaka Power Distribution Co. Ltd.). Distribution in cities other than the capital are handled by three other subsidiaries of BPDB - West Zone Power Distribution Co. Ltd., North West Zone Power Distribution Co. Ltd., and South Zone Power Distribution Co. Ltd. BPDB has been functioning as a single buyer in the power market and exercises some level of dominance. BPDB purchases electricity from public and private generation entities and sells bulk electricity to all distribution entities. Although the private sector exists in generation, they are not allowed to sell power directly to the distribution companies.

81. **Generation**: The current installed generation capacity (as of November 2013) is 10,213 MW (including imports) of which 58 percent is in the public sector and 42 percent is in private sector. Rental power plants comprise 49.3 percent capacity of the private sector or 20.5 percent of the total generation capacity. Currently, 500 MW power is being imported from India and the Indian Government have pledged another 100 MW.\(^{25}\) Among the total installed capacity, 64.5 percent is run by natural gas, 19.2 percent by furnace oil, 6.7 percent by diesel, 2.5 percent by coal and 2.3 percent is hydro power. Total energy generation in FY13 was 38,229 GWh, which is 8.7 percent more than the previous fiscal year. Net generation in public sector was 19,741 GWh and in private sector was 18,488 GWh. On average, 1000 MW load shedding was experienced during peak hours of last summer.

82. **Regulatory Framework**: In 2003, Energy Regulatory Commission Act was enacted under which Bangladesh Energy Regulatory Commission (BERC) was established in 2004 with a vision 'To make provisions for the establishment of an independent and impartial regulatory commission for the energy sector'. The mandate of the Commission includes framing rules and regulation to ensure transparency in the management, operation, and determination of tariff in the electricity, gas, and petroleum sectors. The Commission is mandated to protect consumer and industry interest and promote competitive market.

83. **Policy Framework**: The Government adopted several policies for the overall development of the sector like National Energy Policy 1996 (revised in 2006), Private Sector Power Generation Policy 1996 to attract private investments for power generation, Renewable Energy Policy 2009 to develop renewable energy resources etc. The Government also has declared the policy of 'Electricity to all by 2021', targeting the electrification rate of 100 percent and 600 kWh per capita achievements. In Power Sector Master Plan (PSPM) 2010, power demand forecast is determined and power supply plan is developed in line with it.

**Key Issues**

84. **Constrained supply**: A majority of manufacturing and service firms identify shortage of reliable electricity as the most important constraint to their smooth operation and expansion. The large gap between demand and power supply results in load shedding, inducing more than 60 percent of firms to invest in self-supply (i.e. own diesel generators). Supply is constrained because of several reasons, most important of which is limited investment over the past decade in new base-load generation capacity. Many power plants are decades old and operate below their rated capacity due to inadequate attention to operations and maintenance, and with reduced output of electricity per unit of fuel. About 500 MW of existing gas-fired capacity is idle because of gas shortages. Consequently, even though installed capacity is over 10,000 MW, available capacity is limited to 6,000–6,500 MW. Electricity demand is projected to grow by more than 10 percent per annum over the medium term, given efforts to increase access to grid electricity (presently 53 percent of the population) and 6 percent annual projected economic growth.

85. **Investor concerns:** Despite early success in attracting private investors, no new large independent private producers (IPP) have started operation in more than a decade. The credit-worthiness of the off-taker Bangladesh Power Development Board (BPDB) is a concern for potential investors. Uneasiness about the award process has also colored market perceptions of the IPPs offered in recent years, with several projects failing to reach financial closure.

<table>
<thead>
<tr>
<th>Table 1: Rising Unit Cost of Power</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY08</td>
</tr>
<tr>
<td>------</td>
</tr>
<tr>
<td>Average per unit generation cost of power (BDT/kWh)</td>
</tr>
</tbody>
</table>

*Source: Bangladesh Power Development Board*

86. **Unsustainable short term solutions:** To provide electricity on an emergency basis the government signed 3-5 year contracts with private suppliers for 2,300 MW of generation capacity in diesel or furnace-oil fired ‘rental’ plants. While these plants came on-line rapidly, they are less fuel-efficient than large coal or gas fired plants. Moreover, since the contracts signed were quite generous, the power they supply is expensive. The change in the generation fuel mix over 2010-2013, with liquid fuel moving up from 5 percent to 28 percent of peak generation, has significantly increased the average cost of electricity (Table 1).

<table>
<thead>
<tr>
<th>Table 2: Energy Subsidies in Bangladesh ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Product</td>
</tr>
<tr>
<td>---------</td>
</tr>
<tr>
<td>Petroleum Products</td>
</tr>
<tr>
<td>Electricity</td>
</tr>
<tr>
<td>Generation</td>
</tr>
<tr>
<td>Distribution</td>
</tr>
<tr>
<td>TOTAL</td>
</tr>
</tbody>
</table>

*Source: Energy Subsidies in Bangladesh: A profile of groups vulnerable to reform, IISD 2013. Using an exchange rate of BDT 78.66/US$. Totals may not exactly tally due to rounding.*

87. **Significant fiscal burden:** Direct state support to the energy sector is substantial and has grown over the past decade: budgetary transfers rose from $85m in FY07 to $815m in FY12, before falling back to $640m in FY13 following gradual tariff adjustments over the past two years. These transfers seek to compensate BPDB for the wedge between the average price of power it purchases and the rate at which it sells power to distributors. Distributors in turn also face a financing gap due to the difference between the retail tariffs they are allowed to charge and the amount they pay BPDB for power purchases. This deficit, about $200m in FY12, is typically met by delayed debt service to the government. The gap between the cost of service and consumer payments is unlikely to go down until the short-term rentals are replaced by low cost base load power plants and/or retail tariffs are adjusted to reflect the cost of electricity services. Finally, the government also provides imported diesel and furnace oil for power generation by the rental
power plants at a price below the international market price, the cost of which is included in the $800 million plus annual subsidy to the petroleum sector (Table 2).

88. **Distorted market signals**: The administered price of domestically produced natural gas is fixed at a level considerably below that of the international market. Not only does this represent an opportunity cost for the government in lost revenues, but the lack of an appropriate price signal leads to inefficiencies in allocation and use and limited incentives for further exploration.

89. The electricity tariffs in Bangladesh are characterized by different rates for different consumer categories. A rising block tariff has been in practice essentially to address affordability concerns through a cross-subsidy from large to smaller electricity users. Distribution utilities being a commercial organization, charge for electricity on a 'cost plus performance based return' principle to cover their capital costs, operation costs, and return on equity.

90. Bangladesh still has relatively low electricity tariff rates in South Asia (Table-3). Current average tariff is about 77 percent of the unit cost of generation plus distribution (Tk 8.06 per kwh).26 The cost of generation is expected to increase significantly with the depleting domestic gas reserves. Therefore, the regulated tariff rate is expected to be high in near future in Bangladesh.

### Table 3: Power Tariff in South Asia

<table>
<thead>
<tr>
<th></th>
<th>Afghanistan</th>
<th>Bangladesh</th>
<th>Bhutan</th>
<th>India</th>
<th>Nepal</th>
<th>Pakistan</th>
<th>Sri Lanka</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cents per kwh</td>
<td>9.18</td>
<td>7.7</td>
<td>3.21</td>
<td>7.03</td>
<td>7.63</td>
<td>10.2</td>
<td>10.2</td>
</tr>
</tbody>
</table>

*Source: World Bank, Review of Key Issues in the Power Sector in South Asian Countries, 2013 and WB staff estimates*

**Policy Priorities**

91. **Boost new base-load supply**: There are several options for government consideration to address investor concerns regarding BPDP’s credit-worthiness: (i) BPDB credit enhancement through a guarantee or other similar mechanism, which could also address perceptions about the quality of governance (e.g. through involvement of international financial institutions); (ii) clearly specify and implement a path to financial independence of BPDB and eliminate dependence on subsidies; and, (iii) over time, establish a power market or exchange to help bring in new participants.

92. **Promote efficiency across the value chain**: The demand-supply gap can be reduced through concerted efforts to increase the efficiency of the 2,500 MW of state-owned thermal generation capacity (e.g., through repowering, in alignment with the least cost expansion plan), and proper pricing of power and fuels (gas, oil) to encourage efficient use and reduced waste at the consumer end. Permitting the price of domestic gas to reflect the international price would signal scarcity and provide incentives for conservation and efficient use. It would also help ensure that planned use of imported gas does not create an even greater fiscal burden than currently exists.

93. **Diversify fuel mix to enhance energy security**: Dependence on natural gas for two-thirds of generation and the projected depletion of proven gas reserves together make it imperative for Bangladesh to obtain more gas, both through imports and through ramped up exploration, and to diversify the mix of fuels used for generation. A policy for exploiting other thermal resources (e.g. coal) should be developed in concert with a strategy to harness renewable sources of power—a start has been made through the off-grid renewable energy-based access program. The recent import of power from India is a welcome

---

26 Taking into account the tariff increase announced on March 13, 2014.
development (discussions are also underway with Nepal and Bhutan). Bangladesh is also looking to Myanmar as a source of gas and power, and can play a critical role in championing the development of a regional market and power pool.

94. **Reduce the fiscal burden:** Market-based pricing of key inputs such as natural gas and petroleum products along with end-user electricity tariffs that cover efficient production costs will help greatly in reducing dependence on the exchequer. Work is required on the following: (a) permitting bulk supply tariffs to reflect the market price of generation, (b) retail tariff reform to provide greater certainty to investors, and (c) lower priced renewal of rental contracts, since capital costs have been paid down. To date some contracts have been renewed on a ‘no power no payment’ basis, while some rental prices have come down, more should be done to reduce the cost of rental power and eventually phase it out. Finally, subsidies need to be targeted to the poor, and preferably delivered through direct transfers, rather than below-cost tariffs. It is important to mention that tariff increase is not the only means to cover the revenue gap. There are several aspects including increase in operational efficiency that contribute towards reducing the revenue gap and hence improving the financial viability of the power sector.
## Annex A

### Table A-1: Bangladesh Macroeconomic Indicators

<table>
<thead>
<tr>
<th>Description</th>
<th>FY07</th>
<th>FY08</th>
<th>FY09</th>
<th>FY10</th>
<th>FY11</th>
<th>FY12</th>
<th>FY13</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Growth Rates (%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP Growth</td>
<td>6.4</td>
<td>6.2</td>
<td>5.7</td>
<td>6.1</td>
<td>6.7</td>
<td>6.2</td>
<td>6.0</td>
</tr>
<tr>
<td>GDP Growth Per Capita</td>
<td>5.3</td>
<td>5.2</td>
<td>4.7</td>
<td>5.0</td>
<td>5.6</td>
<td>5.0</td>
<td>4.8</td>
</tr>
<tr>
<td>Per Capita GDP (current US$)</td>
<td>467</td>
<td>538</td>
<td>598</td>
<td>664</td>
<td>732</td>
<td>750</td>
<td>830</td>
</tr>
<tr>
<td>Per Capita GNI (current US$)</td>
<td>502</td>
<td>585</td>
<td>652</td>
<td>726</td>
<td>799</td>
<td>823</td>
<td>913</td>
</tr>
<tr>
<td>Per Capita GNI Atlas Method (US$)</td>
<td>516</td>
<td>574</td>
<td>627</td>
<td>703</td>
<td>782</td>
<td>843</td>
<td>901</td>
</tr>
<tr>
<td><strong>Inflation (%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rate of Inflation (CPI, %) (year on year)**</td>
<td>9.4</td>
<td>12.3</td>
<td>7.6</td>
<td>6.8</td>
<td>10.9</td>
<td>8.7</td>
<td>6.8</td>
</tr>
<tr>
<td>Inflation (GDP deflator)</td>
<td>6.8</td>
<td>8.8</td>
<td>6.6</td>
<td>6.4</td>
<td>7.4</td>
<td>8.5</td>
<td>6.6</td>
</tr>
<tr>
<td><strong>Saving &amp; Investment (% of GDP)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Domestic Saving</td>
<td>20.4</td>
<td>20.3</td>
<td>20.1</td>
<td>20.1</td>
<td>19.3</td>
<td>19.3</td>
<td>19.3</td>
</tr>
<tr>
<td>Gross National Saving</td>
<td>25.8</td>
<td>25.7</td>
<td>26.7</td>
<td>27.7</td>
<td>25.9</td>
<td>27.5</td>
<td>29.0</td>
</tr>
<tr>
<td>Private Investment</td>
<td>19.0</td>
<td>19.3</td>
<td>19.7</td>
<td>19.4</td>
<td>19.5</td>
<td>20.0</td>
<td>19.0</td>
</tr>
<tr>
<td>Public Investment</td>
<td>5.4</td>
<td>5.0</td>
<td>4.7</td>
<td>5.0</td>
<td>5.6</td>
<td>6.5</td>
<td>7.9</td>
</tr>
<tr>
<td><strong>Central Govt. Budget (% of GDP)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Revenue</td>
<td>10.4</td>
<td>11.4</td>
<td>10.4</td>
<td>10.9</td>
<td>12.1</td>
<td>12.5</td>
<td>12.9</td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>13.5</td>
<td>15.0</td>
<td>14.3</td>
<td>14.6</td>
<td>16.1</td>
<td>16.6</td>
<td>17.1</td>
</tr>
<tr>
<td>Overall Budget Deficit</td>
<td>3.1</td>
<td>3.6</td>
<td>3.9</td>
<td>3.7</td>
<td>4.0</td>
<td>4.1</td>
<td>4.3</td>
</tr>
<tr>
<td>Total Public Debt</td>
<td>46.8</td>
<td>46.8</td>
<td>45.4</td>
<td>42.9</td>
<td>44.2</td>
<td>42.8</td>
<td>39.3</td>
</tr>
<tr>
<td><strong>Balance of Payments (% of GDP)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade</td>
<td>40.3</td>
<td>42.3</td>
<td>40.1</td>
<td>37.6</td>
<td>47.9</td>
<td>49.6</td>
<td>46.6</td>
</tr>
<tr>
<td>Exports</td>
<td>17.6</td>
<td>17.7</td>
<td>17.4</td>
<td>16.2</td>
<td>20.5</td>
<td>20.9</td>
<td>20.8</td>
</tr>
<tr>
<td>Imports</td>
<td>22.7</td>
<td>24.7</td>
<td>22.7</td>
<td>21.4</td>
<td>27.4</td>
<td>28.7</td>
<td>25.8</td>
</tr>
<tr>
<td>Services &amp; Income (net)</td>
<td>-3.2</td>
<td>-3.2</td>
<td>-3.5</td>
<td>-2.7</td>
<td>-3.8</td>
<td>-3.9</td>
<td>-4.2</td>
</tr>
<tr>
<td>Current Transfers</td>
<td>9.6</td>
<td>11.1</td>
<td>11.4</td>
<td>11.6</td>
<td>11.1</td>
<td>11.5</td>
<td>11.6</td>
</tr>
<tr>
<td>Current Account Balance (including transfers)</td>
<td>1.4</td>
<td>0.9</td>
<td>2.7</td>
<td>3.7</td>
<td>0.8</td>
<td>-0.4</td>
<td>1.9</td>
</tr>
<tr>
<td><strong>External Indicators</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>External Debt (US$ b.)</td>
<td>19.6</td>
<td>21.0</td>
<td>23.0</td>
<td>22.4</td>
<td>25.4</td>
<td>25.8</td>
<td>26.0</td>
</tr>
<tr>
<td>Ext. Debt as % of GDP</td>
<td>28.7</td>
<td>26.4</td>
<td>25.7</td>
<td>22.3</td>
<td>22.7</td>
<td>22.2</td>
<td>20.0</td>
</tr>
<tr>
<td>BB Gross Reserves (US$ b.) (end of period)</td>
<td>5.1</td>
<td>6.2</td>
<td>7.5</td>
<td>10.75</td>
<td>10.9</td>
<td>10.3</td>
<td>15.3</td>
</tr>
<tr>
<td>BB Gross Reserves (in months of imports)</td>
<td>3.4</td>
<td>3.4</td>
<td>3.7</td>
<td>5.4</td>
<td>3.9</td>
<td>3.3</td>
<td>4.6</td>
</tr>
<tr>
<td><strong>Money and Credit</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>M2 Growth (% , year-on-year)</td>
<td>17.1</td>
<td>17.6</td>
<td>19.2</td>
<td>22.4</td>
<td>21.3</td>
<td>17.4</td>
<td>16.7</td>
</tr>
<tr>
<td>Net Domestic Asset Growth (% , year-on-year)</td>
<td>12.6</td>
<td>18.1</td>
<td>17.8</td>
<td>19.1</td>
<td>25.0</td>
<td>18.5</td>
<td>11.8</td>
</tr>
<tr>
<td>Ratio of Private Sector Credit to GDP (%)</td>
<td>32.2</td>
<td>34.8</td>
<td>38.6</td>
<td>39.1</td>
<td>42.8</td>
<td>44.4</td>
<td>43.6</td>
</tr>
<tr>
<td><strong>Exchange Rate</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nominal Period Average (TK/US$)</td>
<td>69.1</td>
<td>68.6</td>
<td>68.8</td>
<td>69.2</td>
<td>71.2</td>
<td>79.1</td>
<td>79.9</td>
</tr>
<tr>
<td>Nominal End of Period (TK/US$)</td>
<td>68.8</td>
<td>68.5</td>
<td>69.0</td>
<td>69.5</td>
<td>74.2</td>
<td>81.8</td>
<td>77.8</td>
</tr>
<tr>
<td>Real Effective Exchange Rate Index (IMF)</td>
<td>96.5</td>
<td>95.8</td>
<td>105.5</td>
<td>108.3</td>
<td>108.9</td>
<td>105.2</td>
<td>111.6</td>
</tr>
<tr>
<td><strong>Memorandum Items</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP at Current. Prices (Taka bill.)</td>
<td>4,725</td>
<td>5,458</td>
<td>6,148</td>
<td>6,943</td>
<td>7,967</td>
<td>9,181</td>
<td>10,380</td>
</tr>
<tr>
<td>GNI at Current. Prices (Taka bill)</td>
<td>5,077</td>
<td>5,942</td>
<td>6,707</td>
<td>7,589</td>
<td>8,692</td>
<td>10,074</td>
<td>11,425</td>
</tr>
<tr>
<td>Population (mill.)*</td>
<td>146.5</td>
<td>148.0</td>
<td>149.5</td>
<td>151.1</td>
<td>152.9</td>
<td>154.7</td>
<td>156.6</td>
</tr>
<tr>
<td>Population growth Rate</td>
<td>1.1</td>
<td>1.0</td>
<td>1.0</td>
<td>1.1</td>
<td>1.1</td>
<td>1.2</td>
<td>1.2</td>
</tr>
</tbody>
</table>

* Population data is from DECPG.

Table A.2: Bangladesh Current Macro Economic Indicators

<table>
<thead>
<tr>
<th></th>
<th>FY11</th>
<th>FY12</th>
<th>FY13</th>
<th>FY14&lt;sup&gt;1&lt;/sup&gt; (Projection)</th>
<th>FY14&lt;sup&gt;1&lt;/sup&gt; (July-Feb)</th>
<th>FY13&lt;sup&gt;1&lt;/sup&gt; (July-Feb)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP Growth (%)</td>
<td>6.7</td>
<td>6.2</td>
<td>6.0</td>
<td>5.4</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Inflation&lt;sup&gt;2&lt;/sup&gt;</td>
<td>10.9</td>
<td>8.7</td>
<td>6.8</td>
<td>7.0</td>
<td>7.44</td>
<td>7.8</td>
</tr>
<tr>
<td>Export Growth (%)</td>
<td>41.5</td>
<td>5.9</td>
<td>11.2</td>
<td>11.0</td>
<td>14.0</td>
<td>9.4</td>
</tr>
<tr>
<td>Import Growth (%)</td>
<td>41.8</td>
<td>9.9</td>
<td>0.8</td>
<td>14.2</td>
<td>4.0*</td>
<td>-3.3*</td>
</tr>
<tr>
<td>Remittance Growth (%)</td>
<td>6.0</td>
<td>10.2</td>
<td>12.6</td>
<td>6.0</td>
<td>-7.0</td>
<td>17.4</td>
</tr>
<tr>
<td>Reserves (Months of Import)</td>
<td>3.9</td>
<td>3.3</td>
<td>4.6</td>
<td>4.4</td>
<td>5.7</td>
<td>4.4</td>
</tr>
<tr>
<td>Exchange Rate (Taka per Dollar)</td>
<td>71.2</td>
<td>78.9</td>
<td>79.9</td>
<td>..</td>
<td>77.8</td>
<td>79.0</td>
</tr>
<tr>
<td>Total Revenue (% of GDP)</td>
<td>12.1</td>
<td>12.5</td>
<td>12.8</td>
<td>12.6</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>o/w Tax (% of GDP)</td>
<td>10.4</td>
<td>10.4</td>
<td>10.9</td>
<td>10.4</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>Total Expenditure (% of GDP)</td>
<td>16.1</td>
<td>16.6</td>
<td>17.1</td>
<td>17.7</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>o/w Current Exp. (% of GDP)</td>
<td>9.7</td>
<td>9.7</td>
<td>9.9</td>
<td>9.9</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>o/w Subsidies&lt;sup&gt;3&lt;/sup&gt; (% of GDP)</td>
<td>2.0</td>
<td>3.1</td>
<td>3.6</td>
<td>2.4</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>ADP (% of GDP)</td>
<td>4.2</td>
<td>4.1</td>
<td>4.8</td>
<td>4.6</td>
<td>1.8*</td>
<td>2.0*</td>
</tr>
<tr>
<td>Fiscal Deficit (% of GDP)</td>
<td>4.0</td>
<td>4.1</td>
<td>4.3</td>
<td>5.1</td>
<td>..</td>
<td>..</td>
</tr>
<tr>
<td>NBR Revenue Growth (%)</td>
<td>27.6</td>
<td>19.6</td>
<td>14.8</td>
<td>12.7</td>
<td>10.1*</td>
<td>15.9*</td>
</tr>
<tr>
<td>ADP Spending Growth (%)</td>
<td>26.7</td>
<td>15.3</td>
<td>31.6</td>
<td>20.1</td>
<td>3.9*</td>
<td>33.3*</td>
</tr>
<tr>
<td>M2 Growth (%)</td>
<td>21.3</td>
<td>17.4</td>
<td>16.7</td>
<td>17.9</td>
<td>16.2*</td>
<td>18.7*</td>
</tr>
<tr>
<td>Growth of Credit to Public Sector (%)</td>
<td>33.6</td>
<td>19.1</td>
<td>18.1</td>
<td>19.5</td>
<td>11.5*</td>
<td>12.3*</td>
</tr>
<tr>
<td>Growth of Credit to Private Sector (%)</td>
<td>25.8</td>
<td>19.7</td>
<td>10.8</td>
<td>15.4</td>
<td>11.1*</td>
<td>14.8*</td>
</tr>
</tbody>
</table>

<sup>1</sup>Projections are based on IMF, World Bank and government estimates

<sup>2</sup> Base Year 2005/06

<sup>3</sup> Source of Subsidy amount is Medium Term Macroeconomic Policy Statement 2013-14 to 2017-18, Ministry of Finance.

* Till January of relevant fiscal year

All growth rates are year-on-year

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