Chapter-1

Macroeconomic Performance, Near and Medium Term Prospects

World Economic Environment and Outlook

1.1 The world economy is projected to remain on track for sustained strong growth in 2007, led by rapid growth in most emerging market and developing countries, especially China and India. The October 2007 issue of the IMF World Economic Outlook (WEO) projected 5.2 percent global output growth in 2007, down from the 5.4 percent registered in 2006, but remaining noticeably above the long term trend (Table 1.1). In this latest issue of WEO, the IMF made a downward revision of growth in advanced economies matched by an upward revision in emerging and developing economies compared to the projections made in July 2007. Within advanced economies, growth forecasts have been revised downward lightly for the United States and euro area, and largely for the United Kingdom, while within other emerging market and developing countries, growth projections for China and ASEAN-4 have been revised moderately upward. The advanced economies as a group (with 52.0 percent share in 2006 global output) are projected to grow by 2.5 percent, while the other emerging market and developing countries as a group (with 48.0 percent share in 2006 global output) are projected to grow by 8.1 percent in 2007.

1.2 After a short-lived dip in early 2007, falling to just over USD 50 a barrel fostered by the favourable weather conditions, the oil prices experienced rebounding in late March to almost USD 65 a barrel reflecting renewed geopolitical tensions in the Middle East, strengthening of demand due to colder weather, further OPEC production cuts, and declining inventories in key OECD economies. Meanwhile, oil prices remained strong since late March and rose to all-time highs in September, owing to stronger

Table 1.1 Overview of the world economic outlook projections

(annual percentage change)

	2005	2006	2007*	2008*
World output	**4.8**	**5.4**	**5.2**	**4.8**
Advanced economies	2.5	2.9	2.5	2.2
United States	3.1	2.9	1.9	1.9
Japan	1.9	2.2	2.0	1.7
Germany	0.8	2.9	2.4	2.0
United Kingdom	1.8	2.8	3.1	2.3
France	1.7	2.0	1.9	2.0
Italy	0.1	1.9	1.7	1.3
Canada	3.1	2.8	2.5	2.3
Newly industrialised Asian economies	4.7	5.3	4.9	4.4
Other emerging market and developing countries	7.5	8.1	8.1	7.4
Developing Asia	9.2	9.8	9.8	8.8
China	10.4	11.1	11.5	10.0
ASEAN-4	5.1	5.4	5.6	5.6
South Asia	8.6	9.1	8.4	8.0
Bangladesh	6.3	6.4	5.8	6.0
India	9.0	9.7	8.9	8.4
Pakistan	7.7	6.9	6.4	6.5
Sri Lanka	6.0	7.4	6.5	6.5
World trade volume (goods and services)	**7.5**	**9.2**	**6.6**	**6.7**
Imports				
Advanced economies	6.1	7.4	4.3	5.0
Other emerging market and developing countries	12.1	14.9	12.5	11.3
Exports				
Advanced economies	5.8	8.2	5.4	5.3
Other emerging market and developing countries	11.1	11.0	9.2	9.0
Commodity prices (U.S. Dollars)				
Oil	41.3	20.5	6.6	9.5
Non-fuel	10.3	28.4	12.2	-6.7
Consumer prices				
Advanced economies	2.3	2.3	2.1	2.0
Other emerging market and developing countries	5.2	5.1	5.9	5.3
South Asia	5.0	6.4	6.6	4.9
Bangladesh	7.0	6.5	7.2	6.3
India	4.2	6.1	6.2	4.4
Pakistan	9.3	7.9	7.8	7.0
Sri Lanka	10.6	9.5	17.0	11.5

Source: World Economic Outlook, October 2007, IMF.
*=Projection.

growth of demand than initially projected in the face of lower production by the Organization of Petroleum Exporting Countries (OPEC), a smaller-than-expected rise of non-OPEC output, and continuing geopolitical concerns. Non-fuel commodity prices picked up in the first eight months of 2007, driven by metals prices extending their strong price run-up of recent years, while some food prices rose sharply. Consumer price inflation has been contained in the advanced economies in recent months and is projected to drop modestly to 2.1 percent in 2007. Inflation is projected to increase moderately to 5.9 percent in 2007 in other emerging market and developing countries reflecting strong growth of domestic demand and the greater weight of rising food prices in the consumer price index.

1.3 The growth of world trade volume in 2007 is projected to decline to 6.6 percent compared with 9.2 percent in 2006, which is much lower than previous forecast. The growth of exports from both the advanced economies and other emerging market and developing countries are projected to decline to 5.4 percent and 9.2 percent respectively in 2007 and also lower than previous forecasts. The growth of imports for both the advanced economies and other emerging market and developing countries are projected to decline in 2007. The U.S. current account deficit is projected to decline to 5.5 percent of GDP in 2007, as it benefits from recent real effective depreciation of the U.S. Dollar and a more balanced pattern for global demand growth.

1.4 The latest Global Financial Stability Report (GFSR) released by the IMF in October 2007 indicates that financial risks have increased and underlying conditions have worsened as compared to the previous GFSR. Equity markets were initially affected by turbulent conditions in credit markets, with volatility increasing sharply. However, equity prices regained ground subsequently. Since July, more turbulent global financial market conditions have prompted some widening of bond yield spreads and a weakening of equity prices in emerging markets, but, generally market asset valuations remain near historic high. Expectations of policy tightening by the major central banks in advanced economies have been rolled back since the onset of the financial market turmoil. Among emerging markets, some central banks also provided liquidity to ease strains in inter-bank markets, but for others the principal challenge remains to address inflation concerns. In foreign exchange markets, the U.S. dollar has continued to depreciate in real effective terms, while the euro, the pound sterling and the renminbi have remained on appreciating trend. After depreciating somewhat more rapidly through June, the yen rebounded in August as turbulent financial conditions led to some reversal of carry trade flows.

1.5 Looking forward to 2008, in the face of turbulent conditions in financial markets, the global economy is still expected to continue at a solid pace with 4.8 percent growth, albeit 0.4 percentage point lower than the July 2007 WEO projection, aided by strong balance sheets and capital positions of core financial institutions, the high profitability and generally low leverage of the corporate sector, and the healthy situation in labour markets and household net wealth (Table 1.1). Output growth forecasts have been revised downward in all the advanced economies where downward revision of the United States has been the largest. Among other emerging market and developing countries, growth is expected to remain very strong: China is projected to grow at a high 10.0 percent in 2008, 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 world trade volume is projected to increase robustly by 6.7 percent in 2008. With the projected decline in non-fuel commodity prices, inflation is projected to decline in both advanced economies and other emerging market and developing economies.

1.6 While the underlying fundamentals supporting growth are sound and the strong momentum in increasingly important emerging market economies is intact, a number of risks still remain to the global growth outlook. The major downside risks include the risk that inflation pressures could revive as output gaps continue to close, particularly in the event of another spike in oil prices; risk of a disorderly unwinding of large global imbalances, the risk of a financial market volatility, and uncertainty of the potential for a sharper slowdown in the United States, if the housing sector in that country continues to deteriorate. Risks to the outlook from inflation concerns and oil market volatility are now somewhat less negative, as supply constraints and commodity market pressures would be reduced by some moderation in the pace of global growth. Risks related to persistent global imbalances remain a concern. 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 immediate challenge for policymakers is to continue to steer the global economy on a sustainable path that is consistent with low inflation as the global expansion enters its fifth year. The major central banks face distinct challenges in managing monetary policy, reflecting differing cyclical positions and degrees of inflation pressure in their economies. In the United States, signs that growth was likely to continue below trend would justify further interest rate reductions, provided that inflation remains contained. In the euro area, monetary policy can stay on hold over the near term, reflecting the downside risks to growth and inflation from financial market turmoil. However, as these risks dissipate, further tightening eventually may be required. In Japan, given the muted outlook for prices, monetary policy should remain supportive. Despite the weaker growth prospects for advanced economies, a number of emerging market economies still face overheating pressures and rising food prices, and further tightening may be required to contain inflation. 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 FY07 (July 2006 - June 2007), the Bangladesh economy maintained a strong growth underpinned mainly by robust growth in services and notable expansion in manufacturing activities, despite facing high and volatile oil prices in the international market. 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. These policies contributed toward a strong real GDP growth of 6.5 percent in FY07, slightly lower than 6.6 percent of FY06. Economic growth was also aided by increased inflow of workers' remittances from abroad and reasonable growth in exports. In U.S. dollar terms, export earnings recorded a moderate growth of 15.8 percent, while the growth of import payments remained to a sustainable level at 16.6 percent. At the same time, remittances from non-resident Bangladesh nationals increased substantially by 24.5 percent. The country's external current account balance continued to record a significant surplus with a substantial increase in remittances more than offsetting trade deficit and services deficit. A significant surplus in current account balance and a sharp rise in financial account surplus led to a sizeable surplus in the overall balance, which helped improve the international reserve position. Inflation was on uptrend during FY07 due mainly to rising import prices of fuel oil, metal, foodgrain and some other essentials in the international market coupled with problems in the domestic supply chains like political turmoil in the first half of FY07; dislocation of market structure created by anti-hoarding drive and crackdown on corrupt business houses; and lower growth of crop production. Increasing domestic demand induced by high monetary and credit growth added to the uptrend in consumer prices. The annual average inflation increased to 7.20 percent in June 2007 from 7.16 percent in June 2006, while 12-month consumer price inflation on point to point basis increased over the same period to 9.20 percent. Broad money (M2) grew by 17.1 percent in FY07, which was lower than the 19.3 percent growth recorded in FY06 but higher than the projection of 14.7 percent growth. Total domestic credit grew by 14.5 percent, while credit to private sector increased by 15.1 percent in FY07.

Table 1.2 Sectoral GDP growth rates

(at FY96 constant prices: percent)

	FY91-FY00 (Average)	FY01-FY07 (Average)	FY06	FY07P
1. Agriculture	**3.2**	**3.0**	**4.9**	**3.2**
a) Agriculture and forestry	2.1	3.2	5.2	3.0
i) Crops and horticulture	1.8	2.6	5.0	1.9
ii) Animal farming	2.5	5.2	6.2	5.9
iii) Forest and related services	3.6	4.8	5.2	5.3
b) Fishing	8.2	2.1	3.9	4.0
2. Industry	**7.0**	**8.1**	**9.7**	**9.5**
a) Mining and quarrying	6.0	8.1	9.3	10.0
b) Manufacturing	6.9	8.0	10.8	11.2
i) Large and medium scale	7.0	8.0	11.4	11.6
ii) Small scale	6.8	8.1	9.2	10.3
c) Power, gas and water supply	5.5	7.7	7.7	5.4
d) Construction	7.5	8.2	8.3	7.1
3. Services	**4.5**	**5.9**	**6.4**	**6.7**
a) Wholesale and retail trade	5.7	6.7	6.8	7.4
b) Hotel and restaurants	5.5	7.2	7.5	8.2
c) Transport, storage and communication	4.6	7.4	8.0	8.2
d) Financial intermediation	4.8	7.3	8.5	7.5
e) Real estate, renting and business activities	3.5	3.6	3.7	3.8
f) Public administration and defence	6.8	7.0	8.2	8.5
g) Education	6.1	8.0	9.1	9.0
h) Health and social works	4.0	6.4	7.8	7.6
i) Community, social and personal services	2.8	3.8	4.1	4.5
GDP (at FY96 constant market prices)	4.8	5.8	6.6	6.5

Source : Bangladesh Bureau of Statistics.
P = Provisional.

Growth Performance

1.8 The 6.5 percent real GDP growth in FY07 was underpinned, on the supply side, by a robust growth in the industry sector and continued strong growth in the services sector offsetting lower growth in agriculture sector. Growth rate in the agriculture sector achieved a moderate growth of 3.2 percent in FY07 following the post flood high growth of 4.9 percent in FY06, resulting mainly from a lower growth in crops and horticulture sub-sector (Table 1.2). Despite an outbreak of the avian flu in the country, there was a sustained high growth in animal farming sub-sector of 5.9 percent in FY07, albeit moderately lower than the growth rate of FY06. Forest and related services sub-sector attained a slightly higher rate of growth in FY07.

1.9 The industry sector attained robust growth of 9.5 percent in FY07, slightly lower than 9.7 percent of FY06. The 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 growth rate of power, gas and water supply sub-sector was 5.4 percent in FY07 as compared to 7.7 percent in FY06 reflecting setback in electricity generation. The growth rate in construction sub-sector also declined to 7.1 percent in FY07 from 8.3 percent in FY06.

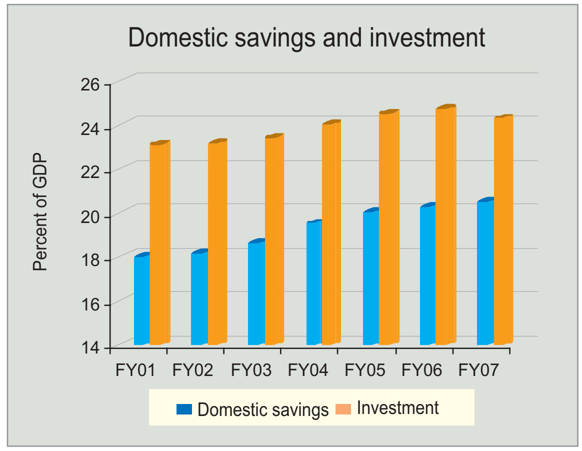
1.10 Overall the services sector grew by 6.7 percent in FY07, higher than 6.4 percent recorded in FY06 and remaining well above the trend level. Despite some fluctuations, the growth was fairly well spread in the different sub-sectors. Increase in industrial output and trade-related activities underpinned higher services sector growth in FY07.

1.11 On the demand side, the growth was broad based reflecting expansion in all major components. Real domestic demand increased by 5.8 percent in FY07, compared with 5.5 percent of FY06. Of the two components of domestic demand, consumption and investment grew by 5.2 percent and 7.2 percent respectively in FY07, against 4.4 percent and 8.3 percent in FY06. Exports of goods and services posted growth of 27.0 percent in FY07, compared to 25.8 percent in FY06.

Savings and Investment

1.12 Available data indicate that domestic savings-GDP ratio rose from 20.3 percent of FY06 to 20.5 percent in FY07, while investment-GDP ratio decreased from 24.7 percent of FY06 to 24.3 percent in FY07 (Chart 1.1). The savings-investment gap as a percentage of GDP, correspondingly, decreased from 4.4 in FY06 to 3.8 in FY07, financed by net factor income from abroad.

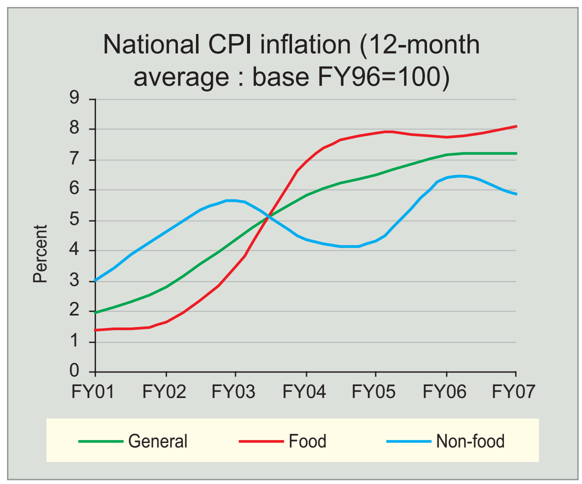
Chart 1.1



Price Situation

1.13 The rising trend of inflation of FY06 as measured by CPI continued in FY07 due mainly to higher prices of oil and some other imported goods in the international market, distortions in the supply side factors and demand pressure generated from excess money supply (Chart 1.2). Slower import of consumer necessities pulling their domestic prices heightened the price pressures. Annual average CPI (base FY96) inflation as of end June 2007 was 7.20 percent, compared to 7.16 percent as of end June 2006. There was a notable increase of food prices component of CPI inflation from 7.8 percent as of end June 2006 to 8.1 percent as of end June 2007, while non-food component of CPI decreased sharply from 6.4 percent as of end June 2006 to 5.9 percent as of end June 2007.

Chart 1.2



Money and Credit Developments

1.14 Bangladesh Bank continued to pursue a cautious restrained monetary policy stance during FY07 with a view to keeping inflationary pressure under control while supporting the targeted real GDP growth. In line with this policy stance, an upward bias in the policy interest rates and reintroduction of BB bills in October 2006 succeeded in limiting inflation around the targeted level up to January 2007. However, cautious monetary policy stance along with additional measures taken by the Government continued to dampen the inflationary pressure. Besides, repo and reverse repo interest rates, 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 17.1 percent in FY07, which was lower than the 19.3 percent growth recorded in FY06 but higher than the projection of 14.7 percent growth. Charts 1.3 and 1.4 depict the trends of growth of the monetary aggregates and sources of M2 respectively. The higher broad money growth was driven mainly by higher than envisaged growth in net foreign assets. Net foreign assets of the banking system increased by 49.3 percent in FY07 compared with the target of 16.8 percent and previous year's increase of 17.9 percent. The credit to public sector grew by 12.5 percent in FY07 compared with projected growth of 13.7 percent, and actual growth of 30.6 percent in FY06 due mainly to downsizing of ADP. Credit to the private sector grew notably by 15.1 percent in FY07, which was lower than 18.3 percent in FY06 but higher than projection of 13.9 percent.

1.16 Of the components of broad money, growth of the currency and demand deposits (17.6 percent) was higher than that of time deposits (16.9 percent), reflecting higher inflationary expectations. The income velocity of money declined from 2.3 of FY06 to 2.2 in FY07, 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 which continued in FY07 in keeping with the tightened monetary policy stance of Bangladesh Bank. The weighted average interest rate on bank advance recorded a modest increase to 12.8 percent as of end June 2007 from 12.1 percent as of end June 2006. The rise in weighted average interest rate on bank deposits over the same period was from 6.7 percent to 6.9 percent.

Chart 1.3

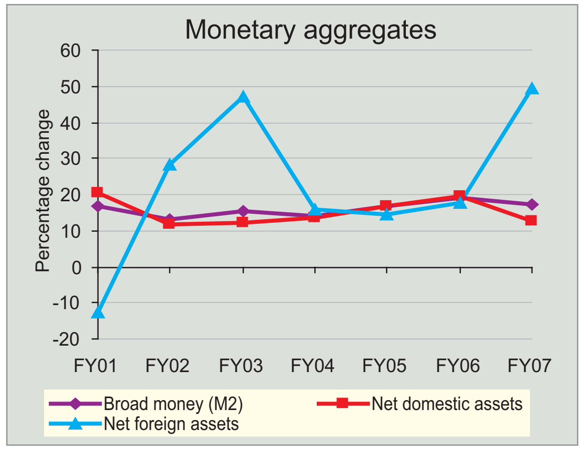
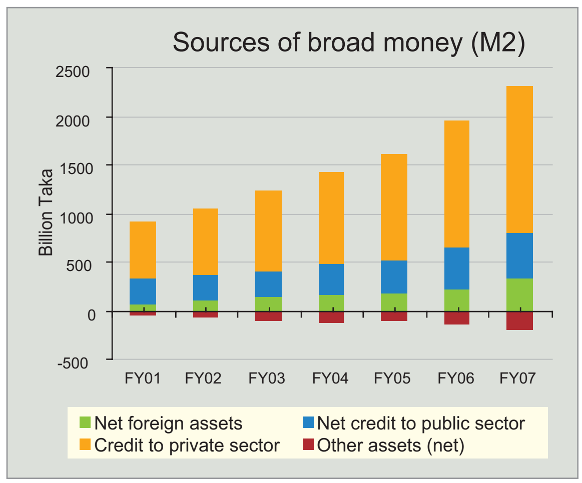


Chart 1.4



Public Finance

1.18 The fundamental basis of FY07 budget was meeting the Millennium Development Goals (MDGs) by achieving the annual targets embodied in Poverty Reduction Strategy Paper (PRSP). The fiscal policy in the budget was geared to accelerate economic growth and create employment opportunities. Promoting private sector investment was a key objective in the FY07 budget. The main focus of the FY07 budget was poverty reduction. The Government pursued a set of strategies which were attuned to the poverty issue. These strategies included among others increasing allocation in education, health and other social sectors; ensuring financial security of the disadvantaged by widening social safety nets; ensuring economic good governance and enhancing public management capacity. The FY07 budget provided for a 14.2 percent increase in total public expenditure, with increase in current expenditure by 13.6 percent, ADP expenditure by 20.9 percent and decrease in other expenditure by 11.5 percent. The projected increase in FY07 total public expenditure was lower than the projected 17.1 percent increase in revenue receipts, with overall budget deficit projected to decrease to 3.7 percent of GDP in FY07 from 3.9 percent of GDP in FY06.

1.19 In the revised budget, revenue as a percentage of GDP fell to 10.6 in FY07 as compared to 10.8 in FY06, and public expenditure as a percentage of GDP declined from 14.7 in FY06 to 14.3 in FY07. Accordingly, overall budget deficit decreased from 3.9 percent of GDP in FY06 to 3.7 percent of GDP in FY07 reflecting strict fiscal discipline and cutting wasteful expenditure through austerity measures (Chart 1.5). Domestic financing of the deficit increased from 2.0 percent of FY06 GDP to 2.1 percent of FY07; foreign financing, lower as percentage of GDP than in FY06, covered the remainder of the deficit (Chart 1.6). The outstanding stock of domestic public debt increased from 16.6 percent of GDP at end June 2006 to 16.8 percent of GDP at end June 2007.

External Sector

1.20 Exports and imports achieved robust and reasonable growth in FY07, and remittances from workers abroad showed a strong and steady growth. Exports (fob) increased by 15.8 percent from USD 10,412 million in FY06 to USD 12,053 million in FY07 and remittances from workers abroad recorded 24.5 percent growth from USD 4,802 million in FY06 to USD 5,979 million in FY07; while imports (fob) increased by 16.6 percent from USD 13,301 million in FY06 to USD 15,511 million in FY07. As a result, current account balance exhibited a notable surplus of USD 952 million in FY07. Expressed in proportion of GDP, export earnings increased from 16.8 percent in FY06 to 17.8 percent in FY07, while import payments increased from 21.5 percent to 22.9 percent during the year.

1.21 The export earnings achieved a moderate growth in FY07 somewhat lower than expected. Exports in RMG sector achieved an impressive growth. Specifically, exports of knitwear (37.4 percent of total exports) grew by a robust 19.3 percent in FY07, driven by a 20.9 percent rise in export volume, with unit price decreasing by 1.3 percent. Exports of woven garments (38.2 percent of total exports) grew moderately by 14.1 percent in FY07 due to increase in volume by 22.2 percent, with unit price decreasing by 6.7 percent. Frozen shrimps and fish (4.2 percent of total exports) grew strongly by 12.2 percent, supported by increases in both volume and unit price. Exports of leather also increased during the year reflecting increase in unit price while export volume decreased. Exports of tea, however, declined by 42.0 percent, with decrease in volume while average unit price increased slightly. Exports of engineering products, home textile, and ceramic tableware

Chart 1.5

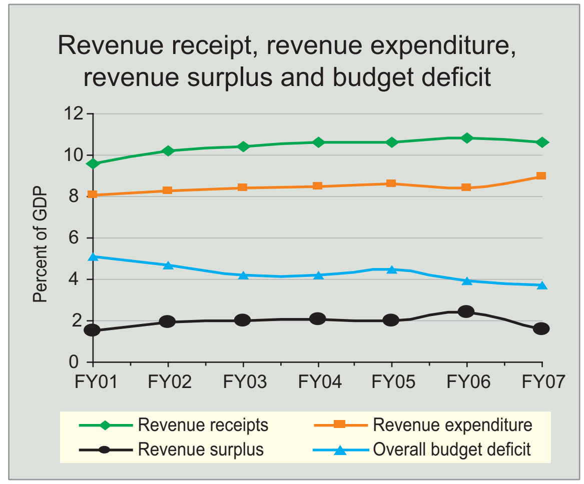
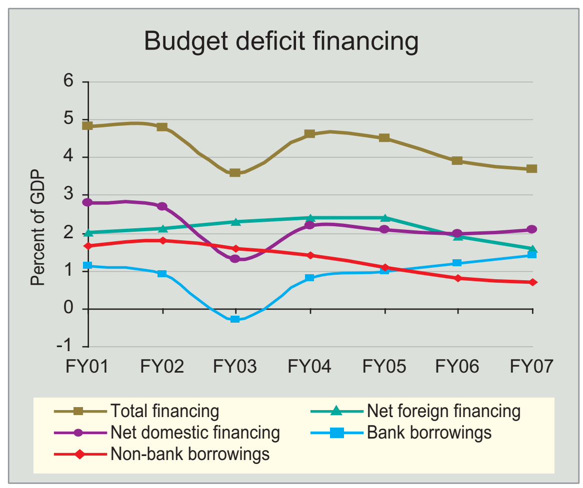


Chart 1.6



increased over last year performance and also over target. This indicates a trend toward diversification of the export base.

1.22 The higher growth of imports in FY07 (16.6 percent) was mainly attributable to the higher prices of oil and some other imported items in the international market, and increased foodgrains imports necessitated by the lower growth of crop production. The commodities whose import payments, however, increased steadily in FY07 include rice, wheat, sugar, pulses, and edible oil reflecting their higher prices in the international market. Significant increases also occurred in the imports of POL, textile and articles thereof, yarn, and raw cotton reflecting pick up in industrial output. Robust import growth in capital machinery reflected mainly dynamism in investment activities in the country.

1.23 Despite larger trade deficit and services deficit in FY07, the country's external current account balance was in a significant surplus due to robust growth in workers' remittances during the year.

1.24 The overall balance of payments recorded a significant surplus of USD 1,493 million in FY07, which was much higher than surplus of USD 338 million of FY06, reflecting a notable improvement in current account balance and a larger surplus in the financial account. Gross foreign exchange reserves held by the Bangladesh Bank increased by USD 1,593 million to USD 5,077 million at the end of FY07 from USD 3,484 million at the end of FY06, about 3.9 months of import cover.

1.25 The foreign exchange market experienced a mixed trend in FY07 under the floating exchange rate regime. During the first quarter of FY07, Taka-US Dollar exchange rate experienced pressure with exchange rates ranging within Taka 69.49-69.85. With the beginning of 2nd quarter Taka started to gradually recover its lost value and by mid-October 2006 it appreciated up to Taka 66.00 against US Dollar. But it again weakened and by end of November 2006 it depreciated up to a record high of Taka 72.95 per US Dollar. During the 3rd quarter of the year Taka showed somewhat appreciating trend due to improved liquidity in the market, resulting from increased inward remittances with exchange rates ranging within Taka 68.80-70.55. However, at the end of FY07 Taka-US Dollar exchange rates remained relatively stable with exchange rates at Taka 68.70-69.30. During FY07 Bangladesh Bank purchased US Dollar 649.5 million from the commercial banks for absorbing excess liquidity from the market. However, the nominal Taka-US dollar exchange rate appreciated by 1.3 percent from Taka 69.73 per US dollar at end-June 2006 to Taka 68.80 per US dollar at end-June 2007 (Chart 1.8). In nominal effective term, Taka depreciated by 2.9 percent in FY07. Reflecting higher rate of inflation in

Chart 1.7

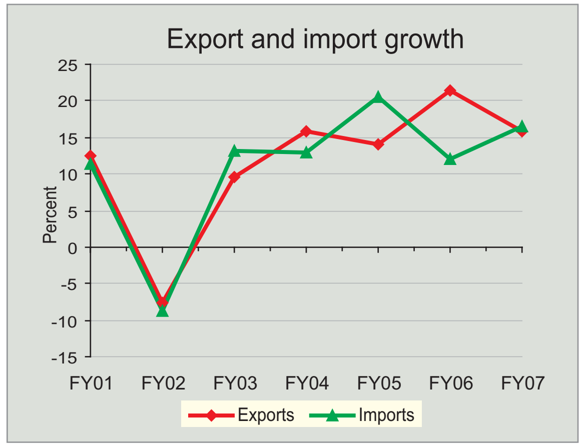


Chart 1.8

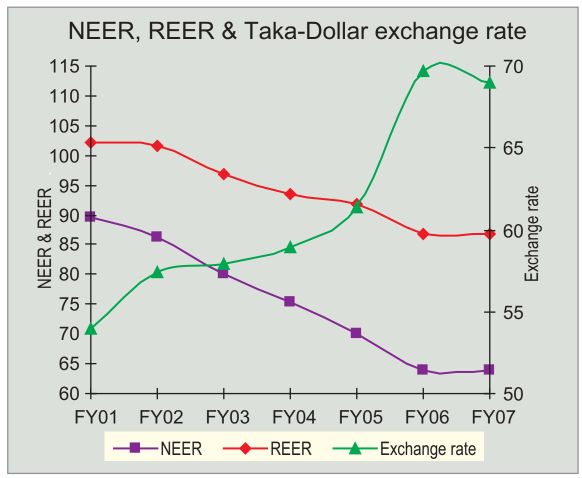
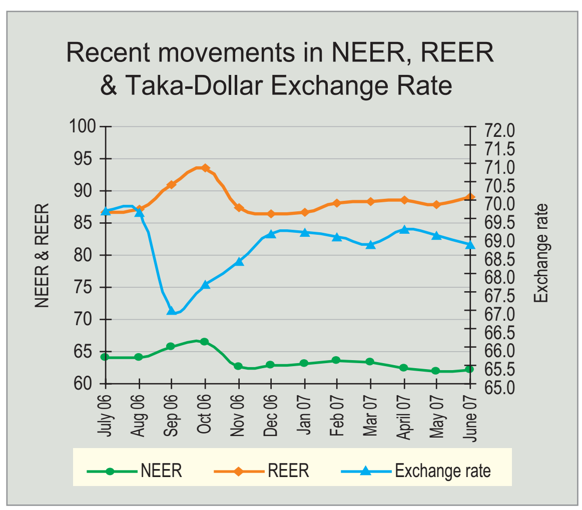


Chart 1.9



Bangladesh relative to trade partners, however, overall real effective exchange rate of the Taka appreciated by 2.4 percent in FY07.

1.26 The outstanding external debt of Bangladesh increased to USD 19,703 million as of end June 2007 from USD 18,603 million as of June 2006. However, as ratio of GDP it stood at 29.1 percent at end June 2007 against 30.0 percent at end June 2006. Repayment of official external debt was USD 38.0 million or 5.7 percent higher in FY07 than the repayment in FY06. Debt service payments abroad as a percentage of exports in FY07 were lower at 5.8 percent, against 6.4 percent in FY06.

Near and Medium Term Outlook for the Bangladesh Economy

1.27 In view of medium term outlook of sustainable economic growth and low inflation for world and south Asian economies and assuming continuation of prudent policies and progress in advancing structural reforms, the near and medium term economic prospects of Bangladesh appear favourable. In the updated Medium Term Macroeconomic Framework (MTMF) of PRSP[1], real GDP growth has been projected to increase to 7.0 percent in FY08 sustaining at or above 7.0 percent through FY10, aided by improved macroeconomic stability and intrinsic resilience, buoyancy in the overall agricultural sector growth, steady growth in the manufacturing sector, competitive business environment and sustained improvement in the investment climate, and ongoing implementation of economic reform programmes including SOE and NCB reforms (Table-III of Appendix-2). To support the pro-poor growth targets envisaged in the MTMF, the gross domestic investment is projected to increase gradually from 26.2 percent of GDP in FY08 to 27.4 percent in FY09 and 28.1 percent in FY10 through mobilisation of internal and foreign resources. Inflation is projected to decline from 6.5 percent in FY08 to 5.0 percent in FY10, with an appropriately cautious restrained monetary policy stance towards maintaining price stability coupled with the support of prudent fiscal and trade policies. In view of the growth supportive policy stance with maintaining a target CPI inflation, broad money (M2) growth is projected to slowdown gradually over the years from 15.0 percent in FY08 to 13.0 percent in FY10. Apart from the monetary policy stance, BB is now focused on corporatizing and restructuring of NCBs, which will increase efficiency of the financial system and enhance its resilience contributing to firm up the monetary stability. 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 from 10.8 percent in FY08 to 11.2 percent in FY10 by systematic consolidation of the tax instruments, and strengthening and restructuring of the tax administration. For attaining and maintaining the highest sustainable output growth for rapid reduction of pervasive poverty coupled with recent reform measures aimed at improving the efficiency and probity of government spending, the expenditure-GDP ratio is projected at 16.4 percent in FY08, and 14.9 percent in FY09 and 15.0 percent in FY10. Consequently, the overall budget deficit is projected at 5.6 percent of GDP in FY08 and stabilized at 3.8 percent of GDP in FY09 and FY10. A sizable amount of liability arising from an assumption of accumulated loss of BPC has been the important aspect in projecting large budget deficit for FY08. This will increase financing from domestic sources to 3.6 percent of GDP in FY08. After that, the budget deficit is projected to be financed in almost equal proportion from foreign and domestic sources over the years. Exports are projected to grow at or above 18.0 percent each year during FY08 to FY10. The growth of imports is projected to decrease gradually from 19.0 to 17.0 percent during FY08 to FY10. The external current account balance as percent of GDP is projected to show surpluses of 0.7 percent in FY08 and 0.1 percent in FY09, and then exhibit a deficit of 0.4 percent in FY10. The gross official foreign exchange reserves are projected to rise to USD 5,300 million in FY08, USD 6,112 million in FY09 and USD 7,151 million in FY10, maintaining at least 2.8 months of import cover over the years.

1.28 The outlook envisaged in the MTMF faces several near and medium term downside risks

[1] PRSP entitled 'Unlocking the Potential: National Strategy for Accelerated Poverty Reduction' has been announced by the Government in October 2005. Meanwhile, the Ministry of Finance has already updated the projections of MTMF in June 2007.

and uncertainties originating from (i) the rising inflationary pressures, (ii) the sustained high global oil prices, (iii) under-pricing of energy products, (iv) infrastructure constraints (especially power, ports, and transportation), (v) probable adverse effects in the RMG sub-sector from 2008 onwards due to the expiry of restriction imposed on China, (vi) restoring business confidence for strengthening private sector investment activities, and (vii) the political developments and outcome of the next general elections scheduled to be held in late 2008. Apart from these risks, economic prospects in the near and medium term particularly for FY08 are likely to be affected by the repeated floods and cyclone Sidr in the first half of the financial year. Taking into consideration the present state of the economy and future challanges as well as opportunities, the Policy Analysis Unit (PAU) of Bangladesh Bank has estimated a range of GDP growth between 6.2 to 6.5 percent for FY08. However, this does not necessarily reflect the official position of the management of the Bangladesh Bank. The figures may be revised in view of the unfolding situation and forthcoming data on the various sectors of the economy.

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. Presently, Bangladesh and all other south Asian countries have been experiencing inflationary pressures mainly because of rising world commodity prices including food, fuel oil and increasing demand from rising income. Furthermore, in Bangladesh, production losses due to natural calamities have added to the inflationary pressures, with a tentative prediction by PAU of 12-month average CPI inflation in the range of 8.1 to 8.5 percent in FY08. Alongside measures for relief and rehabilitation, continuation of cautious and restrained monetary policy stance along with strong administrative measures to break the syndicated control of business and smuggling of some goods outside the country, and proper monitoring of markets are expected to help contain the rising trend of inflation. Moreover, the activities of open market operation conducted by the BDR, selling essential commodities under TCB and withdrawal import duty on essential consumer goods announced in the Budget, importation of foodgrain by the government, strengthening of internal procurement, provision for subsidy on fertilizers and diesel and widening of the Social Safety Net Programme (SSNP) will keep inflation at a tolerable level. For minimizing the sufferings of general consumers, a legal framework to protect consumers' rights is under active consideration. BB has given directives to the commercial banks for providing credit facilities on softer terms to new importers, easing the LC margin for food items, extending time limit for customer facility and arranging higher agricultural credit for easing of the supply side constraints. Moreover, a significant increase in allocation for research and other activities in agricultural sector to increase agricultural productivity should be considered as a priority in preparing the national budget.

1.30 The sustained high global oil prices have heightened pressure on country's balance of payments, threatened fiscal and monetary stability alongside adversely affecting the economic activity. 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 the use of alternative indigenous fuels and enhancing the efficiency of energy use.

1.31 Initiatives to remove infrastructural inadequacies, especially the power shortages, should be strengthened to support the near and medium term GDP growth targets and to improve external competitiveness. An analysis of World Bank shows that a 1 percent increase in number of power outages in a year reduces the Total Factor Productivity (TFP) of the average firm by 10 percent. Power shortages also adversely affect agriculture production, especially irrigation of the boro crop, which in turn hit the economy hard. A financial restructuring and recovery plan (FRRP) to develop the power sector has been adopted by the government and initial implementation of the plan has started. Implementing reforms with corporatization and financial restructuring of power sector entities, and strengthening of the Bangladesh Energy Regulatory Commission (BERC) under the framework of efficient and cost-reflective power prices and better governance would be necessary to make the sector more appealing for substantial investment.

1.32 After expiry of MFA quota, Bangladesh achieved a successful exports growth during the last two years. But, 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, long term business relationship, and the development of internationally reputed customer bases. On the other hand, to reduce the overwhelming dependence on RMG, measures need to be taken to diversify the exports.

1.33 Industrial and developing countries agreed to provide duty- and quota-free market access for at least 97 percent of export items originating from Least-Developed Countries (LDCs) by 2008 declared in the WTO Ministerial Conference, held in Hong Kong SAR during 13-18 December 2005. Negotiations under WTO's Doha Development Round, however, suspended in July 2006, are likely to restart in near future. A successful outcome of the negotiations is needed to strengthen the multilateral trading system for LDCs and other poor developing countries. 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 form of market access privileges, less stringent disciplines, and assistance in trade related capacity building. 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.

1.34 Significant progress has been made in the financial sector especially in the banking sector by de-emphasising the role of the NCBs, strengthening competitive pressures, loosening government control, tightening prudential regulations and regulatory oversight, and upgrading provisioning standards. Key measures have been taken including increase in the capital adequacy ratio to international norms, tightening of loan classification, issuance of risk guidelines, and improvements in corporate governance of banks. The Banking Companies Act, 1991 is being amended for strengthening dynamism in the activities of the banking companies. Apart from this, other segments of the financial sector, such as capital markets and microfinance need to be seen as essential element in the overall reform agenda. 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. Improvement of treasury risk management, diversification of government securities market and development of a secondary market for government bonds will be necessary to reduce the high costs of domestic borrowing for deficit financing. These and other sectoral reform agenda need to be implemented on a sustained basis with strong political commitment.

1.35 Maintaining a favourable investment environment and a sound macroeconomic management are important to strengthen private sector investment in the economy. Recently, the World Bank in its report "Doing Business 2006" ranked Bangladesh above China, India and the median Low Income Country (LIC) for required time and procedures to start a business. After declaring a state of emergency on 11 January 2007, the present caretaker Government has taken strong steps focusing on the economic front. Though the rapid actions to anti-corruption and anti-hoarding drive are creating panic to some extent in the business activities, it may be noted that Bangladesh's position will go further up when the reforms just outlined are successfully implemented.