Macroeconomic Performance, Near and Medium Term Prospects

World Economic Environment and Outlook

1.1 The world economy that registered an unprecedented average growth of 5.0 percent a year for consecutive four years is now entering a major downturn in the face of the most severe shock in mature financial markets since 1930s. The major advanced economies are already in recession while a number of emerging and developing countries are under inflationary pressure. The downturn in advanced economies has been triggered by collapse of the US subprime mortgage following major corrections in housing markets in US and a number of advanced countries. Advanced economies grew at a collective annual rate of only one percent during the period from the fourth quarter of 2007 through the second quarter of 2008, down from 2.5 percent during the first three quarters of 2007 while the emerging and developing economies grew at 7.5 percent (down from 8 percent) during the same period. Under the situation, the October 2008 issue of the IMF World Economic Outlook projected 3.9 percent global output growth in 2008, down from the 5.0 percent rate registered in 2007 (Table 1.1). In this latest issue of WEO, the IMF made a downward revision of growth in advanced economies, and growth forecast in emerging and developing economies remained unchanged, compared with the projections made in July 2008. Growth forecasts have been revised downward for most of the advanced economies, larger for France, Spain and Japan, and growth projections for most of emerging market and developing countries have also been revised downward. The advanced economies as a group (with 56.4 percent share in 2007 global output) are projected to grow by 1.5 percent, while the emerging market and developing countries as a group (with 43.6

Table 1.1 Overview of the world economic outlook projections

(annual percentage change)

	2006	2007	2008*	2009*
World output	**5.1**	**5.0**	**3.9**	**3.0**
Advanced economies	3.0	2.6	1.5	0.5
United States	2.8	2.0	1.6	0.1
Japan	2.4	2.1	0.7	0.5
Germany	3.0	2.5	1.8	-
United Kingdom	2.8	3.0	1.0	-0.1
France	2.2	2.2	0.8	0.2
Italy	1.8	1.5	-0.1	-0.2
Canada	3.1	2.7	0.7	1.2
Newly industrialised Asian economies	5.6	5.6	4.0	3.2
Emerging and developing economies	7.9	8.0	6.9	6.1
Developing Asia	9.9	10.0	8.4	7.7
China	11.6	11.9	9.7	9.3
ASEAN-5	5.7	6.3	5.5	4.9
South Asia	9.2	8.7	7.6	6.4
Bangladesh	6.5	6.3	7.0	5.6
India	9.8	9.3	7.9	6.9
Pakistan	6.9	6.4	5.8	3.5
Sri Lanka	7.7	6.8	6.1	5.1
World trade volume (goods and services)	**9.3**	**7.2**	**4.9**	**4.1**
Imports				
Advanced economies	7.5	4.5	1.9	1.1
Emerging and developing economies	14.7	14.2	11.7	10.5
Exports				
Advanced economies	8.4	5.9	4.3	2.5
Emerging and developing economies	11.0	9.5	6.3	7.4
Commodity prices (U.S. Dollars)				
Oil	20.5	10.7	50.8	-6.3
Nonfuel	23.2	14.1	13.3	-6.2
Consumer prices				
Advanced economies	2.4	2.2	3.6	2.0
Emerging and developing economies	5.4	6.4	9.4	7.8
South Asia	6.5	6.9	8.8	8.8
Bangladesh	7.1	9.1	10.1	10.0
India	6.2	6.4	7.9	6.7
Pakistan	7.9	7.8	12.0	23.0
Sri Lanka	10.0	15.8	23.7	20.0

Source: World Economic Outlook, October 2008, IMF.

*=Projection.

percent share in 2007 global output) are projected to grow by 6.9 percent in 2008.

1.2 Oil prices experienced strong run-up from late August to early January 2008 sparked by heightened geopolitical concerns about tensions in the Middle East and some weather-related production shutdowns. Although prices eased thereafter with concerns about slowing global growth, prices recovered in February and stayed above USD 100 a barrel since end-February before declining to around USD 50 a barrel in November following severe crisis in the international financial markets. Oil prices declined further to around USD 50 a barrel by end November 2008. The non-fuel commodity price boom picked up at much higher levels in real terms than at any time in the past 20 years, despite some correction since mid-July 2008 amid the slowdown of the global economy. Consumer price inflation has increased markedly in the advanced economies and is projected to be 3.6 percent in 2008. Consumer price rises have been particularly strong in emerging and developing economies and inflation is projected to increase to 9.4 percent in 2008 reflecting strong growth of domestic demand and the greater weight of energy and particularly food in the consumer price index.

1.3 The growth of world trade volume in 2008 is projected to decline to 4.9 percent compared with 7.2 percent in 2007, which is 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 4.3 percent and 6.3 percent respectively in 2008 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 2008. The U.S. current account deficit is projected to decline at around 5 percent of GDP in the first half of 2008, as it benefits from recent real effective depreciation of the U.S. Dollar. However, dollar appreciated significantly during October 2008. If this trend continues, current account deficit as percentage of GDP for US may rise again.

1.4 The latest Global Financial Stability Report (GFSR) released by the IMF in October 2008 indicates that the global financial system has undoubtedly come under increasing strains since the April 2008 GFSR, and risks to financial stability that erupted in August 2007 have developed into the largest financial shock since the Great Depression. Equity markets have turned downward while volatility measures have remained elevated. Risk spreads on both sovereign and corporate paper have continued to widen. At the same time, domestic interest rates have been increased in response to rising inflation, but real rates have declined. Mortgage-related securities have continued to fall, amid deteriorating U.S. housing market conditions. Liquidity remains seriously impaired despite aggressive responses by major central banks, while concern about credit risks has intensified. In foreign exchange markets, the U.S. dollar has continued to depreciate to its lowest level in decades in real effective terms, helping to bring down the U.S. current account deficit in the first half of 2008, while the euro, the yen, and other floating currencies such as the Canadian Dollar and some emerging economy currencies appreciated.

1.5 Looking forward in 2009, in the face of financial crisis entering a new, more severe stage in September 2008, the global economy is projected to slow further to 3.0 percent growth, 0.9 percentage point lower than the July 2008 WEO projection, with slowed activity in the advanced economies, while growth will also moderate in the emerging and developing economies (Table 1.1). Output growth forecasts have been revised downward in all of the countries of advanced economies where growth would be negative in Italy, Spain and the UK. Among other emerging market and developing countries, growth is expected to ease but remain at a high level: China is projected to grow at 9.3 percent in 2009, driven by strong domestic demand and a rapidly rising current account balance. South Asia's (Bangladesh, India, Pakistan and Sri Lanka) growth rate is also expected to be quite robust. The world trade volume is projected to grow at a lower rate by 4.9 percent in 2008 compared with 7.2

percent in 2007. With the projected decline in non-fuel commodity prices, inflation is projected to decline in both advanced economies and emerging market and developing economies.

1.6 The overall balance of risks to the short-term global growth outlook remains tilted to the downside. The major downside risks include the risk arising from the still-unfolding events in financial markets, growth risks intensified from inflation and oil market, and risk of a disorderly unwinding of large global imbalances. Global financial markets continue to be fragile and indicators of systemic risk remain strong. Rising losses in the context of a global slowdown could add to strains on capital and exacerbate the squeeze on credit availability. There is a need to continue strong efforts by the policymakers to deal with financial market turmoil in order to avoid a full-blown crisis of confidence or a credit crunch. The immediate priorities are to rebuild counterparty confidence, reinforce the capital and financial soundness of institutions, and ease liquidity strains. Longer-term reforms will be needed including improving mortgage market regulation, promoting the independence of rating agencies, broadening supervision, strengthening the framework of supervisory cooperation, and improving crisis resolution mechanisms. Inflation is a rising concern and will constrain the policy response to slower growth. Inflation risks to growth are now more balanced, in light of the decrease in commodity prices and the slower trajectory of the global economy. Volatility of oil prices indicates an important source of two-way risks to the projections. On the upside, continued decline in oil prices would provide some stabilizing benefit to the global economy. On the other hand, continued limited spare capacity could again push oil prices up, keeping pressure on consumer purchasing power, particularly in oil-importing countries. Risks related to persistent global imbalances remain a concern. The key actions for adjustment in the imbalances suggested by the IMF 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 major central banks face distinct challenges in managing monetary policy, reflecting differing cyclical positions and degrees of inflation pressure in their economies. Monetary policymakers in the advanced economies face a delicate balancing act between alleviating the downside risks to growth and guarding against a buildup in inflation. In the United States, rising downside risks to output, amid considerable uncertainty about the financial turbulence and the deterioration in labor market conditions, justifies the Federal Reserve's interest rate cuts and a continuing bias toward monetary easing. In the euro area, although current inflation is uncomfortably high, prospects point to its falling back below 2 percent during 2009, in the context of an increasingly negative outlook for activity. Accordingly, the European Central Bank can afford some easing of the policy stance. In Japan, there is merit in keeping interest rates on hold, although there would be some limited scope to reduce interest rates from already-low levels. 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. With a flexible exchange rate regime, currency appreciation will tend to provide useful support for monetary tightening. 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. Negotiations under WTO's Doha Development Round, however, suspended in July 2006, have restarted in August 2008. But sharp divisions among the US, India and China about access to agricultural markets in the developing world could not be bridged and the negotiation ended without agreement. 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 FY08 (July 2007 - June 2008), the Bangladesh economy showed signs of resilience by maintaining a satisfactory growth momentum in the face of repeated floods and cyclone Sidr, and a spike in prices of oil, rice and most commodities in the global market. The Government and the Bangladesh Bank continued to adopt policies in bringing the economy back to its growth momentum. The Government's growth stimulating and poverty reduction programmes coupled with prudent monetary policies of BB contributed toward a strong real GDP growth of 6.2 percent in FY08, slightly lower than 6.4 percent of FY07. Economic growth was also aided by rapid growth in exports and surging remittances. Inflation was on uptrend during FY08 due mainly to rising import prices of fuel oil, foodgrains and some other essentials in the international market; and lower growth of crop production. To stave off the uptrend in inflation, the monetary policy stance pursued by the Bangladesh Bank aimed at stabilizing the exchange rate of Taka. The annual average inflation increased modestly to 9.9 percent in June 2008 from 7.2 percent in June 2007, while 12-month consumer price inflation on point to point basis increased over the same period to 10.0 percent. Broad money (M2) grew by 17.6 percent in FY08, which was higher than the 17.0 percent growth recorded in FY07 and also higher than the target under the programme. Total domestic credit grew by 21.8 percent, while credit to private sector increased by 24.9 percent in FY08 reflecting increased economic activities in the real sector. In U.S. dollar terms, export earnings recorded a strong growth of 15.7 percent, while the growth of import payments was high at 25.6 percent. At the same time, remittances from non-resident Bangladesh nationals increased substantially by 32.4 percent. The country's external current account balance continued to record a significant surplus with a substantial increase in remittances more than offsetting widened trade deficit and services deficit. A significant surplus in current account balance and a surplus in capital account more than offsetting a deficit in financial account led to a sizeable surplus in the overall balance, albeit lower than surplus of FY07, which helped improve the international reserve position.

Table 1.2 Sectoral GDP growth rates

(at FY96 constant prices: percent)

	FY91-FY00 (Average)	FY01-FY08 (Average)	FY07	FY08^P
1. Agriculture	**3.2**	**3.2**	**4.6**	**3.6**
a) Agriculture and forestry	2.1	3.5	4.7	3.5
i) Crops and horticulture	1.8	3.0	4.4	3.4
ii) Animal farming	2.5	4.8	5.5	2.4
iii) Forest and related services	3.6	4.9	5.2	5.4
b) Fishing	8.2	2.4	4.1	4.1
2. Industry	**7.0**	**7.8**	**8.4**	**6.9**
a) Mining and quarrying	6.0	8.0	8.3	8.6
b) Manufacturing	6.9	7.8	9.7	7.4
i) Large and medium scale	7.0	7.7	9.7	7.2
ii) Small scale	6.8	8.0	9.7	7.9
c) Power, gas and water supply	5.5	7.0	2.1	4.9
d) Construction	7.5	7.9	7.0	5.9
3. Services	**4.5**	**6.0**	**6.9**	**6.7**
a) Wholesale and retail trade	5.7	6.8	8.0	7.2
b) Hotel and restaurants	5.5	7.2	7.5	7.6
c) Transport, storage and communication	4.6	7.5	8.0	8.7
d) Financial intermediation	4.8	7.7	9.2	9.0
e) Real estate, renting and business activities	3.5	3.6	3.8	3.6
f) Public administration and defence	6.8	7.0	8.4	7.2
g) Education	6.1	8.0	9.0	7.9
h) Health and social works	4.0	6.5	7.6	7.5
i) Community, social and personal services	2.8	3.9	4.6	4.6
GDP (at FY96 constant market prices)	4.8	5.8	6.4	6.2

Source : Bangladesh Bureau of Statistics.
P = Provisional.

Growth Performance

1.8 The 6.2 percent real GDP growth in FY08 was underpinned, on the supply side, by a moderate growth in the agriculture sector and continued strong growth in the industry sector and in the services sector. Growth rate in the agriculture sector achieved a moderate growth of 3.6 percent in FY08 following two consecutive floods, cyclone Sidr and an widespread outbreak of the avian flu in the country, resulting mainly from a lower growth in animal farming, and crops and horticulture sub-sector (Table 1.2). Forest and related services sub-sector attained a slightly higher rate of growth in FY08.

1.9 The industry sector attained a satisfactory growth of 6.9 percent in FY08, but this was lower than 8.4 percent of FY07. The growth was supported mainly by 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 4.9 percent in FY08 as compared to 2.1 percent in FY07 due mainly to an upward trend in gas output. The growth rate in construction sub-sector declined to 5.9 percent in FY08 from 7.0 percent in FY07 reflecting slowdown in private and public construction due to high price of construction materials as well as downsizing of the Annual Development Programme.

1.10 Overall the services sector grew by 6.7 percent in FY08, slightly lower than 6.9 percent recorded in FY07 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 the services sector growth in FY08. Transport, storage and communication sub-sector made a higher growth in FY08.

1.11 On the demand side, the growth was broad based reflecting expansion in all major components. Real domestic demand increased by 6.0 percent in FY08, compared with 6.6 percent of FY07. Of the two components of domestic demand, consumption and investment grew by 5.9 percent and 6.4 percent respectively in FY08, against 5.9 percent and 8.5 percent in FY07. Exports of goods and services posted growth of 16.9 percent in FY08, compared to 15.2 percent in FY07.

Savings and Investment

1.12 Available data indicate that domestic savings-GDP ratio decreased from 20.4 percent

Chart 1.1

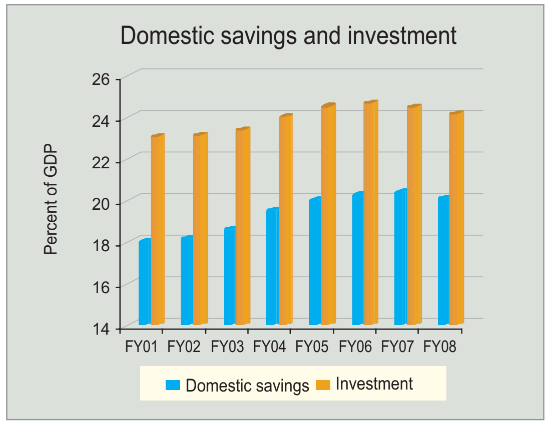
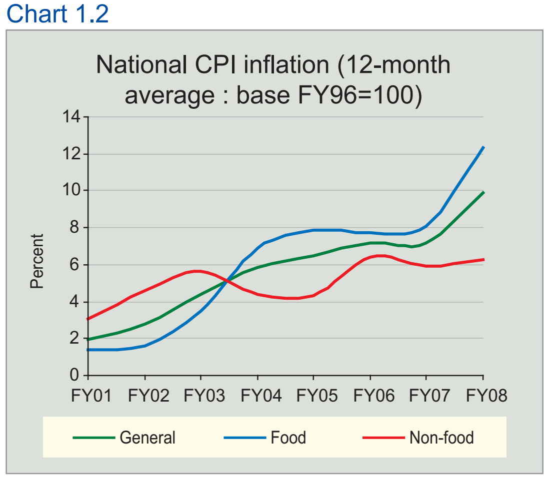


Chart 1.2



of FY07 to 20.1 percent in FY08, and investment-GDP ratio decreased marginally from 24.5 percent of FY07 to 24.2 percent in FY08 (Chart 1.1). The savings-investment gap as a percentage of GDP, correspondingly, remained the same at 4.1 in FY07 and FY08, financed by net factor income from abroad.

Price Situation

1.13 The rising trend of inflation of FY07 as measured by CPI continued throughout FY08 due mainly to higher prices of oil and some other imported goods in the international market, disruptions in production and supply caused by repeated floods and cyclone (Chart 1.2). Annual average CPI (base FY96) inflation as of end June 2008 was 9.9 percent, compared with 7.2 percent as of end June 2007. There was a notable increase of food prices component of CPI inflation from 8.1 percent as of end June 2007 to 12.3 percent as of end June 2008, and non-food component of CPI also increased from 5.9 percent as of end June 2007 to 6.3 percent as of end June 2008.

Money and Credit Developments

1.14 Bangladesh Bank pursued growth supportive and prudent monetary policy stance during FY08 to ease the uptrend in inflationary tendency and to provide support for the highest sustainable output growth. To adhere to its pro-growth monetary policy stance, BB prudently used monetary policy instruments at its disposal during FY08. Moreover, BB's efforts to rationalize lending rate has been continuing.

1.15 Broad money (M2) growth stood at 17.6 percent in FY08, which was higher than the 17.0 percent growth recorded in FY07 and also higher than the target under the programme. Charts 1.3 and 1.4 depict the trends of growth of the monetary aggregates and sources of M2 respectively. The growth in broad money was driven mainly by higher growth in net domestic assets. Net foreign assets of the banking system increased by 15.1 percent in FY08 compared with the target of 3.4 percent but notably lower than previous year's increase of 49.4 percent. The credit to public sector grew by 11.9 percent in FY08 compared with projected growth of 26.4 percent, and actual growth of 12.4 percent in FY07 due mainly to downsizing of ADP, better revenue collection and increased flow of foreign fund. Credit to the private sector grew notably by 24.9 percent in FY08, which was higher than 15.0 percent in FY07 and also higher than projection of 14.9 percent reflecting increased economic activities in the real sector.

1.16 Of the components of broad money on the liability side, growth of the currency and

Chart 1.3

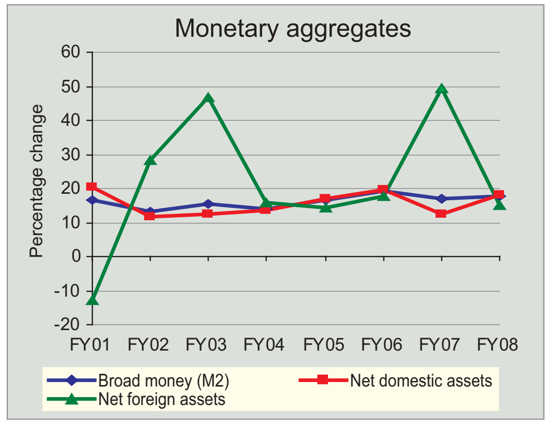
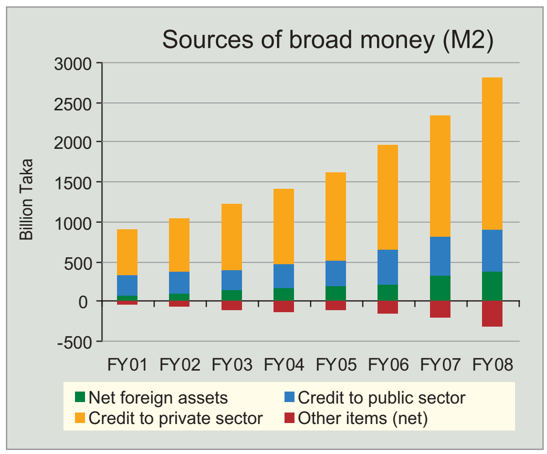


Chart 1.4



demand deposits (19.2 percent) was higher than that of time deposits (17.1 percent), reflecting higher inflationary expectations. The income velocity of money declined from 2.23 of FY07 to 2.18 in FY08, 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. Thereafter, weighted average interest rate on bank advances recorded a decrease to 12.3 percent as of end June 2008 from 12.8 percent as of end June 2007, while that on bank deposits increased slightly to 7.0 percent.

Public Finance

1.18 The FY08 budget was formulated within the framework of the national poverty reduction strategy, "Unlocking the Potential : National Strategy for Accelerated Poverty Reduction (NSAPR)." The duration of the strategy was extended till June 2008. The fiscal policy in the budget was meant for pro-poor economic growth and supporting private sector investment as well. The focus of the FY08 budget was poverty reduction. The budget pursued a set of objectives which included creation of employment opportunities, removal of infrastructure constraints, improvement of law and order situation, establishment of fiscal discipline, unfettered development of private sector, human resources development, social sector investment, further widening of social safety-net, and strengthening of financial management. The FY08 budget had 40.1 percent increase in total public expenditure, of which the current expenditure contributed 24.2 percent, the ADP expenditure 4.2 percent and the other expenditure 493.1 percent (other expenditure included BPC's liability of Taka 75.2 billion). The projected increase in FY08 total public expenditure was higher than the projected 15.8 percent increase in revenue receipts, with overall budget deficit projected to increase to 6.2 percent of GDP in FY08 from 3.7 percent of GDP in FY07.

1.19 In the revised budget, revenue as a percentage of GDP increased to 11.3 in FY08 as compared to 10.6 in FY07, and public expenditure as a percentage of GDP increased from 14.3 in FY07 to 17.5 in FY08. Accordingly, overall budget deficit increased from 3.7 percent of GDP in FY07 to 6.2 percent in FY08 (Chart 1.5). Domestic financing of the deficit increased from 2.1 percent of FY07 GDP to 3.7 percent of FY08; foreign financing, also higher as percentage of GDP than in FY07, 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 2007 to 17.4 percent of GDP at end June 2008.

Chart 1.5

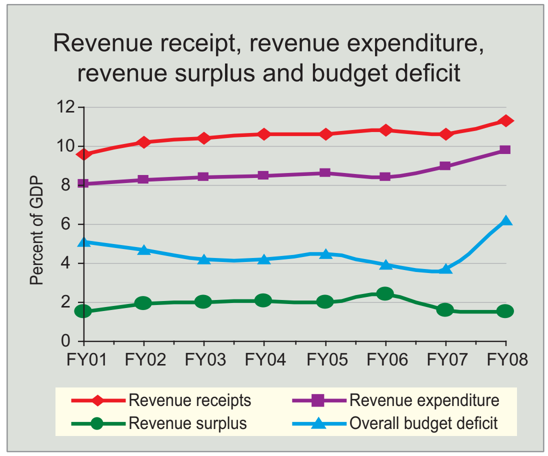
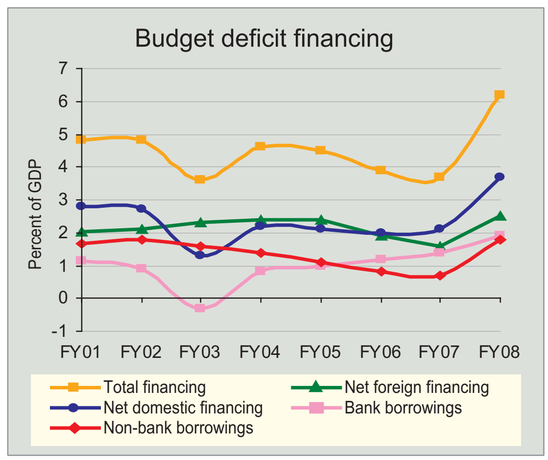


Chart 1.6



External Sector

1.20 Exports and import achieved robust growth in FY08, and remittances from workers abroad showed a strong and steady growth. Exports (fob) increased by 15.7 percent from USD 12,053 million in FY07 to USD 13,945 million in FY08 and remittances from workers abroad recorded 32.4 percent growth from USD 5,979 million in FY07 to USD 7,915 million in FY08; while imports (fob) increased by 25.6 percent from USD 15,511 million in FY07 to USD 19,486 million in FY08. As a result, current account balance exhibited a notable surplus of USD 672 million in FY08.

Expressed in proportion of GDP, export earnings increased from 17.6 percent in FY07 to 17.7 percent in FY08, while import payments increased from 22.7 percent in FY07 to 24.7 percent during the year.

1.21 The export earnings achieved a robust growth in FY08 somewhat lower than expected growth. Exports in RMG sector achieved an impressive growth. Specifically, exports of knitwear (39.2 percent of total exports) grew by a robust 21.5 percent in FY08, driven by a 21.0 percent rise in export volume and 0.4 percent rise in unit price. Exports of woven garments (36.6 percent of total exports) grew moderately by 10.9 percent in FY08 due mainly to increase in volume by 10.6 percent. Frozen shrimps and fish grew strongly by 3.6 percent, supported by increases in both volume and unit price. Export of tea increased strongly by 114.6 percent, supported by increases in both volume and unit price. Export of leather grew by 6.9 percent, reflecting increase in export volume while unit price decreased. Exports of home textile, footwear and ceramic tableware increased over last year performance. This indicates a trend toward diversification of the export base.

1.22 The higher growth of imports in FY08 (25.6 percent) was mainly attributable to the higher prices of fuel oil and some other imported commodities in the international market, and increased foodgrains imports necessitated by the lower crop production. The commodities whose import payments, however, increased steadily in FY08 include rice, wheat, milk and cream, edible oil, pulses, and sugar reflecting their higher prices in the international market. Significant increases also occurred in the import payments of crude petroleum, and petroleum products, despite decrease in volume of imports. Import payments of chemicals, dyeing and tanning materials, plastics and articles thereof, raw cotton, and yarn have also increased reflecting pick up in industrial output.

1.23 Despite larger trade deficit and services deficit in FY08, the country's external current account balance was in a significant surplus due

Chart 1.7

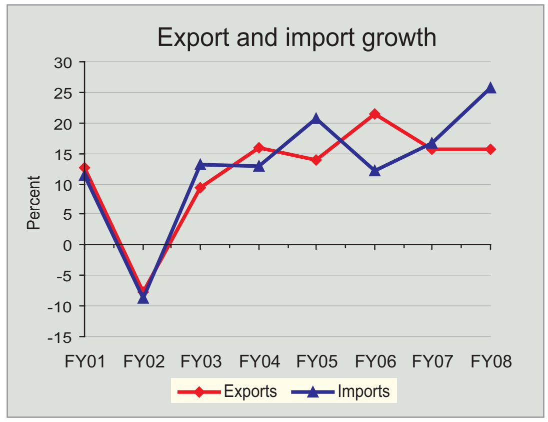


Chart 1.8

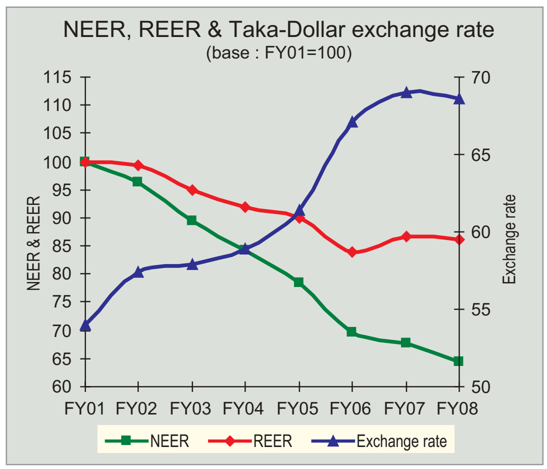
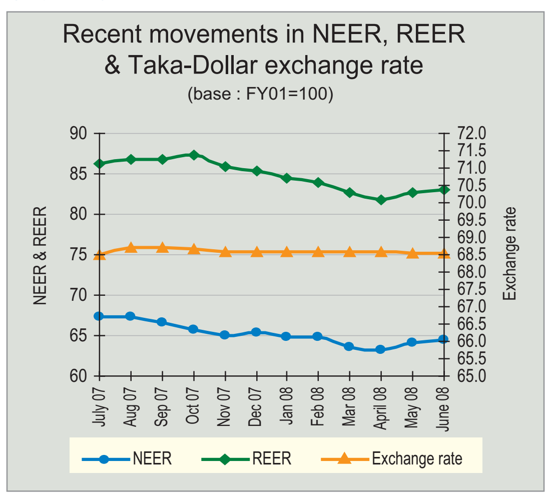


Chart 1.9



mainly to a significant growth in workers' remittances during the year.

1.24 The overall balance of payments recorded a significant surplus of USD 604 million in FY08, which was lower than the larger surplus of USD 1,493 million of FY07. Gross foreign exchange reserves held by the Bangladesh Bank increased by USD 1,072 million to USD 6,149 million at the end of FY08 from USD 5,077 million at the end of FY07, about 3.8 months of import cover.

1.25 Foreign exchange market of the country enjoyed almost adequate liquidity during FY08 due to more than expected foreign currency inflow throughout the year by remittances from non-resident Bangladesh nationals along with the usual export proceeds. Bangladesh Bank's intervention in the market also helped keep liquidity at an appropriate level. Exchange rate of Bangladesh Taka against US Dollar remained almost stable. During the first quarter of FY08, Taka-US Dollar exchange rate started with Taka 68.85. Initially there was a modest pressure on the exchange rate due to higher demand in the foreign exchange market. With the beginning of 2nd quarter, Taka started to appreciate and in mid-December it stood at Taka 68.48. During the 3rd quarter of the year, Taka remained relatively stable with exchange rates ranging within Taka 68.56-68.60. However, at the end of FY08, Taka gained slightly and stood at Taka 68.53. The weighted average Taka-Dollar exchange rate came down from Taka 68.80 at end June 2007 to Taka 68.53 at end June 2008. During the 2nd quarter of FY08, BB injected US Dollar 735.5 million to ease the higher import payments related liquidity pressure in the foreign exchange market. At the end of FY08, BB purchased US Dollar 202.5 million from the commercial banks for absorbing excess liquidity of the market. However, the nominal Taka-US Dollar exchange rate appreciated by 0.4 percent from Taka 68.80 per US dollar at end June 2007 to Taka 68.53 per US dollar at end June 2008 (Chart 1.8). In nominal effective term, Taka depreciated by 4.8 percent in FY08, but the real effective exchange rate of the Taka depreciated lower by 0.6 percent reflecting higher rate of inflation in Bangladesh relative to trade partners.

1.26 The outstanding external debt of Bangladesh increased to USD 20,110 million as of end June 2008 from USD 19,355 million as of June 2007. However, as ratio of GDP it stood at 25.5 percent at end June 2008 against 28.3 percent at end June 2007. Repayment of official external debt was USD 63.0 million or 8.9 percent higher in FY08 than the repayment in FY07. Debt service payments abroad as a percentage of exports in FY08 were lower at 5.5 percent, against 5.8 percent in FY07.

Near and Medium Term Outlook for the Bangladesh Economy

1.27 By maintaining macroeconomic stability through prudent fiscal and monetary policy with supportive external sector policy and progress in advancing structural reforms, against the backdrop of recent natural disasters and food crisis, the near and medium term economic prospects of Bangladesh appear favourable. In the updated Medium Term Macroeconomic Framework (MTMF) of PRSP[1/] under the base case scenario, the real GDP growth has been projected to increase gradually to 6.5 percent in FY09, 7.0 percent in FY10, and 7.2 percent in FY11, aided by sustained macroeconomic stability, increased business and investment facility, increased growth in the industry and services sector, buoyancy in the overall agricultural sector growth, expansion and diversification of the export base, increased efficiency and technological progress, and ongoing implementation of economic reform programmes. To support the pro-poor growth targets envisaged in the MTMF, the gross domestic investment is projected to increase gradually from 24.4 percent of GDP in FY09 to 26.3 percent in FY10 and 27.0 percent in FY11 supported by introduction and implementation

[1/] Source : Moving Ahead - National Strategy for Accelerated Poverty Reduction II (FY2009-11), Planning Commission, Government of the People's Republic of Bangladesh, October 2008.

of pro-industrialisation and investment friendly economic policies and strategies. Inflation is projected to decline gradually from 9.0 percent in FY09 to 7.0 percent in FY11, with an appropriately monetary policy stance aimed at ensuring reasonable price stability and providing support to sustainable and high output growth. 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 16.9 percent in FY09 to 15.3 percent in FY11. 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 11.3 percent in FY09 to 11.9 percent in FY11 by systematic consolidation of the tax instruments, and strengthening and restructuring of the tax administration. Moreover, identification of large taxpayers, opportunities given for declaring undisclosed income earned legally for a specified time, special drive for collection of income tax, enhancing social awareness regarding payment of taxes voluntarily would help rise revenue-GDP ratio. 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 to decline from 16.3 percent in FY09 to 15.9 percent in FY11. Consequently, the overall budget deficit is projected to decline gradually from 5.0 percent of GDP in FY09 to 4.0 percent of GDP in FY11. The negative impacts of international price hike of oil, food and fertilizer together with expanded Social Safety Net Programmes have been the important aspects in projecting large budget deficit for FY09. This will increase financing from domestic sources to 2.8 percent of GDP in FY09. After that, the budget deficit is projected to be financed in equal proportion from foreign and domestic sources over the years. On the external front, growth rates of exports are projected to increase gradually from 16.5 to 17.5 percent during FY09 to FY11. The growth of Imports is projected at 21.0 percent over the years. The external current account balance as percent of GDP is projected to exhibit gradual increase of deficits to 0.9, 1.3 and 1.7 percent in FY09, FY10 and FY11 respectively. The gross official foreign exchange reserves are projected to rise to USD 6,200 million in FY09, USD 6,350 million in FY10 and USD 6,500 million in FY11.

1.28 The outlook envisaged in the MTMF faces several near and medium term downside risks and uncertainties originating from (i) the probable rising inflationary pressures, (ii) the probable high prices of oil and other commodities in the world market, (iii) floods and other natural disasters, and climate change, (iv) infrastructure constraints (especially power, gas, ports, and transportation), (v) probable adverse effects in the RMG export growth due to falling growth prospects in U.S. and the country's other major trade partners, and (vi) probable adverse impact of global slowdown on aid inflow and workers' remittances. Besides, failure to meet following challenges may add to the problems: (i) ensuring food security, (ii) increase productivity, (iii) diversifying export products and markets, and (iv) smooth transition to democracy.

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. Recently, Bangladesh and all other south Asian countries have been experiencing inflationary pressures resulting mainly from higher food and energy prices. Furthermore, in Bangladesh, production losses due to repeated floods and cyclone Sidr have added to the inflationary pressures. Easing of the inflationary pressure requires higher growth and increased production of essential food and other items in the face of tight and unstable world market for these commodities. Providing support to sustainable and high output growth as adopted in the MTMF, BB has already been announced its monetary policy stance for the first half of

FY09 aiming at reasonable price stability. Alongside adoption of measures to encourage increased flow of credit to the economy's productive sectors, BB will review the policy rates to introduce corrective measures speedily if necessary, for anchoring inflation expectations. As the priority is to increase domestic production, it would be important to take precautions against any unexpected natural disasters along with taking measures to minimize domestic vulnerabilities and risks by ensuring timely and adequate supply of inputs to the farmers, 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. Special attention would be given by BB to continue existing refinance support to agriculture, SMEs, and housing loans. For minimizing the sufferings of general consumers, a Consumer Rights Protection Ordinance 2008 has already been promulgated. Climate change, including potential changes in sea levels and local climatic conditions may pose a significant risk to longer term growth which needs attention to reduce vulnerability on the economic activities of coastal areas.

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. Maintaining fiscal discipline by the Government and minimizing the dependence on financing fiscal deficit from the banking system generate less inflationary pressure. The Government raised administered prices of oil from 1 July 2008 which will ease BPC subsidies. Meanwhile, Government has revised the oil prices downward on 27 October 2008 following recent decline in global oil prices. It is important to introduce a pricing system providing for automatic adjustment of domestic fuel prices to international market prices with some mechanisms to protect the farmer and the poor from hardships. Besides, there is a need to reduce dependence 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 taken to support the near and medium term GDP growth targets and to improve external competitiveness. An effective energy policy including implementing reforms with corporatization and financial restructuring of power sector entities, and strengthening of the Bangladesh Energy Regulatory Commission (BERC) is the most important factors for achieving more rapid economic growth. To make the sector more appealing for substantial investment, concerted and coordinated efforts by the Government, regulatory authority and specialist infrastructure agencies and the private sector are needed. Otherwise, the continuing power shortages would widen the gap between rising aggregate demand and domestic production which in turn create challenge for monetary policy to restraining aggregate demand with consequent adverse impact on production and growth.

1.32 The depth and severity of the recent global financial crisis as well as its impact on Bangladesh Economy is still unfolding. However, Bangladesh is relatively insulated from the financial side, but the global growth outlook, especially the growth prospect in the U.S. and the country's other major trade partners, has weakened which could create adverse impact on export growth, particularly export growth of RMGs. Bangladesh needs to remain alert regarding its competitiveness of exports especially in the price-sensitive RMGs. Moreover, domestic labour unrest in this sector remains a concern. 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. Efforts need to be made for larger access for our RMG products in the markets where access still remains limited such as Australia and Japan. 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. But the negotiations for a new global trade pact have collapsed in August 2008 in the face of sharp divisions between the US, India and China about access to agricultural markets in the developing world. 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 also 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 has been 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 elements 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 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. The uncertainty among the investors following anti-corruption and anti-hoarding drive have started to ease. In this regard, the government has officially announced formation of the first-ever public-private business forum named 'Bangladesh Better Business Forum' (BBBF), basically designed to improve interaction between the business community and government high-ups. It is also necessary to have such a forum to achieve sustainable economic growth, especially by maintaining an investment and business-friendly atmosphere in the country. Appropriate actions to improve performance of Chittagong and Mongla ports have started reflecting on business and trade. Recently, the World Bank in its report "Doing Business 2009" ranked Bangladesh above China, India, Pakistan and the median Low Income Country (LIC) for required time and procedures to start a business, although there is slight drop of overall ranking from 104 to 110 out of 181 economies. Simplifying foreign borrowing by the private sector, rationalising the foreign exchange transactions to encourage increased FDI and foreign portfolio investment, particularly in medium and large-scale industries and enterprises, including infrastructure building, and above all positive political developments centred on late 2008 general election with a sound economic environment would make Bangladesh a middle income economy by the end of the next decade.