Chapter-1

Macroeconomic Performance, Near and Medium Term Prospects

World Economic Environment and Outlook

1.1 The growth of world economy is projected to remain very strong in 2006, led by a robust growth in the United States and, in most emerging market and developing countries, especially China and India. The September 2006 issue of the IMF World Economic Outlook (WEO) projected 5.1 percent global output growth in 2006, 0.2 percentage point higher than expected last April, also higher than 4.9 percent recorded in 2005 and remaining noticeably above the historical trend (Table 1.1). Reflecting higher than expected growth in most countries of advanced economies and emerging and developing economies, the WEO projection in this latest issue has made upward revision in global growth rate compared with the projection made in April 2006. The advanced economies as a group (with 52.3 percent share in 2005 global output) are projected to grow by 3.1 percent, while the other emerging market and developing countries as a group (with 47.7 percent share in 2005 global output) are projected to grow by 7.3 percent in 2006.

1.2 Oil and other commodity prices continued at elevated levels in the first eight months of 2006. The oil price rose sharply above its pre-Katrina peak in early May and again in early August to reach a new record high of $76 per barrel, supported by tight spare capacity in global markets–both in production and refining–against the background of buoyant GDP growth, security concerns in the Middle East, and continued risks to production in some large producers elsewhere notably Nigeria. Non-fuel commodity prices picked up strongly between January and July 2006, reaching its highest level in real terms since 1990–on surging metal prices. Consumer price inflation

Table 1.1 Overview of the world economic outlook projections

(annual percentage change)

	2004	2005	2006*	2007*
World output	**5.3**	**4.9**	**5.1**	**4.9**
Advanced economies	3.2	2.6	3.1	2.7
United States	3.9	3.2	3.4	2.9
Japan	2.3	2.6	2.7	2.1
Germany	1.2	0.9	2.0	1.3
France	2.0	1.2	2.4	2.3
United Kingdom	3.3	1.9	2.7	2.7
Italy	1.1	-	1.5	1.3
Canada	3.3	2.9	3.1	3.0
Newly industrialised Asian economies	5.9	4.5	4.9	4.4
Other emerging market and developing countries	7.7	7.4	7.3	7.2
Developing Asia	8.8	9.0	8.7	8.6
China	10.1	10.2	10.0	10.0
ASEAN-4	5.8	5.1	5.0	5.6
South Asia	7.8	8.2	7.9	7.2
Bangladesh	6.1	6.2	6.2	6.2
India	8.0	8.5	8.3	7.3
Pakistan	7.4	8.0	6.2	7.0
Sri Lanka	5.4	6.0	5.6	6.0
World trade volume (goods and services)	**10.6**	**7.4**	**8.9**	**7.6**
Imports				
Advanced economies	9.1	6.0	7.5	6.0
Other emerging market and developing countries	16.4	11.9	13.0	12.1
Exports				
Advanced economies	8.8	5.5	8.0	6.0
Other emerging market and developing countries	14.6	11.8	10.7	10.6
Commodity prices (U.S. Dollars)				
Oil	30.7	41.3	29.7	9.1
Non-fuel	18.5	10.3	22.1	-4.8
Consumer prices				
Advanced economies	2.0	2.3	2.6	2.3
Other emerging market and developing countries	5.6	5.3	5.2	5.0
South Asia	4.2	4.8	6.0	5.6
Bangladesh	6.1	7.0	6.8	6.1
India	3.9	4.0	5.6	5.3
Pakistan	4.6	9.3	7.9	7.3
Sri Lanka	7.9	10.6	8.0	7.0

Source: World Economic Outlook, September 2006, IMF.

*=Projection.

in 2006 is projected to increase modestly to 2.6 percent in advanced economies and, decline slightly to 5.2 percent in other emerging market and developing countries.

1.3 The growth of world trade volume in 2006 is projected to increase to 8.9 percent compared with 7.4 percent in 2005, also higher than previous forecast. The growth of exports from the advanced economies is projected to increase to 8.0 percent in 2006, while that of exports from other emerging market and developing countries is projected to decline gradually to 10.7 percent but will continue to remain at a high level. Reflecting their strong output growth, the growth of imports for both the advanced economies and other emerging market and developing countries is projected to increase markedly in 2006 which is also higher than expected last April. Reflecting continued strong domestic demand relative to its trading partners and higher oil prices, the U.S. current account deficit is projected to widen to 6.6 percent of GDP in 2006 from 6.4 percent in 2005, matched by large surpluses continuing in Japan, parts of emerging Asia, and oil exporting countries in the Middle East and elsewhere.

1.4 The global economic expansion has continued to be supported by the favourable financial market conditions, characterized by unusually low risk premiums, low financial volatility, long run interest rates still remaining below average, and interest rate spreads remaining close to historic lows. In foreign exchange markets, reflecting in part market concerns with further rise in the U.S. current account deficit, the U.S. dollar has depreciated modestly in real effective terms since late 2005 against the euro, and to a lesser degree the yen, partly reversing its appreciation during the previous 12 months. The latest Global Financial Stability Report (GFSR) released by the IMF in September, 2006 indicates that in recent years the global financial system has gathered strength and resilience, aided by solid corporate fundamentals, healthy financial market conditions with strong earnings supported by rapid growth in household credit, and global default rates remaining near record low levels. The latest GFSR further indicates that the financial institutions and markets are in a strong position to manage cyclical risks stemming from higher interest rates and/or higher inflation, further increase in oil prices, a more rapid cooling-off in the U.S. housing market and a sudden unwinding of global imbalances.

1.5 Looking forward in 2007, global economic growth is expected to have only a modest deceleration at 4.9 percent, 0.2 percentage point above the April 2006 WEO projection aided by prudent macroeconomic policies, a largely reduced capacity bottlenecks and a more stable financial market conditions (Table 1.1). Amongst the advanced economies, forcasts have been revised upward in Germany, France, Japan and the United Kingdom, and downward in the United States, Italy and Canada and newly industrialised Asian economies. Amongst the other emerging market and developing countries, activity remains very strong with forecasts revised upwards in most countries and region: China is projected to grow at a high 10.0 percent in 2007, driven by strong domestic demand and a rapidly rising current account balance. South Asia's (Bangladesh, India, Maldives, Nepal, Pakistan and Sri Lanka) growth rate is also expected to be quite robust. The growth in the volume of world trade in 2007 is projected to decrease to 7.6 percent but is expected to remain at a double-digit level for other emerging and developing countries. With the projected decline in non-fuel commodity prices, inflation is projected to decline in both advanced and, other emerging market and developing economies.

1.6 Notwithstanding the greater-than-expected momentum in the global economy, a number of risks remain to the short and medium term outlook, with the balance of risks slanted to the downside. The major downside risks are: high and volatile oil prices, a tightening of financial market conditions, rising global imbalances and an avian flu pandemic. The oil market is likely to be characterized by robust consumption growth and production uncertainties, in the context of buoyant global activity and limited spare capacity. Moreover, the International Energy

Agency (IEA) estimates that investment in the oil sector is probably 20 percent below what is needed to meet projected demand over the medium to long term. Measures need to be taken for progress in improving the medium-term supply-demand balance in oil markets, including through eliminating obstacles to upstream and downstream investment; ensuring full pass-through to domestic oil prices accompanied by a suitable safety net for the poorest; and strengthening conservation efforts. Such measures would also help reduce price volatility in the short term, by making markets less vulnerable to shocks. Further rise in global short-term and long-term interest rates, and pick up volatility and risk premiums could tighten financial market conditions significantly and may expose global economic expansion to some disruption. The WEO has long argued that the key actions for adjustment in the imbalances include measures to increase savings in the United States; exchange rate appreciation, along with measures to boost domestic demand in emerging Asia; structural reform to boost domestic demand and growth in the euro area and Japan; and measures to increase demand in oil exporters. The worse-case scenario for avian flu pandemic underscores the importance of moving ahead with necessary public health precautions and providing the necessary assistance to developing countries. The World Trade Organization (WTO) Ministerial Conference in Hong Kong SAR, which was the second such conference since the Doha Round, sets specific deadlines for intermediate steps in the negotiations focused heavily on agriculture and development. A successful outcome to the negotiations is needed to strengthen the multilateral trading system and provide impetus to global economic growth.

Developments in the Bangladesh Economy

1.7 During FY06 (July 2005 – June 2006), the Bangladesh economy achieved a higher growth underpinned mainly by a strong post-flood recovery in agriculture and notable expansion in manufacturing activities, despite facing excessive price hike of oil and some other necessary importables in the international market, in addition to the phase out of the Multi-Fibre Arrangement (MFA). With a view to achieving higher economic growth, the Government and the Bangladesh Bank continued to adopt policies to support economic activities to the highest sustainable level, while maintaining a moderate CPI inflation along with turning the import growth to a sustainable level. These policies contributed toward a strong real GDP growth of 6.7 percent in FY06, moderately higher than 6.0 percent of FY05. Economic growth was also aided by strong growth in exports and workers' remittances from abroad. In U.S. dollar terms, export earnings recorded a significantly higher growth of 21.6 percent, while the growth of import payments slowed down to a sustainable level at 12.1 percent. At the same time, remittances from non-resident Bangladesh nationals increased substantially by 24.8 percent. The country's external current account balance turned to a significant surplus with robust growth in exports and remittances reinforced by a slower growth in import payments. A significant surplus in current account balance as well as capital account led to a sizeable surplus in the overall balance, which helped improve the international reserve positon. Although there have been no major disruptions in domestic output, climatic or otherwise, inflation was on uptrend during FY06. The pressures on consumer prices emerged mainly through external trade channels, with the growing exports of consumer necessities pulling their domestic prices to higher export prices; rising import prices of fuel oil, food items, other consumer items and production inputs feeding promptly and fully into domestic prices, except for partial shielding by the government in some fuel oil and fertilizer prices. Depreciation of the Taka also to some extent added to the uptrend in consumer prices. The annual average inflation increased to 7.2 percent in June 2006 from 6.5 percent in June 2005, while 12-month consumer price inflation on point to point basis increased over the same period to 7.5 percent. Broad money (M2) grew by 19.3 percent in FY06 which was higher than the 16.7 percent growth recorded in FY05 and also higher than the projection of 14.3 percent growth. Total domestic credit grew by 21.1 percent, while credit to private sector increased by 18.3 percent in FY06 reflecting the higher demand for credit due to accelaration of economic activities.

Growth Performance

1.8 The 6.7 percent real GDP growth in FY06 was underpinned, on the supply side, by the post-flood recovery in the agriculture sector and a robust growth in the industry sector, in addition by the continued strong growth in the services sector. Growth rate in the agriculture sector recovered well to 4.5 percent in FY06 from 2.2 percent of FY05, resulting mainly from a strong growth in crops and horticulture, and fishing sub-sectors (Table 1.2). There was a sustained high growth in animal farming sub-sector, albeit moderately lower than the growth rate of FY05, while forest and related services sub-sector attained a slightly higher rate of growth in FY06.

1.9 The industry sector attained 9.6 percent growth in FY06, significantly up from 8.3 percent of FY05. The higher rate of growth was supported mainly by a continued improved performance in manufacturing sub-sector, facilitated by strong and sustained growth in export-oriented manufacturing activity and expansion in domestic demand. There was a sustained growth rate increase in the mining and quarrying sub-sector. The construction sub-sector also made some gain in the growth rate. The growth rate of power, gas and water supply sub-sector was 7.7 percent in FY06 as compared to 8.9 percent in FY05.

1.10 Overall the services sector grew by 6.5 percent in FY06, slightly higher than 6.4 percent recorded in FY05 and remaining well above the trend level. The growth was fairly well spread in the different sub-sectors. Increase in industrial output and trade-related activities underpinned higher services sector growth in FY06.

1.11 On the demand side, the growth was broad based reflecting expansion in all major components. Real domestic demand increased by 6.1 percent in FY06, compared with 5.8 percent of FY05. Of the two components of domestic demand, consumption and investment

Table 1.2 Sectoral GDP growth rates

(at FY96 constant prices: percent)

	FY91-FY00 (Average)	FY01-FY06 (Average)	FY05	FY06P
I. Agriculture	**3.2**	**2.8**	**2.2**	**4.5**
a) Agriculture and forestry	2.1	3.2	1.8	4.7
i) Crops and horticulture	1.8	2.6	0.2	4.2
ii) Animal farming	2.5	5.1	7.2	6.3
iii) Forest and related services	3.6	4.8	5.1	5.2
b) Fishing	8.2	1.8	3.7	3.9
2. Industry	**7.0**	**7.8**	**8.3**	**9.6**
a) Mining and quarrying	6.0	7.7	8.4	8.7
b) Manufacturing	6.9	7.4	8.2	10.5
i) Large and medium scale	7.0	7.3	8.3	11.0
ii) Small scale	6.8	7.7	7.9	9.0
c) Power, gas and water supply	5.5	8.1	8.9	7.7
d) Construction	7.5	8.4	8.3	8.4
3. Services	4.5	**5.8**	**6.4**	**6.5**
a) Wholesale and retail trade	5.7	6.7	7.1	7.3
b) Hotel and restaurants	5.5	7.1	7.1	7.5
c) Transport, storage and communication	4.6	7.3	7.9	8.3
d) Financial intermediation	4.8	7.0	8.9	7.1
e) Real estate, renting and business activities	3.5	3.5	3.7	3.7
f) Public administration and defense	6.8	6.7	8.0	8.2
g) Education	6.1	7.6	7.9	8.0
h) Health and social works	4.0	6.1	7.4	7.1
i) Community, social and personal services	2.8	3.6	4.1	4.1
GDP (at FY96 constant market prices)	4.8	5.6	6.0	6.7

Source : Bangladesh Bureau of Statistics.
P = Provisional.

grew by 5.4 percent and 8.0 percent respectively in FY06, against 4.2 percent and 10.7 percent in FY05. Exports of goods and services posted growth of 15.7 percent in FY06, compared to 15.6 percent in FY05.

Savings and Investment

1.12 Available data on savings-GDP ratio and investment-GDP ratio indicate slowly rising trend. Domestic savings-GDP ratio rose from 20.0 percent of FY05 to 20.3 percent in FY06, while investment-GDP ratio rose from 24.5 percent of FY05 to 25.0 percent in FY06 (Chart 1.1). The savings-investment gap as a percentage of GDP, correspondingly, increased from 4.5 in FY05 to 4.7 in FY06, financed mainly by net factor income from abroad.

Price Situation

1.13 The rising trend of inflation of FY05 as measured by CPI continued in FY06 due to higher prices of oil and some other imported goods in the international market, a steady depreciation of the Taka associated with balance of payments pressure from rising import prices and demand pressure generated from excess money supply (Chart 1.2). Growing exports of consumer necessities pulling their domestic prices towards the higher export prices heightened the price pressures. Some non-economic factors as voiced in the media, such as market manipulations through syndication by major market players and extortions in the supply chains have also to some extent added to the uptrend in consumer prices. Annual average CPI (base FY96) inflation as of end June 2006 was 7.2 percent, compared with 6.5 percent as of end June 2005. There was a slight decrease of food prices component of CPI inflation from 7.9 percent as of end June 2005 to 7.8 percent as of end June 2006, while non-food component of CPI rose sharply from 4.3 percent as of end June 2005 to 6.4 percent as of end June 2006.

Chart 1.1

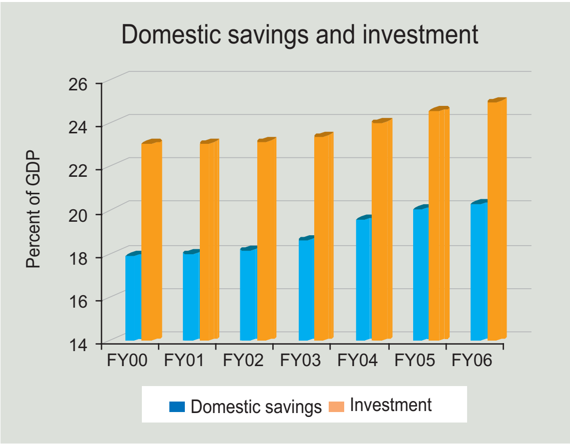
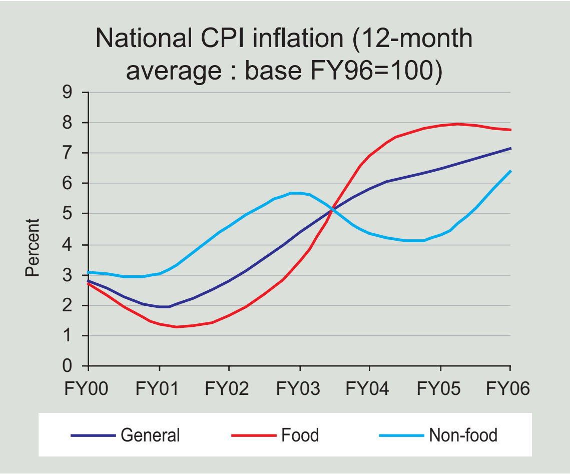


Chart 1.2



Money and Credit Developments

1.14 Bangladesh Bank continued to pursue a cautious and restrained monetary policy stance during FY06 with a view to curbing excess demand from inflationary expectations while supporting the highest sustainable real GDP growth. In line with this policy stance, early in FY06, Cash Reserve Requirement (CRR) and Statutory Liquidity Ratio (SLR) were raised from 4.5 and 16.0 percent respectively to 5.0 and 18.0 percent of demand and time liabilities of scheduled banks towards slowing down the growth of domestic credit and its components. Besides, repo and reverse repo interest rates and treasury bill/bond yield rates were maintained on sustained uptrend during the year in an attempt to slowdown credit growth.

1.15 Broad money (M2) growth stood at 19.3 percent in FY06 which was higher than the 16.7 percent growth recorded in FY05 and also higher than the projection of 14.3 percent growth. Charts 1.3 and 1.4 depict the trends of growth of the monetary aggregates and sources of M2. The higher broad money growth was driven by both higher than envisaged growth in net foreign assets and net domestic assets. Net foreign assets of the banking system increased by 17.9 percent in FY06 compared with the target of 9.2 percent and previous year's increase of 14.3 percent. The public sector credit grew substantially by 30.6 percent compared with projected growth of 27.8 percent, and actual growth of 19.3 percent in FY05 due mainly to financing of high cost imports of petroleum products by the state owned BPC. Credit to the private sector grew by 18.3 percent in FY06, which was higher than 17.0 percent in FY05 and also higher than projection of 13.9 percent reflecting acceleration of economic activities.

1.16 Under the components of broad money on the liability side, growth of the currency and demand deposits (20.5 percent) was higher than that of time deposits (18.9 percent), reflecting higher inflationary expectations. The income velocity of money declined from 2.5 of FY05 to 2.3 in FY06, indicating increased monetization and financial deepening in the economy.

1.17 The declining trend of interest rates that persisted over a couple of years till FY05 reversed in FY06 in keeping with the tightened monetary policy stance of Bangladesh Bank. The weighted average interest rate on bank credit recorded a modest increase to 12.1 percent as of end June 2006 from 10.9 percent as of end June 2005. The rise in weighted average interest rate on bank deposits over the same period was from 5.6 percent to 6.7 percent.

Public Finance

1.18 The FY06 budget was formulated with emphasis on extensive improvement in social and physical infrastructure and increasing economic efficiency by addressing key reform issues, promoting dynamism of the private sector, and enhancing initiatives for high growth and rapid reduction of poverty. The budget aims at facilitating economic growth for raising employment opportunities in the farm and non-farm sectors along with Small and Medium Enterprises (SMEs) as well. Widening social safety nets and implementing targeted poverty reduction programmes, the FY06 budget had positive impacts for the disadvantaged and vulnerable, especially poor women. The FY06 budget provided for a 15.7 percent increase in total public expenditure, with increase in current expenditure by 12.4 percent, ADP expenditure by 19.5 percent and other expenditure by 23.2 percent. The projected increase in FY06 total public expenditure was lower than the projected 16.6 percent increase in revenue receipts, with

Chart 1.3

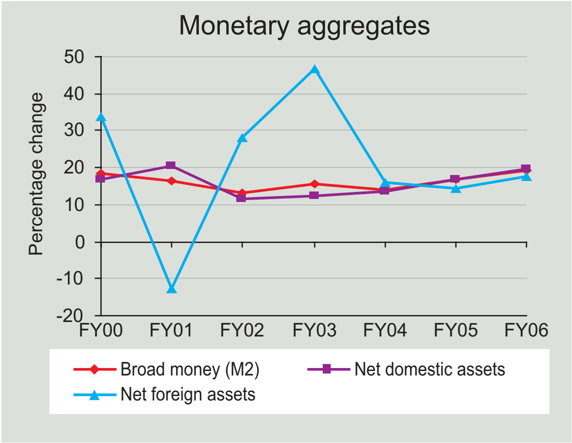
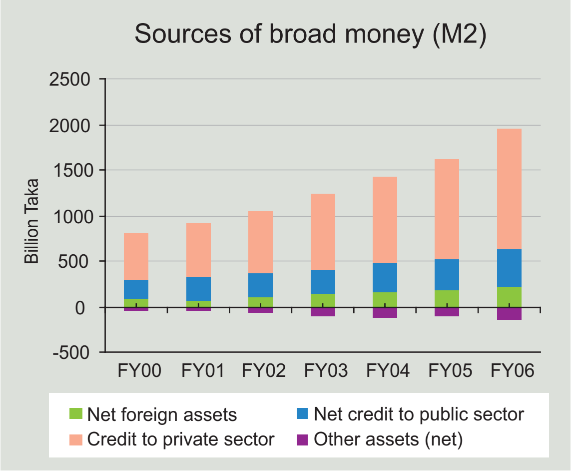


Chart 1.4



overall budget deficit projected at 4.5 percent of GDP in FY06 remaining unchanged at the level of FY05.

1.19 In the revised budget, revenue as a percentage of GDP rose to 10.8 in FY06 as compared to 10.6 in FY05, while public expenditure as a percentage of GDP declined from 15.1 in FY05 to 14.7 in FY06. Accordingly, overall budget deficit decreased from 4.5 percent of GDP in FY05 to 3.9 percent in FY06 reflecting strict fiscal discipline and cutting wasteful expenditure through austerity measures (Chart 1.5). Domestic financing of the deficit declined from 2.1 percent of FY05 GDP to 2.0 percent of FY06; foreign financing, also lower as percentage of GDP than in FY05, covered the remainder of the deficit (Chart 1.6). The outstanding stock of domestic public debt increased from 16.4 percent of GDP at end June 2005 to 16.6 percent of GDP at end June 2006.

External Sector

1.20 Exports and remittances from workers abroad continued to achieve strong growth in FY06, while import growth slowed down to a sustainable level. Exports (fob) increased by 21.6 percent from USD 8,573 million in FY05 to USD 10,422 million in FY06 and remittances from workers abroad recorded 24.8 percent growth from USD 3,848 million in FY05 to USD 4,802 million in FY06; while imports (fob) increased by 12.1 percent from USD 11,870 million in FY05 to USD 13,301 million in FY06. As a result, current account balance exhibited a notable surplus of USD 572 million in FY06. Expressed in proportion of GDP, export earnings increased from 14.2 percent in FY05 to 16.8 percent in FY06, while import payments increased from 19.7 percent to 21.4 percent during the year.

1.21 The export earnings achieved more than expected growth in FY06 after MFA expiry, aided mainly by a high export demand in the U.S. and European markets. Exports in RMG sector achieved an impressive growth. Specifically, exports of knitwear (34.4 percent of total exports) grew by a strong 35.4 percent in FY06, driven by a 37.4 percent rise in export volume, with unit price decreasing by 1.5 percent. Exports of woven garments (38.8 percent of total exports) grew moderately by 13.5 percent in FY06 due to increase in volume by 17.9 percent, with unit price decreasing by 3.8 percent. Raw jute (2.3 percent of total exports) grew strongly by 54.2 percent, supported by increases in both volume and unit price. Exports of jute goods also increased during the year reflecting increases in both volume and unit price. Exports of tea, however, declined by 24.7 percent, with decreases in both volume and unit price. Exports of handicrafts and ceramic tableware declined, other non-traditional items like engineering products,

Chart 1.5

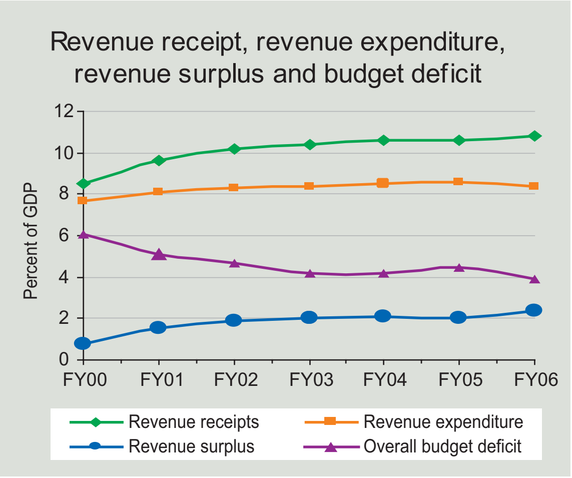
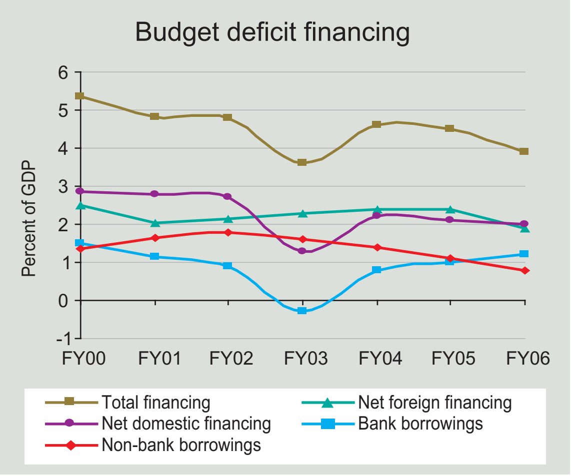


Chart 1.6



electronics, textile fabrics, and bi-cycle increased over last year performance and also over target. This indicates a trend toward diversification of the export base.

1.22 The decelerated growth of imports in FY06 (12.1 percent) was mainly attributable to the reduced imports of foodgrains, milk & cream, spices and most other edible products. The commodities whose import payments, however, increased significantly in FY06 include crude petroleum and POL, reflecting their higher prices in the international market. Significant increases also occurred in the imports of plastic and rubber & articles thereof, raw cotton, yarn, chemicals, dyeing and tanning materials, and textile and articles thereof, reflecting pick up in industrial output. Robust import growths in iron, steel and other base metal, clinker, and capital machinery reflected mainly dynamism in investment activities in the country.

1.23 Despite larger services deficit of USD 1,110 million in FY06, up from USD 870 million in FY05, the country's external current account balance was in a significant surplus due to smaller trade deficit and robust growth in workers' remittances during the year.

1.24 The overall balance of payments recorded a significant surplus of USD 365 million in FY06, which was much higher than surplus of USD 67 million of FY05, reflecting a notable improvement in current account balance and a larger surplus in capital account, despite impacted mainly by large net outflows in trade credit and other short term loans, the financial account swung into a deficit from a large surplus of FY05. Gross foreign exchange reserves held by the Bangladesh Bank increased by USD 553.8 million to USD 3,483.8 million at the end of FY06 from USD 2,930.0 million at the end of FY05, about 3.1 months of import cover.

1.25 Despite improvement in the external sector, the foreign exchange market experienced substantial pressure in FY06 under the floating exchange rate regime. Pressures on Taka-US Dollar exchange rate generated by continued price hike for import of petroleum and many other major commodities in the world market coupled with higher growth in lending to the private sector in FY05 continued in FY06 as well. Taka-US Dollar exchange rate showed an uptrend during the first two months of FY06, then remained almost stable up to the first week of December 2005. Thereafter, Taka depreciated substantially up to the beginning of April 2006. With tightening of monetary policy stance and substantial inflow of foreign exchange from the sources of exports and wage earners, Taka gained some lost value over the remaining part of the year. However, during FY06 the nominal Taka-US dollar exchange rate depreciated by 8.6 percent from Taka 63.75 per US dollar at end-June 2005 to Taka 69.73 per

Chart 1.7

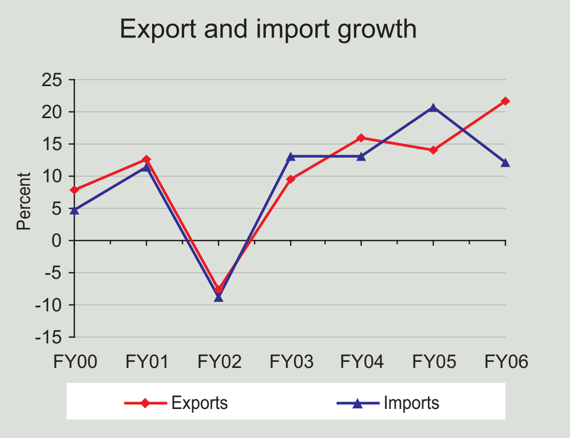


Chart 1.8

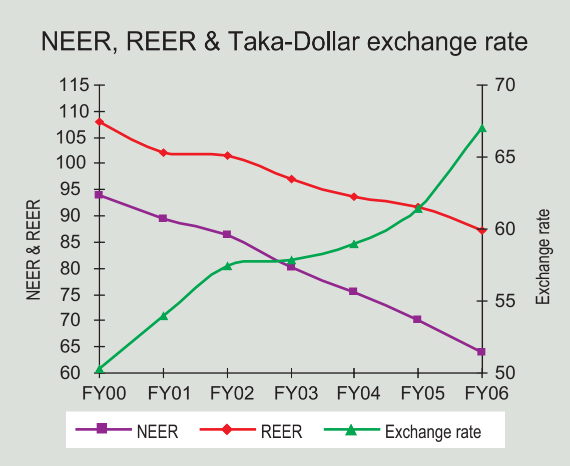
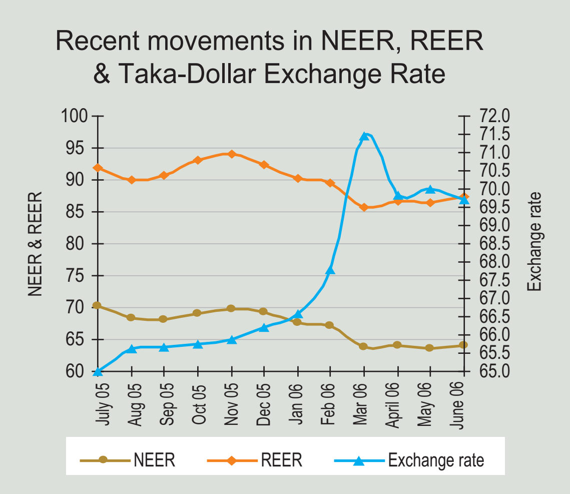


Chart 1.9



US dollar at end-June 2006 (Chart 1.8). In nominal effective term, Taka depreciated by 8.8 percent in FY06. Reflecting higher rate of inflation in Bangladesh relative to trade partners, however, overall the real effective exchange rate of the Taka depreciated by 5.3 percent in FY06, providing a boost to Bangladesh's external competitiveness.

1.26 The outstanding external debt of Bangladesh increased to USD 18,908 million as of end June 2006 from USD 18,416 million as of end June 2005. However, as ratio of GDP it stood at 30.5 percent at end June 2006 remaining unchanged at the level of end June 2005. Repayment of official external debt was USD 11.0 million or 1.7 percent lower in FY06 than the repayment in FY05. Debt service payments abroad as a percentage of exports in FY06 were lower at 6.2 percent, against 7.6 percent in FY05.

Near and Medium Term Outlook for the Bangladesh Economy

1.27 Though the economy has been facing the challenges of MFA phase out and persistent fuel price hike, assuming the continuation of prudent policies and structural reforms, the near and medium term economic prospects of Bangladesh appear favourable. In the Medium Term Macroeconomic Framework (MTMF) of PRSP entitled 'Unlocking the Potential : National Strategy for Accelerated Poverty Reduction' announced by the Government in October 2005, real GDP growth has been projected to increase to 6.8 percent in FY07 sustaining at 7.0 percent in FY08 and FY09, aided by improved macroeconomic stability and intrinsic resilience, buoyancy in the overall agriculture sector growth, steady growth in the manufacturing sector, SOE and NCB reforms, and sustained improvement in the investment climate. To support the target growth rates envisaged in the MTMF, the gross domestic investment is projected to increase from 25.5 percent of GDP in FY07 to 26.0 percent in FY08 and FY09. Inflation is projected to decline to 6.0 percent in FY07 from 7.2 percent of FY06 and then come down gradually to 4.5 percent in FY09, with easing of domestic supply bottlenecks and an appropriately tightened monetary policy stance towards maintaining price stability, coupled with the support of a prudent fiscal policy. In view of the growth supportive policy stance with maintaining a target CPI inflation, broad money (M2) is projected to grow at 13.0 percent in FY07 and decline slightly at 12.5 percent in FY08 and FY09. The MTMF envisages that fiscal policy will be designed to maintain macroeconomic stability and create room for private sector investment with a view to supporting economic growth and MDGs, while protecting fiscal sustainability. The revenue-GDP ratio is projected to rise gradually from 11.3 percent in FY07 to 12.0 percent in FY09 by systematic consolidation of tax instruments and strengthening tax administration. For attaining and maintaining the highest sustainable output growth for rapid reduction of pervasive poverty, the expenditure-GDP ratio is also projected to increase from 15.7 percent in FY07 to 16.4 percent in FY09. Consequently, the overall budget deficit is projected to stabilize at 4.4 percent of GDP during FY07 to FY09, with domestic financing of 1.9 percent of GDP in FY07 and then declining to 1.8 percent of GDP in FY08 and FY09. The external current account balance as percent of GDP is projected to maintain almost the same level of deficit of 2.0 percent during FY07 to FY09. The gross official foreign exchange reserves are projected to rise to USD 3,655 million in FY07 and further to USD 4,400 million in FY09, maintaining 2.5 months of import cover over the years.

1.28 The outlook envisaged in the MTMF faces several near and medium term downside risks and uncertainties originating from (i) the rising inflationary pressures, (ii) the sustained high global oil prices, (iii) under-pricing of energy products, (iv) serious power shortages, (v) probable adverse effects in the RMG sub-sector from 2008 onwards due to the expiry of restriction imposed on China, (vi) the political developments centering around the general election to be held in early 2007 and (vii) the possibility of a slow progress in implementing structural reforms in an election year.

1.29 Stabilizing the inflation rate is a major challenge for the policymakers because a low and stable rate of inflation is critical for accelerated economic growth and poverty reduction. Continuation of cautious monetary policy along with strong administrative measures to check syndicate control of business, extortion and smuggling of some goods outside the country are expected to help contain the rising trend of inflation.

1.30 The sustained high global oil prices that have heightened pressure on country's balance of payments and threatened fiscal and monetary stability underscore the need for further rationalization of the domestic administered prices of petroleum products. In this regard, a pricing system providing for automatic adjustment of domestic fuel prices to international market prices may be considered, with some mechanisms to protect the poor from hardships. Besides, there is a need to reduce dependency on imported petroleum products by maximising use of alternative indigenous fuels and enhancing the efficiency of energy use.

1.31 Significant progress has been made in implementing sectoral structural reforms, especially in the financial sector in terms of improving regulatory oversight and upgrading provisioning standards. Reforms aiming at improved fiscal sustainability by expanding the tax base, systematic consolidation of tax instruments, improving tax administration and strengthening public expenditure management have also achieved good success. These and other sectoral reform agenda need to be implemented on a sustained basis with strong political commitment.

1.32 Initiatives to remove infrastructural inadequacies, especially the power shortages, should be taken to support the near and medium term GDP growth targets and to improve external competitiveness. The probable adverse effects from the quota elimination for Bangladesh may come into reality after 2008, when the restriction imposed on China will expire. Therefore, for survival in the increasingly competitive global garment trade, a competitive RMG sector needs to be built with upgrading infrastructures, developing financial capacity of manufacturers, labour compliance standards, design and product development capability, advanced production facilities, and long term business relationship.

1.33 Negotiations under WTO's Doha Development Round, suspended in July 2006, is likely to restart in near future. As the leader of LDCs in WTO, Bangladesh is expected to play an important role in salvaging the stalled negotiations. In this regard, Bangladesh needs to work hard to ensure a significant proportion of proposed aid for trade package for LDCs. In the absence of critical breakthrough in WTO negotiations, Bangladesh also needs to continue its efforts addressing the issue of market access through bilateral and regional agreements, especially under SAFTA and BIMSTEC.