Macroeconomic Performance, Near and Medium Term Prospects

World Economic Environment and Outlook

1.1 The global economy that plunged into deep recession – following a massive financial crisis that erupted in September 2008 – appears to be recovering after more than a year helped by unprecedented macroeconomic and financial policy support. The recovery is expected to be pulled up by the strong performance of Asian economies and stabilisation or modest recovery elsewhere, but the stabilisation is uneven and the recovery is expected to be slow. Following an unprecedented rate of decline in real GDP during the fourth quarter of 2008 and continuation of falling trend during the first quarter of 2009, the advanced economies as a group now showing signs of decelerated contraction but are still projected not to show a sustained pickup in activity in 2009. Accordingly, GDP in the advanced economies as a group (with 55.1 percent share in 2008 global output) is projected to decline by 3.4 percent in 2009. Emerging and developing economies as a group (with 44.9 percent share in 2008 global output) are projected to eke out a modest 1.7 percent growth in 2009. The October 2009 issue of the IMF World Economic Outlook has projected global output growth to contract by 1.1 percent in 2009, reflecting most severe global recession after the post-World War II period (Table 1.1). In this latest issue of WEO, the IMF made an upward revision of growth forecasts both in advanced economies, and emerging and developing economies, compared with the projections made in July 2009. Growth forecasts have been revised upward for most of the advanced economies

Table 1.1 Overview of the World Economic Outlook projections

(annual percentage change)

	2007	2008	2009*	2010*
World output	**5.2**	**3.0**	**-1.1**	**3.1**
Advanced economies	2.7	0.6	-3.4	1.3
United States	2.1	0.4	-2.7	1.5
Japan	2.3	-0.7	-5.4	1.7
Germany	2.5	1.2	-5.3	0.3
United Kingdom	2.6	0.7	-4.4	0.9
France	2.3	0.3	-2.4	0.9
Italy	1.6	-1.0	-5.1	0.2
Canada	2.5	0.4	-2.5	2.1
Newly industrialised Asian economies	5.7	1.5	-2.4	3.6
Emerging and developing economies	8.3	6.0	1.7	5.1
Developing Asia	10.6	7.6	6.2	7.3
China	13.0	9.0	8.5	9.0
ASEAN-5	6.3	4.8	0.7	4.0
South Asia				
Bangladesh	6.3	6.0	5.4	5.4
India	9.4	7.3	5.4	6.4
Pakistan	5.6	2.0	2.0	3.0
Sri Lanka	6.8	6.0	3.0	5.0
World trade volume (goods and services)	**7.3**	**3.0**	**-11.9**	**2.5**
Imports				
Advanced economies	4.7	0.5	-13.7	1.2
Emerging and developing economies	13.8	9.4	-9.5	4.6
Exports				
Advanced economies	6.3	1.9	-13.6	2.0
Emerging and developing economies	9.8	4.6	-7.2	3.6
Commodity prices (U.S. dollars)				
Oil	10.7	36.4	-36.6	24.3
Nonfuel	14.1	7.5	-20.3	2.4
Consumer prices				
Advanced economies	2.2	3.4	0.1	1.1
Emerging and developing economies	6.4	9.3	5.5	4.9
South Asia				
Bangladesh	9.1	7.7	5.3	5.6
India	6.4	8.3	8.7	8.4
Pakistan	7.8	12.0	20.8	10.0
Sri Lanka	15.8	22.6	4.6	13.0

Source : World Economic Outlook, October 2009, IMF.
*=Projection.

except for US, UK and Canada, and growth projections for most of the emerging and developing countries have also been revised upward driven mainly by developing Asia.

1.2 A stronger-than-expected downturn in activity in advanced, emerging and other developing economies, after the financial crisis of several months, prompted commodity prices to start falling in mid-2008 after abruptly ending the price boom of the past few years. Commodity prices broadly stabilised in early 2009 and subsequently staged a strong rally in the second quarter – and have responded to the signs of expected pickup in activity. After peaking at an all-time record high of USD 143 a barrel on 11 July 2008, oil prices collapsed to about USD 38 by end December 2008, mostly affected by the rapid decline in global activity and the sharp deterioration in near-term global prospects. Oil prices further reached a low of USD 36 a barrel on 27 February 2009, however, started to rebound in March and climbed to USD 70 by midyear. The non-fuel commodity prices too – notably metals and food prices – fell rapidly during the second half of 2008, which have somewhat recovered more recently, reflecting improved market sentiment, U.S. dollar depreciation, and commodity-specific factors. Global inflation has subsided quickly, resulting from the sharp drop in activity and rise in output gaps. In the advanced economies, consumer price inflation is projected close to zero percent as oil prices remained far below levels one year earlier, despite their recent pickup. In emerging and developing economies, inflation is projected to decrease to 5.5 percent in 2009, though the declining pressure has been limited among some emerging economies.

1.3 The growth of world trade volume in 2009 is projected to decline sharply by 11.9 percent compared with 3.0 percent increase in 2008, which is higher than previous forecast. The growth of exports from both the advanced economies and other emerging and developing countries are projected to contract by 13.6 percent and 7.2 percent in 2009 respectively. The growth of imports for both the advanced economies and emerging and developing countries are also projected to decline in 2009. The U.S. current account deficit is projected to decline at 3.5 percent in the first quarter of 2009, down from around 5 percent in the first half of 2008. However, dollar has appreciated significantly since September 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 2009 indicates that financial conditions have improved, as unprecedented policy interventions have been undertaken by central banks and governments, and the risks to the global financial system have moderated from the extreme levels identified in the July 2009 Global Financial Stability Report (GFSR). However, supportive forces are still weak. House price misalignments remain substantial in many countries and are yet to bottom out. Corporate bond markets have reopened, but overall bank credit growth continues to diminish. Securitization markets continue to be impaired except supported by government or central bank. Emerging market sentiment has strengthened, but markets remain vulnerable to capital outflows. However, cuts in policy interest rates, continued provision of ample liquidity, credit easing, public guarantees, and bank recapitalization have appreciably lowered concerns about systemic failure. In foreign exchange markets, one of the side effects of the financial crisis has been the shifting of capital flows to the most liquid and safe government securities market since 2008 which led to significant appreciation of the euro, U.S. dollar, and yen. The renminbi and other currencies closely linked to the dollar have also appreciated in real effective terms. Most other emerging economy currencies have weakened sharply, as private capital account flows have reversed, despite use of international reserves for support.

1.5 Looking forward in 2010, the global economy is projected to recover gradually by 3.1 percent growth, 0.6 percentage point higher than envisaged in the July 2009 WEO, largely reflecting carryover from a stabilisation of output during the second half of 2009 (Table 1.1). Output growth forecasts have been revised upward for all the countries of advanced economies and growth forecasts have also been revised upward for most of the countries of emerging market and developing economies. Among emerging and developing countries, growth in China is expected at 9.0 percent in 2010, maintaining a strong performance given the global context. South Asian countries' growth rates are also expected to be moderate, reflecting substantial macroeconomic stimulus and a pickup in global demand. The world trade volume is projected to grow at 2.5 percent in 2010 compared with the estimated decline of growth by 11.9 percent in 2009. Despite the projected increase in oil and non-fuel commodity prices, inflation is projected to rise but remain close to 1 percent for advanced economies, and decline to 4.9 percent in emerging and developing economies.

1.6 The overall balance of risks to the short-term global growth outlook remains tilted to the downside. The main downside risks to the rising unemployment and a loss of confidence in the stability of the financial sector could put renewed downward pressure on asset prices and potentially trigger a deflationary episode. 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. Falling house prices are another risk that could undermine confidence in bank capital base. Rising unemployment and an increasing share of households with "negative equity" (house prices are currently below outstanding mortgages for 20 percent of borrowers) threaten a further increase in foreclosure rates that could generate serious overshooting and continued housing weakness through 2010. This concern underlines the importance of effective implementation of recent government initiatives to facilitate mortgage restructuring and to ensure an adequate supply of credit. 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. Another challenge is that the financial sector continues to be dependent on significant public support, resulting in an unparallel transfer of risk from the private to the public sector. The expansionary monetary policy, reflected in the surge of money supply in the central bank balance sheets, will need to be tightened to contain inflationary pressures once investors and consumers begin to spend again. Moreover, reducing fiscal deficit which has already substantially increased through the unprecedented amounts spent to bail out financial firms, discretionary fiscal stimulus measures, and the impact of the recession on taxes and transfer payments, will be an important political challenge. Though the time has not yet come to start withdrawing all the various forms of financial, monetary, and fiscal support, however, work will need to begin on exit strategies from the support policies in order to address market uncertainty. Medium term policies need to ensure that steps taken to normalise policies and markets are consistent with establishing a lasting framework of sound financial regulation, sustainable fiscal balances, and the maintenance of price stability.

1.7 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

1.8 During FY09 (July 2008 - June 2009), the Bangladesh economy attained 5.9 percent real GDP growth, only mildly impacted by the ongoing global slowdown because of the limited openness and strengthened domestic demand. Adequate domestic production in crops and resilience of the service sector helped the real economy to remain steady. The Government and the Bangladesh Bank continued to adopt policies in bringing the economic stability and higher growth. Economic growth was also aided by slowed but still double digits sustained healthier growth in exports and buoyant workers' remittances inflows. Inflation has significantly subsided during FY09 due mainly to falling prices of crops in the domestic market because of higher growth of crop production, and declining prices of most imported items in the international market, particularly non-food items in the backdrop of ongoing global recession. The annual average inflation declined to 6.7 percent in June 2009 from 9.9 percent in June 2008, while 12-month consumer price inflation on point to point basis declined sharply over the same period to 2.3 percent. Broad money (M2) grew by 19.2 percent in FY09, which was higher than the 17.6 percent growth recorded in FY08 and also higher than the target under the programme. Total domestic credit grew by 15.9 percent, while credit to private sector increased by 14.6 percent in FY09 as compared to 24.9 percent in FY08 reflected in weakening external demand and entrepreneur's extra-cautiousness in investment activities in the face of global recession. In U.S. dollar terms, export earnings recorded a slower but sustained healthier growth of 10.1 percent during FY09, while the growth of import payments was low at 4.2 percent. At the same time, remittances from non-resident Bangladesh nationals increased substantially by 22.4 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 surplus in capital account more than offsetting a deficit in financial account led to a sizeable surplus in the overall balance, which helped improve the international reserve position.

Growth Performance

1.9 The 5.9 percent real GDP growth in FY09 was underpinned, on the supply side, by a strongly performed growth in the agriculture and services sector, while growth in industry sector slowed mainly due to weakening of export demand. The agriculture sector achieved a robust growth of 4.6 percent in FY09, supported by favourable weather and optimistic price expectation, overcoming adversities of the preceding year. The crops and horticulture, and animal farming sub-sectors attained higher output growth in FY09 (5.0 and 3.5 percent respectively, against previous year’s 2.7 and 2.4 percent). The growth in forest and related services sub-sector in FY09 remained at the same 5.5 percent level of FY08. The fishery sub-sector achieved a slightly lower rate of growth of 4.0 percent in FY09 as compared to 4.2 percent in FY08 due mainly to decline in shrimp exports – which resulted mainly from the voluntary bar imposed by the Bangladeshi shrimp industry on the use of nitrofuran, a banned antibiotic (Table 1.2).

1.10 The industry sector grew by 5.9 percent in FY09, was lower than 6.8 percent of FY08. The growth in manufacturing sub-sector weakened significantly from 7.2 percent of FY08 to 5.9 percent of FY09. 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 dipped to 4.5 percent in FY09 as compared to 6.8 percent in FY08, reflecting persistent inadequacy of physical infrastructure. The growth rate in construction sub-sector in FY09 remained at the same 5.7 percent level of FY08.

1.11 Overall, the services sector grew by 6.3 percent in FY09, slightly lower than 6.5 percent recorded in FY08 and remaining well above the trend level. Despite some fluctuations, the growth was fairly well spread in the different sub-sectors. Wholesale and retail trade is likely to attain a somewhat lower growth of 6.4 percent in FY09 because of decreases in industrial production, and import of commodities. Transport, storage and communication sub-sector also made a lower growth in FY09.

1.12 On the demand side, the growth was broad based reflecting expansion in all major components. Real domestic demand increased by 5.8 percent in FY09, compared with 4.4 percent of FY08. Of the two components of domestic demand, consumption and investment grew by 5.8 percent and 5.7 percent respectively in FY09, against 5.4 percent and 1.8 percent in FY08. Exports of goods and services posted a growth of 10.6 percent in FY09, compared to 16.9 percent in FY08.

Table 1.2 Sectoral GDP growth rates

(at FY96 constant prices: percent)

	FY91-FY00 Average	FY01-FY09 Average	FY08	FY09^{P}
I. Agriculture	**3.2**	**3.3**	**3.2**	**4.6**
a) Agriculture and forestry	2.1	3.6	2.9	4.8
i) Crops and horticulture	1.8	3.1	2.7	5.0
ii) Animal farming	2.5	4.6	2.4	3.5
iii) Forest and related services	3.6	5.0	5.5	5.5
b) Fishing	8.2	2.5	4.2	4.0
2. Industry	**7.0**	**7.6**	**6.8**	**5.9**
a) Mining and quarrying	6.0	8.2	8.9	9.4
b) Manufacturing	6.9	7.5	7.2	5.9
i) Large and medium scale	7.0	7.4	7.3	5.7
ii) Small scale	6.8	7.8	7.1	6.6
c) Power, gas and water supply	5.5	6.9	6.8	4.5
d) Construction	7.5	7.6	5.7	5.7
3. Services	**4.5**	**6.0**	**6.5**	**6.3**
a) Wholesale and retail trade	5.7	6.7	6.8	6.4
b) Hotel and restaurants	5.5	7.2	7.6	7.6
c) Transport, storage and communication	4.6	7.5	8.6	7.6
d) Financial intermediation	4.8	7.7	8.9	8.0
e) Real estate, renting and business activities	3.5	3.6	3.8	3.8
f) Public administration and defence	6.8	6.9	6.2	7.0
g) Education	6.1	8.0	7.8	8.0
h) Health and social works	4.0	6.6	7.0	7.6
i) Community, social and personal services	2.8	4.0	4.6	4.7
GDP (at FY96 constant market prices)	4.8	5.8	6.2	5.9

Source : Bangladesh Bureau of Statistics.
P = Provisional.

Savings and Investment

1.13 Available data indicate that domestic savings-GDP ratio decreased from 20.3 percent of FY08 to 20.0 percent in FY09, and investment-GDP ratio remained at the same 24.2 percent level of FY08 (Chart 1.1). The savings-investment gap as a percentage of GDP, correspondingly, increased from 3.9 in FY08 to 4.2 FY09, financed by net factor income from abroad.

Price Situation

1.14 The collapse of global commodity price bubble in 2008 impacted the consumer price inflation in Bangladesh with some lag. The double digit levels of inflation in FY08 continued until the first quarter of FY09. However, that trend of inflation began to ease thereafter with good domestic harvest bringing down food grain prices and with falling import prices of fuel oil and other commodities. Point to point inflation, however, has already ceased the decline of the past few months, edging up to 5.4 percent of May 2009 from 5.0 percent of March 2009. But, the inflation dropped again to 2.3 percent in June 2009, much lower than 10.0 percent of June 2008, reflecting sharp fall of food prices over the year. Annual average CPI (base FY96) inflation as of end June 2009 was 6.7 percent, as compared with 9.9 percent as of end June 2008 (Chart 1.2). There was a notable decrease of food prices component of CPI inflation from 12.3 percent as of end June 2008 to 7.2 percent as of end June 2009, and non-food component of CPI also decreased from 6.3 percent as of end June 2008 to 5.9 percent as of end June 2009.

Money and Credit Developments

1.15 Bangladesh Bank pursued supportive monetary policy stance during FY09 seeking to maintain adequate credit flow for sustained high real output growth while containing inflation within tolerable moderate levels. Responding to targeted monetary policy stance in avoiding inflationary pressures and high domestic credit growth in the first quarter of FY09, repo and reverse repo were both raised by 25 basis points in September and November 2008 respectively. BB reversed repo and reverse repo interest rates both easing by 50 basis points in March 2009 to maintain easy credit conditions for investors including those in export sectors hurt by global recession. Moreover, BB also refrained from reverse repo operations leaving the Taka liquidity from its USD purchases unsterilised.

1.16 Broad money (M2) growth stood at 19.2 percent in FY09, which was higher than the 17.6 percent growth recorded in FY08 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

Chart 1.1

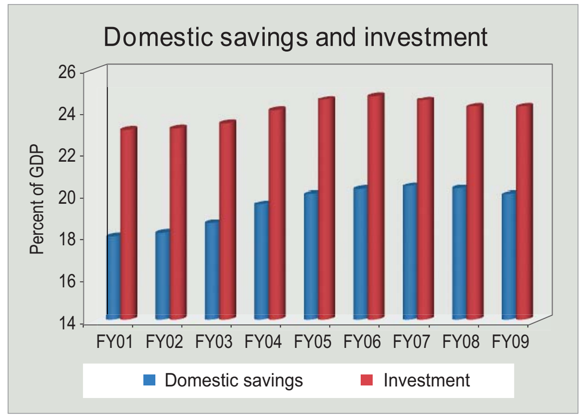


Chart 1.2

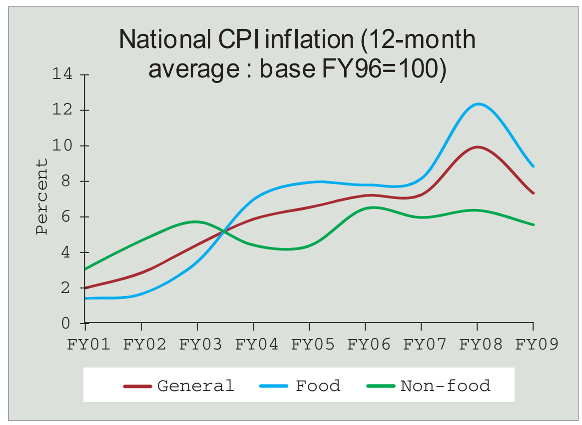
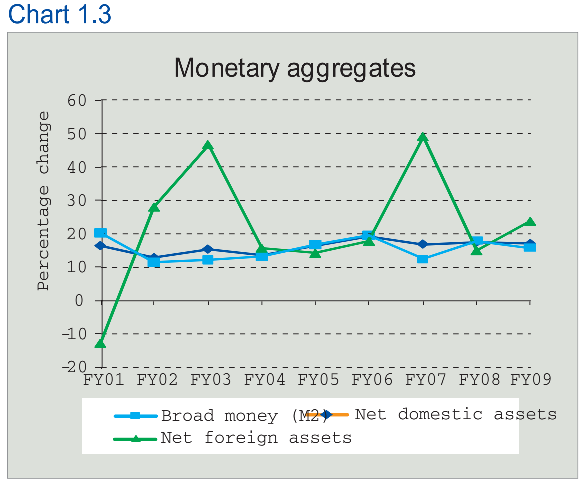


Chart 1.3



respectively. The growth in broad money was driven mainly by higher growth in net foreign assets. Net foreign assets of the banking system increased notably by 26.7 percent in FY09 compared with the target of 9.5 percent and previous year's increase of 15.1 percent. The credit to public sector grew by 20.3 percent in FY09 compared with projected growth of 23.9 percent, and actual growth of 11.7 percent in FY08. Credit to the private sector grew by 14.6 percent in FY09, which was lower than 24.9 percent in FY08 and also lower than projection of 17.5 percent reflecting economic activities slackened in the real sector.

1.17 Of the components of broad money on the liability side, growth of the currency and demand deposits (12.0 percent) was much lower than that of time deposits (21.4 percent). This was consistent with the higher rate of decline in the income velocity of money. The 5.5 percent FY09 decline in income velocity of money was notably higher than the 1.8 percent decline of FY08, reflecting increased monetisation in the economy.

1.18 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 - again on a decreasing trend - recorded a decrease to 11.9 percent as of end June 2009 from 12.3 percent as of end June 2008, while that on bank deposits as of end June 2009 remained at the same 7.0 percent level of end June 2008.

Public Finance

1.19 The FY09 budget was formulated within the broad objectives of maintaining macroeconomic stability, accelerating growth and reducing poverty. Apart from these, priorities had been given to maintaining price level of essentials within tolerable limit, employment

Chart 1.4

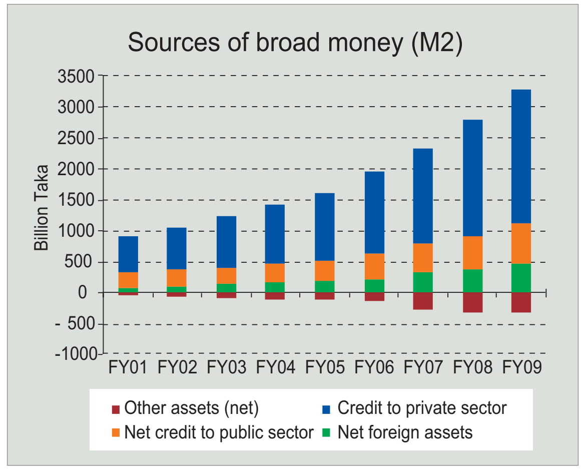


Chart 1.5

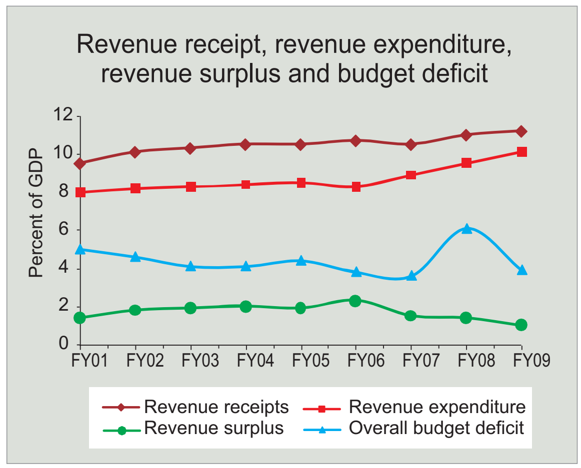
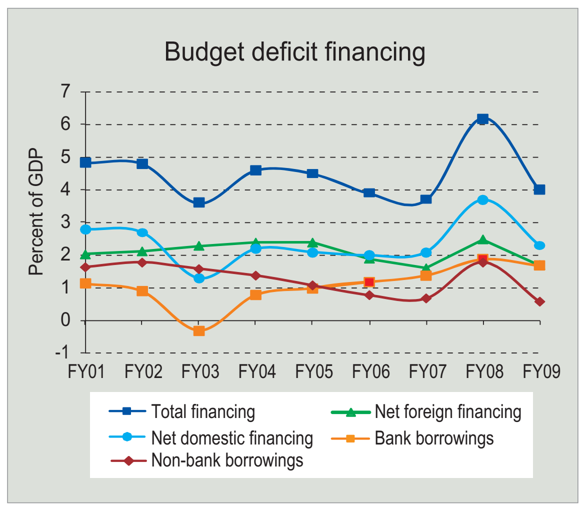


Chart 1.6



generation, widening and deepening of social safely-net programmes, reducing regional disparity, increasing agricultural production, ensuring food security, increasing power generation and the overall development of communication network including IT. The proposed FY09 budget provided 6.8 percent increase in total public expenditure, with increase in current expenditure by 16.3 percent and ADP expenditure by 13.8 percent, and with decrease in other expenditure by 27.9 percent. The projected increase in FY09 total public expenditure was lower than the projected 14.6 percent increase in revenue receipts, and overall budget deficit projected to decrease to 5.0 percent of GDP in FY09 from 6.2 percent of GDP in FY08.

1.20 In the revised budget, revenue as a percentage of GDP decreased to 11.2 in FY09 as compared to 11.3 in FY08, while public expenditure as a percentage of GDP decreased from 17.5 in FY08 to 15.3 in FY09. Overall budget deficit decreased from 6.2 percent of GDP in FY08 to 4.1 percent of GDP in FY09 (Chart 1.5). Domestic financing of the deficit decreased from 3.7 percent of FY08 GDP to 2.3 percent of FY09; foreign financing, higher as percentage of GDP than in FY08, covered the remainder of the deficit (Chart 1.6). The outstanding stock of domestic public debt increased from 17.2 percent of GDP at end June 2008 to 17.3 percent of GDP at end June 2009.

External Sector

1.21 The pace of export growth slowed significantly but still maintained a double digits steady growth, while import growth was low in FY09. However, remittances from workers abroad showed a strong and steady growth. Exports (fob) increased by 10.1 percent from USD 14,151 million in FY08 to USD 15,583 million in FY09 and remittances from workers abroad recorded 22.4 percent growth from USD 7,915 million in FY08 to USD 9,689 million in FY09; while imports (fob) increased slowly by 4.2 percent from USD 19,481 million in FY08 to USD 20,291 million in FY09. As a result, current account balance exhibited a notable surplus of USD 2,536 million at the end of FY09. Expressed in proportion of GDP, export earnings decreased from 17.8 percent in FY08 to 17.4 percent in FY09, while import payments decreased from 24.5 percent in FY08 to 22.7 percent in FY09.

1.22 The export earnings achieved a low but still double digits growth in FY09, falling 6.4 percent short of the expected growth as global recession affected shipments mainly in the second half of FY09. Exports in RMG sector achieved an impressive growth. Specifically, exports of knitwear (41.3 percent of total exports) grew by a robust 16.2 percent in FY09, somewhat lower than the target, driven by a 20.4 percent increase in export volume and 3.5 percent decrease in unit price. Exports of woven garments (38.0 percent of total exports) - exceeding the expected growth - posted a growth of 14.5 percent in FY09 due mainly to increase in volume by 15.2 percent. Frozen food witnessed a 14.9 percent negative growth during FY09, and leather exports also slipped by 37.7 percent. Exports of footwear, home textiles, textile fabrics and agricultural products achieved growth, but fell short of targets. Exports of terry towels, handicraft, computer services and chemical products increased over last year performance. This indicates a trend toward diversification of the export base.

1.23 The lower growth of imports in FY09 (4.2 percent) was mainly attributable to the lower prices of fuel oil and some other imported commodities in the international market, and decreased imports of food grains because of good domestic harvest. Imports payments for capital machinery also posted a negative growth during FY09, indicating sluggishness in investment activities.

1.24 The overall balance of payments recorded a significant surplus of USD 2,058 million in FY09, which was much higher than the surplus of USD 331 million of FY08. Gross foreign exchange reserves held by the Bangladesh Bank increased by USD 1,322.2 million to USD 7,471.0 million at the end of FY09 from USD 6,148.8 million at the end of FY08, about 4.4 months of import cover.

1.25 The foreign exchange market of the country was almost stable during FY09. Despite global financial meltdown, the market enjoyed adequate supply of liquidity during FY09 like the preceding year. 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 with tolerable corrections. However, during the first quarter of FY09, Taka appreciated by 3 paisa to Taka 68.47 from Taka 68.50 against US dollar. In the second quarter, Taka started to depreciate and stood at Taka 68.92. During the third quarter, it further depreciated with exchange rates ranging within Taka 68.90-69.03 per US dollar. The nominal Taka-US Dollar exchange rate depreciated by 0.8 percent from Taka 68.53 per US dollar at end June 2008 to Taka 69.06 per US dollar at end June 2009 (Chart 1.8). In nominal effective term against the eight currency basket (base: 2000-2001=100), Taka appreciated by 4.5 percent in FY09, while the real effective exchange rate of the Taka appreciated by 6.4 percent.

1.26 The outstanding external debt of Bangladesh increased to USD 20,831 million as of end June 2009 from USD 20,266 million as of June 2008. However, as ratio of GDP it stood at 23.3 percent at end June 2009 against 25.5

Chart 1.7

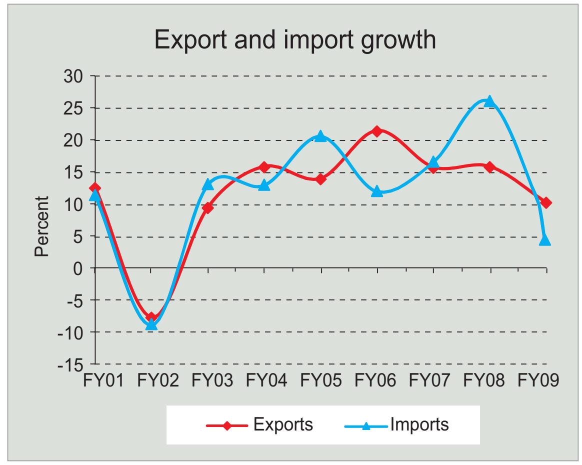


Chart 1.8

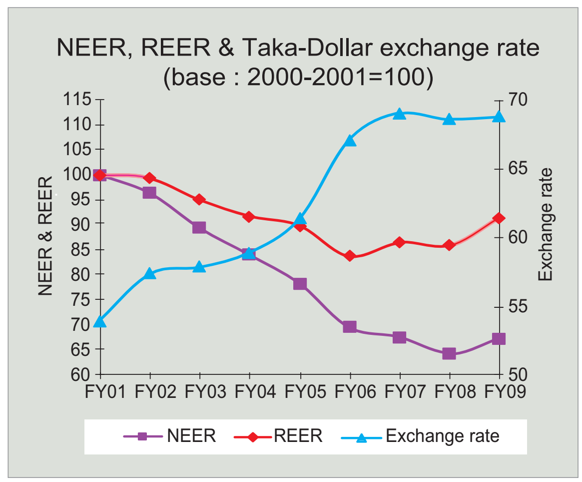
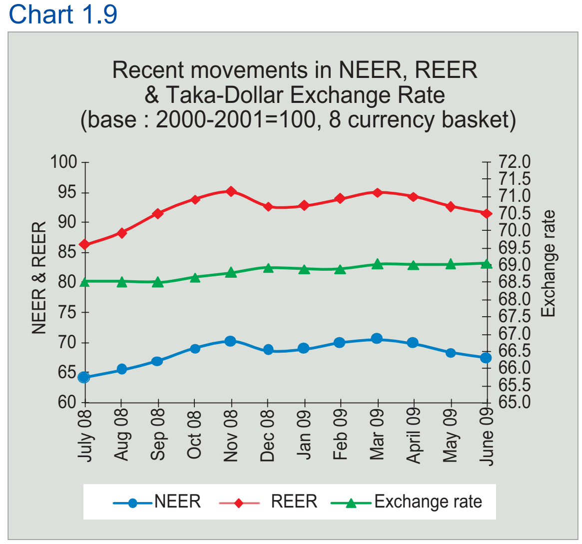


Chart 1.9



percent at end June 2008. Repayment of official external debt was USD 64 million or 8.3 percent higher in FY09 than the repayment in FY08. Debt service payments abroad as a percentage of exports in FY09 was slightly lower at 5.3 percent, against 5.4 percent in FY08.

Near and Medium Term Outlook for the Bangladesh Economy

1.27 Although global economy is beginning to stabilize showing the signs of recovery, the third wave of recession is likely to impact the Bangladesh economy, necessitating some downward revision in the medium term economic forecasts. In the updated Medium Term Macroeconomic Framework (MTMF), the real GDP growth has been projected conservatively to be in the range of 5.5 to 6.0 percent in FY10. The growth rate for FY10 may exceed the target following faster global economic recovery together with investment plan implementing initiatives including public private partnership (PPP). Then, economic growth is expected to grow 6.0 percent in FY11 and pick up to 6.5 percent in FY12. The growth projections may be achieved by sustained macroeconomic stability with increased growth in the industry and services sector including enhanced emphasis on the rapid expansion of SMEs and with improved agricultural productivity and diversification. The gross domestic investment is projected to increase gradually from 23.6 percent of GDP in FY10 to 25.2 percent in FY12 supported by introduction and implementation of pro-industrialisation and investment friendly economic policies and strategies which will create additional employment opportunities in the economy and result in further reduction in poverty levels. Inflation is projected to decline to 6.5 percent in FY10 and to 6.0 percent in FY12, with monetary policy stance to support attainment of highest sustainable output growth without triggering escalation of inflation. In view of the growth supportive policy stance with maintaining target CPI inflation, broad money (M2) growth is projected to slowdown gradually over the years from 16.3 percent in FY10 to 16.0 percent in FY12. In this regard, BB in its Monetary Policy Statement of July-December 2009 revised the projection of broad money growth for FY10 at 15.5 percent. The MTMF envisages that Government's fiscal policy is designed to maintain macroeconomic stability and fiscal sustainability, and create room for investing in the infrastructure and human resources with a view to supporting sustainable high levels of economic growth and MDGs. The revenue-GDP ratio is estimated at 11.2 percent in FY09 and projected to rise to 11.5 percent in FY12 by continuing ongoing reforms and revenue enhancing measures. Expanding VAT and the income tax net, modernising and rationalising the taxation system, and decentralising the tax collection operations are the key elements of Government's revenue strategy, would help raise revenue-GDP ratio. The expenditure-GDP ratio is projected to decline from 16.6 percent in FY10 to 16.2 percent in FY12. In order to improve the efficiency and probity of public expenditure, the Government will accelerate the implementation of its Strategic Vision for Public Finance Management (PFM) backed up by an expanded programme of support from its development partners. Consequently, the overall budget deficit is projected to decline gradually from 5.0 percent of GDP in FY10 to 4.7 percent of GDP in FY12. On the external front, growth rates of exports are projected to increase from 12.5 to 18.5 percent during FY10 to FY12. The growth rates of imports are projected to increase from 13.0 to 16.0 percent during FY10 to FY12. The external current account balance as percent of GDP is projected to 0.2 in FY10 and is projected to decline progressively to -0.4 in FY12.

1.28 The outlook envisaged in the MTMF faces several near and medium term downside risks and uncertainties originating from (i) probable adverse effects of the global financial crisis on exports and workers' remittance inflows, (ii) continuous return of migrant workers laid off in recession-ridden host countries, (iii) weakening in investment momentum, (iv) risk of exacerbating domestic inflation if unexpectedly faster global recovery takes hold, (v) infrastructure constraints (especially power, gas, ports, and transportation), and (vi) floods and other natural disasters, and climate change.

1.29 Unless the global economy recovers rapidly, FY10 will be a challenging one to attain the growth projection close to FY09 level within the indications that the global financial crisis is beginning to impact the economy. Despite its limited openness and regulated external exposure, the weakened global growth outlook, especially the growth prospect in developed countries and in the Middle East could impact exports and remittances adversely. Under the situation, Bangladesh needs to remain alert to the worrisome signs in export arena including increased export volatility, pressure from the buyers for higher discount in the backdrop of slowing export orders, and the competition of exports especially in the price-sensitive RMGs. Moreover, domestic labour unrest in the RMG sector remains a concern. To mitigate the global financial crisis, the Government has already made allocation of Taka 4.50 billion in FY09 as fiscal stimulus to three export sectors namely jute, leather and frozen food. Rescheduling without necessary down payment has been allowed up to 30 September 2009 on the banker customer relationship for the affected export oriented industries especially frozen food, leather and leather products, jute and jute goods, textiles (including spinning) and RMG industry. Size of the Export Development Fund has already been raised from 100 million US dollar to 150 million US dollar. Single borrower credit limit from this fund has been increased from 1.0 million to 1.5 million US dollar. By all means, for survival in the increasingly competitive global garment trade in the midst of the global financial crisis, 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.

1.30 If the global recovery falters and the recession prolongs, the growth of workers' remittance inflows – a key driver of economic growth and poverty reduction in Bangladesh – is likely to experience a decline. The sharp and sustained decline in global oil prices coupled with financial crisis adversely affecting construction sector in Middle Eastern economies has slowed migration of workers to job markets abroad. The immigration controls in destination countries together with sporadic episodes of return of laid off migrant workers could worsen workers' remittance inflows and weaken investment momentum, dampening domestic demand and output. In avoiding prolonging of a recession, the challenge is to protect the laid-off workforce with basic subsistence safety net and opportunities of alternative employment. With the threatening risks from global recession, the FY10 budget will provide substantially larger allocations for programmes in generating additional employment in agriculture and rural sector to cover the sloth in the labour market industry and manpower export sector. The financial sector should continue to engage extensively in financing SMEs by the support of refinance from the BB for creation of new employment and output. Recently, BB has taken up special refinancing scheme of Taka 5 billion and signed an agreement with BRAC, a leading non-governmental organisation (NGO) in which sharecroppers will receive collateral-free loans for the first time.

1.31 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. The plummeting trends of global commodity prices by and large ceased in the beginning of 2009 and started to edging up, may involve some risk of exacerbating domestic inflation. The stimulus measures adopted by the Government and BB's policy measures including lowering policy rates in coping with global financial crisis may need to be revisited to exit strategies for withdrawal of supports in avoiding build-up of inflationary pressures while maintaining fiscal sustainability. Lessening of the inflationary pressure requires higher growth and increased production of essential food and other items; the government and BB has placed special emphasis on the agriculture sector in generating new employment and output; BB has made engagement in agricultural financing mandatory for all banks, with refinance support for agricultural, SME and other priority sector lending. Moreover, BB has already announced Agricultural/Rural Credit Policy and Programme for the Fiscal Year (2009-2010), targeting as so far the highest amount of Taka 115 billion for disbursement to agriculture loan. This directional bias in credit policies is also intended to enhance inclusiveness (a qualitative rather than quantitative dimension) of economic growth in reaching out to all population segments hurt by the failed markets and institutions. Environmental sustainability should be seen as another dimension of challenge, as climate change including potential changes in sea levels and local climatic conditions may pose a significant risk to longer term qualitative growth which needs attention to reduce vulnerability on the economic activities.

1.32 Initiatives to remove infrastructure inadequacies, especially the power shortages, should be taken as priority to support the near and medium term GDP growth targets and to improve external competitiveness. A comprehensive energy plan including establishment of power plant, strengthening of power transmission and distribution facilities, and implementing reforms with corporatisation and financial restructuring of power sector entities needs to be seen as the most important factors to economic development including industrialisation. Concerted and coordinated efforts by the Government, regulatory authority and the private sector would make the sector more appealing for substantial investment. Building up new capacities to generate electricity, the Government has already planned to establish some power plants under Public-Private Partnership programme announced in the FY10 national budget.

1.33 Banks in Bangladesh are still in a happy position with no episodes of bankruptcy or credit crunch. Rather than themselves needing to be bailed out, banks help the real economy in coping with the fallouts of global recession triggered by the financial tsunami. Meantime, significant progress has been made in the financial sector especially in the banking sector by strengthening competitive pressures, 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. However, considering the prevailing global economic situation, BB has instructed to the banks with mandatory rather than advisory guidance in lowering lending rates and service charges/fees in priority economic sectors. BB has also acted to heighten awareness of corporate social responsibility in the financial sector to promote the programmes for helpless population segments.

1.34 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.

1.35 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 global financial crisis which slackened the investment momentum, necessitates the investment friendly policy formulation, and legal and regulatory reforms. Recently, the World Bank in its report "Doing Business 2009" ranked Bangladesh 110 out of 181 countries in the category of Ease of Doing Business: Global Rank, but in the category of protecting investors Bangladesh was ranked at 18. To encourage increased FDI and foreign portfolio investment, and implement investment initiatives in Public-Private Partnership (PPP) for infrastructure building with a sound economic and political environment would make Bangladesh a middle income country. It may be mentioned that per capita GNI of Bangladesh has risen by about 50 percent in four years upto FY09, reaching USD 690 as of end June 2009. At this rate, reaching the middle income threshold of USD 976 should not take more than another four years, say, not beyond 2013.