External Sector

External Trade and the Balance of Payments

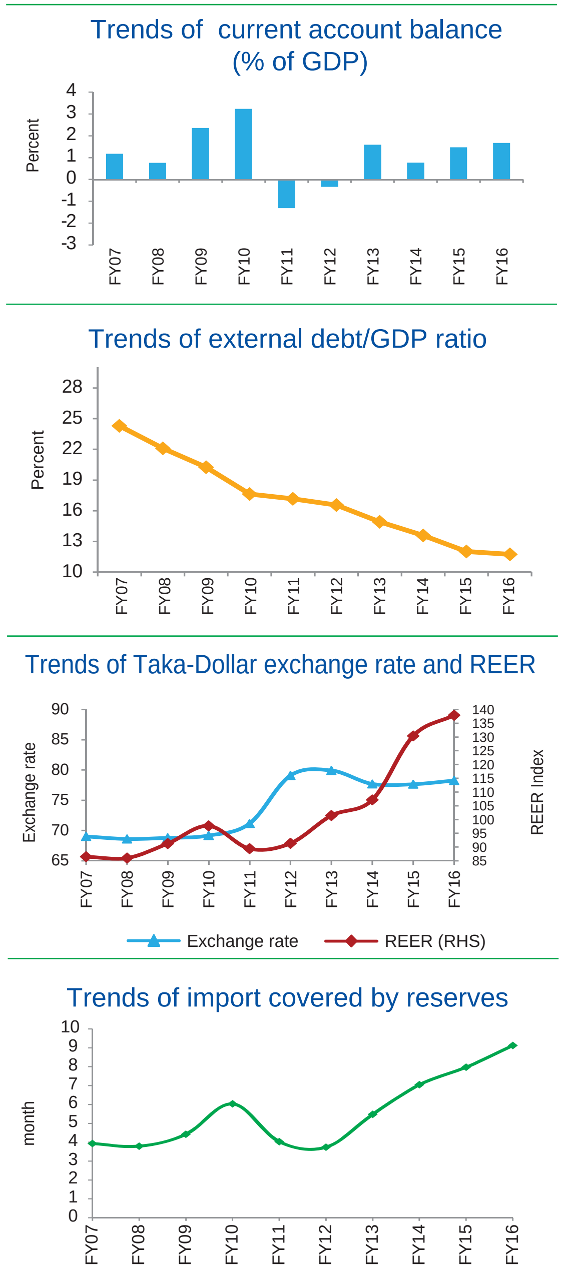
11.1 In FY16, despite a weak global economic recovery, macroeconomic performance in Bangladesh was strong, driven by buoyant performance of external sector activities. Export growth increased, while import posted a somewhat lower growth due to lower prices of food and non-food commodities (i.e., iron, cotton, coal, fertiliser, crude petroleum and soya bean oil). Consequently, the current account balance improved, further stabilising the foreign exchange market, building foreign reserves. Capital and financial account surplus decreased, but was cushioned by a strong current account balance.

11.2 Most external sector indicators (Chart 11.1) showed improvements in FY16. Current account balance as percentage of GDP stood at 1.7 in FY16 against 1.5 in FY15. External debt to GDP ratio declined further and stood at 11.7 percent. REER index appreciated by 5.6 percent but export performance held up well. The foreign exchange reserves stood at USD 30.17 billion covering around 8 months of prospective imports of goods and services.

Balance of Payment

11.3 The current account improvement stemmed from strong export earnings and a pickup in income from services. The capital and financial accounts surplus decreased

Chart 11.1 Key indicators of external sector



Source: Bangladesh Bank.

Box 11.1 Capital Account Convertibility: Bangladesh Perspective

Capital account convertibility (CAC) means freedom to convert currency both in terms of outflows and inflows for capital transactions at a market determined exchange rates. Simply, CAC means that it allows anyone to convert local currency into foreign currency or vice versa without any controls or restrictions. However, international movement of capital is not always free. Controls are used by the countries to insulate the economy from erratic flows of capital, which can lead to financial instability.

Liberalisation in capital transactions is considered as an integral part of the overall liberalisation process in developing countries. External private capital is a very important source of funds of investing in the developing economies. Fisher (1997)[1] asserts that financial integration and free capital mobility facilitate a more efficient global allocation of savings and help to channel resources into the most productive uses, and therefore, increasing economic growth and welfare. However, during the last three decades, a number of countries have opened-up their economies for being integrated with the world by loosening financial regulations to ensure capital movement freely. While, a number of countries have been much benefited by utilising and managing the flow of foreign capital successfully for their growth and development; on the other hand, some countries had to face a severe financial crises due not to manage the flow of capital efficiently. Experiences from both sides have put remarkable lessons for the countries like Bangladesh.

Bangladesh has already been undertaken some measures in liberalising capital flows together with other reforms. Since 1990s, Bangladesh embarked on a path of stepped up reforms for financial sector development and increasing openness with the global trade and financial flows towards spurring investment and output growth. Adopting market based interest rate system, significant trade and tariff liberalisation, accepting of IMF Article VIII obligation for full convertibility of Taka for current external transactions, and adopting market based exchange rate are the mentionable measures.

External capital account transactions have also been liberalised gradually to attract foreign direct investment (FDI) and foreign portfolio investment (FPI) inflows. Bangladesh permits full foreign ownership in enterprises. Foreign investors are free to invest in any sector except the few reserve sectors. They are also allowed to buy and sell government bonds, and shares and debentures through capital market activities. The amount received from the sales of equity, profits, disinvestment proceeds and capital gains on FDI and FPI are freely repatriable abroad. In addition, to the liberalisation move towards CAC, short-term borrowings from abroad by local corporate bodies have also been allowed. However, restriction still remains on outward investment by Bangladeshi investors.

Given the importance of huge investment need to become an upper middle income country by 2030, greater inflows of foreign capital is imperative. Considering the need of capital inflows for its growth path, it is likely that Bangladesh will be entering into greater liberalised regime in future. However, before that some measures should be adopted, such as i) formation of a technical committee to prepare a road map for full CAC regime, ii) cutting down the budget deficits for fiscal consolidation, iii) strengthening prudential banking regulations and standard of supervision, iv) implementation of inflation targeting framework, and v) widening the multi-financial intermediation process. It is imperative that CAC would certainly benefit us and therefore, considering the above measures, Bangladesh should move towards CAC regime gradually to achieve resilience and protect vulnerability emanating from full CAC.

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[1] Fischer, S., 1997. Capital account liberalisation and the role of the IMF. Seminar paper that was presented at the seminar 'Asia and the IMF. [online] Available at: https://www.imf.org/en/News/Articles/2015/09/28/04/53/sp091997.

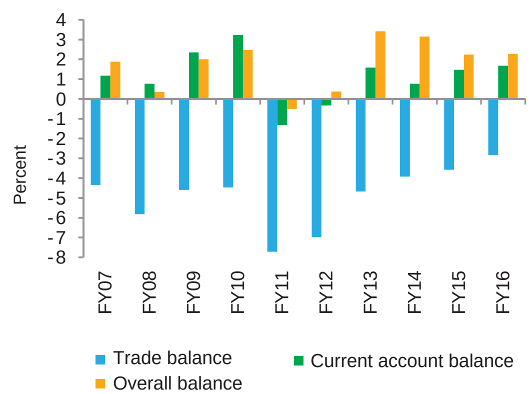
and stood at USD 478 million and USD 1610 million respectively in FY16. During the same period, overall balance recorded a surplus of USD 5036 million compared to USD 4373 million in FY15 (Chart 11.2 and Table XVI of Appendix-3.)

11.4 Trade Balance recorded a deficit of USD 6274 million during FY16 as compared to the deficit of USD 6965 million during FY15. Significant growth of gross exports along with slight import growth led to lower trade deficit. The deficit in the services account decreased by 12.3 percent to USD 2793.0 million in FY16 from USD 3186.0 million in FY15. The deficit of primary income accounts also lessened by 10.0 percent to USD 2582.0 million in FY16 from USD 2869.0 million in FY15. Secondary income decreased by 3.4 percent from USD 15895.0 million in FY15 to USD 15355.0 million in FY16. The workers' remittances recorded 3.0 percent decrease in FY16. The net outcome of all these, the current account balance increased substantially from USD 2875.0 million surplus in FY15 to USD 3706.0 million in FY16.

11.5 Foreign Direct Investment (FDI) is now an important driver of the financial account. The Government in its 7th five year plan placed strategic priority on FDI. FDI inflow increased by 9.3 percent, crossing the USD 2.0 billion mark for the first time. Portfolio investment, however, decreased significantly by 67.3 percent to USD 124 million in FY16, partly reflecting the lower yield in government securities.

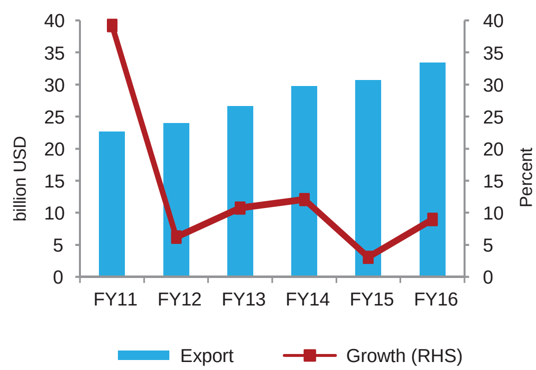
11.6 Merchandise exports (fob) increased by 8.9 percent to USD 33441.0 million and imports (fob) increased by 5.5 percent to USD 39715 million in FY16 (Chart 11.3 and 11.4). The balance of payments position is given in Table XVI of Appendix-3.

Chart 11.2 Trends of trade, current account and overall balances (percent of GDP)



Source: Bangladesh Bank.

Chart 11.3 Trends of export earnings



Source: Export Promotion Bureau.

Exports

11.7 Table 11.1 shows that export earnings increased by 9.8 percent in FY16 to USD 34257.2 million from USD 31208.9 million in FY15. Apparels (woven garments and knitwear products) constitutes the largest share of exports (above four fifths).

Box 11.2 Recent Trade Dynamics of EPZ Enterprises in Bangladesh

In order to stimulate rapid economic growth of the country, particularly through industrialisation, the government has adopted an 'Open Door Policy' to attract foreign investment to Bangladesh. The Bangladesh Export Processing Zones Authority (BEPZA) is the official organ of the government to promote, attract and facilitate foreign investment in the Export Processing Zones (EPZs). The main objectives of setting up EPZs are to boost up investment and accelerate volume of export. EPZs facilitate economic development in the form of foreign trade. It is observed that almost 50 percent industries are concentrated in CEPZ and DEPZ and remaining are operating in other EPZs. Foreign investments in EPZ areas showed an increasing trend during last two decades except for the FY09 where investments declined to USD 150 million.

As of June 2016, it is found that three fourth of investments is concentrated to CEPZ and DEPZ (68 percent) and the rest is engaged scattered in other EPZs (Chart 1). However, from FDI point of view it is found that foreign investments in EPZ areas are less than that of non-EPZ areas (Chart 2).

Chart 1: Share of investment of EPZs

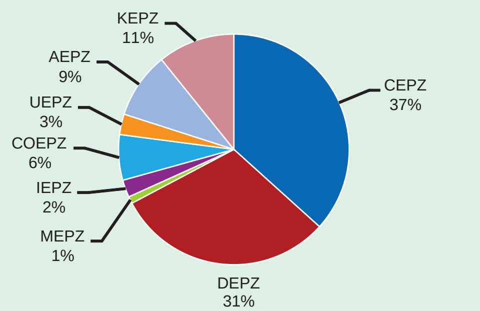
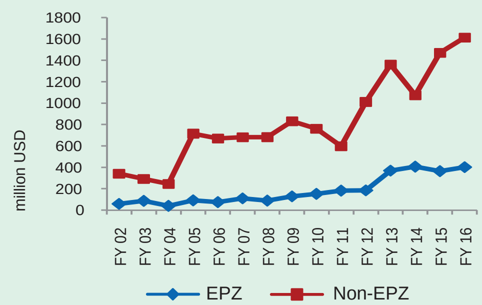


Chart 2: FDI in EPZs and Non-EPZs



The time series data also shows that FDI in EPZ areas is less volatile compared to non-EPZ areas although FDI are increasing both areas over the years (Chart 2). It is observed that 56 percent of investments belongs to 100 percent foreign owned companies, 15 percent to joint venture companies and the rest by local companies.

The Chart 3 shows that among total export from EPZs, 47 percent came from CEPZ and 39 percent from DEPZ. However, total exports from EPZs is not so significant as percent GDP (Chart 4).

Chart 3: Share of export from EPZs

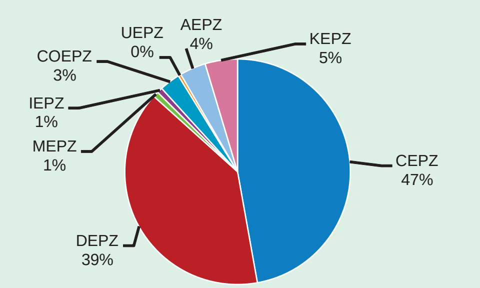
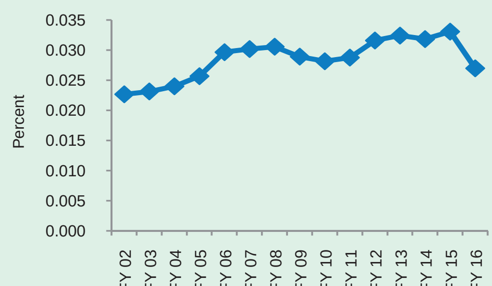


Chart 4: EPZs export as percent of GDP



Most of the industries are concentrated in CEPZ. The main reason is that port is very near and thus local transport cost is very small. Therefore, better transport facilities must be given priority while establishing a new EPZ. The EPZ needs to be seen as a strategy embracing export promotion, industrial policy and growth center. Government initiatives are needed to encourage economic cooperation between firms inside and outside the zones.

Composition of Exports

11.8 **Readymade garments (woven and knitwear):** Woven and knitwear products, which fetch about 82 percent of total export earnings, registered a strong growth from USD 25491.4 million of FY15 to USD 28094.1 million in FY16. Woven and Knitwear products grew by 12.8 and 7.5 percent in FY16 respectively.

11.9 **Leather:** Export earnings from leather and leather products increased by 3.0 percent to USD 666.1 million in FY16.

11.10 **Frozen food:** The frozen foods sector comprises mainly of shrimps. Receipt from export of shrimp and fish decreased by 7.1 percent from USD 558.8 million of FY15 to USD 519.4 million in FY16.

11.11 **Footwear:** Export earnings from footwear products increased by 6.1 percent to USD 714.0 million in FY16 from USD 673.3 million in FY15.

11.12 **Chemical Products:** Export earnings from chemical products increased by 10.5 percent to USD 123.7 million in FY16 against USD 111.9 million in FY15.

11.13 **Tea:** Export earnings from tea decreased by 30.8 percent to USD 1.8 million in FY16 as against USD 2.6 million in FY15.

11.14 **Jute goods (excluding carpets):** In FY16, export earnings from jute goods decreased by 1.4 percent to USD 746.4 million as against USD 757.0 million in FY15.

11.15 **Raw jute:** In FY16, raw jute valued at USD 173.2 million was exported, up from USD 111.6 million in FY15.

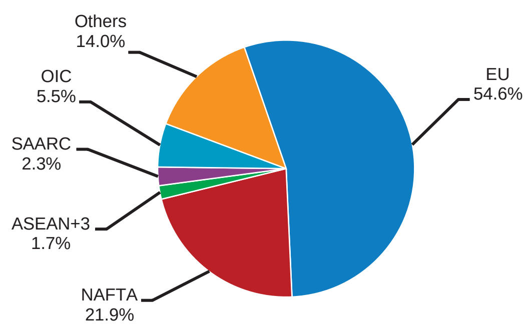
Table 11.1 Composition of merchandise exports

(million US dollar)

Items	FY15	FY16	% change
1) Raw jute	111.6	173.2	55.2
2) Jute goods	757.0	746.4	-1.4
3) Tea	2.6	1.8	-30.8
4) Leather and leather products	646.7	666.1	3.0
5) Frozen shrimps and fish	558.8	519.4	-7.1
6) Woven garments	13064.6	14738.7	12.8
7) Knitwear products	12426.8	13355.4	7.5
8) Chemical products	111.9	123.7	10.5
9) Petroleum by-product	77.6	297.0	282.7
10) Engineering products	447.0	510.1	14.1
11) Specialised textiles	107.0	108.7	1.6
12) Footwear	673.3	714.0	6.1
13) Others	2224.0	2302.7	3.5
Total:	**31208.9**	**34257.2**	9.8

Source: Export Promotion Bureau.

Chart 11.4 Destinational pattern of exports in FY16



Source: EPB.

Export Markets

11.16 One important feature of export diversification is market diversification. Bangladesh's exports now reach some 200 countries. In FY16, 54.6 percent of exports were destined for the EU bloc while 21.9 percent entered into the NAFTA bloc. Export to the ASEAN+3, OIC and SAARC countries was 1.7, 5.5 and 2.3 percent respectively of total exports in FY16 (Chart 11.4).

Export Development Fund (EDF)

11.17 The EDF commenced its operation in 1989 with the participation of International Development Association (IDA) and Government of Bangladesh (GOB), with an initial fund of USD 30.16 million to provide foreign exchange refinancing facilities to exporters. With growing exports, the size of the EDF grew too. In June 2016, the fund was enhanced to USD 2000 million. Furthermore, USD 200 million has been allocated to refinance the Green Projects. Exporters can avail EDF loan for imports against export LC/firm export contract/inland back to back L/C through Authorised Dealer (AD) banks. The EDF refinancing covers sectors like textile, garments, accessories/packaging material, plastic goods, leather goods & footwear, ceramic wares, dyed yarn, agro-food processing, bicycle, etc. At present, the single party borrower limit is set at USD 20.0 million, except leather goods & footwear, ceramic wears, dyed yarn, agro-food processing, bicycle, accessories & packaging and plastic goods manufacturer exporters. However, this limit is maximum USD 15.0 million for leather goods & footwear, ceramic wears, dyed yarn, agro-food processing, bicycle and USD 2.0 million for accessories and packaging and 1.00 million for plastic goods manufacturers. The interest rate on EDF financing facilities is six month USD LIBOR+2.5 percent. Out of that, Bangladesh Bank's portion is LIBOR+1 percent and the rest of 1.5 percent is shared by commercial banks. In general, the reimbursement from the EDF is initially made for a tenor of 180 days with a provision for further extension of 90 days, if required for delay in repatriation of related export proceeds of the exporter concerned. On a revolving basis, the total disbursement from EDF in FY16 stood at USD 3.84 billion compared to USD 3.55 billion in FY15. The outstanding balance at the end of June, 2016 stood at USD 1.69 billion which was USD 1.64 billion in the previous year.

Table 11.2 Composition of merchandise imports (based on customs records)

(million US dollar)

Items	FY15	FY16^{P}	% change
A. Food grains	**1490.6**	**1057.6**	**-29.1**
1. Rice	508.0	112.2	-77.9
2. Wheat	982.6	945.4	-3.8
B. Other food items	**2980.4**	**3511.2**	**17.8**
1. Milk & cream	277.2	215.0	-22.4
2. Spices	182.4	198.5	8.8
3.Oil seeds	374.0	532.1	42.3
4. Edible oil	923.8	1436.4	55.5
5. Pulses (all sorts)	434.3	477.5	9.9
6. Sugar	788.7	651.7	-17.4
C. Consumer and intermediate goods	**19847.6**	**20488.6**	**3.2**
1. Clinker	638.4	571.2	-10.5
2. Crude petroleum	316.0	383.9	21.5
3. POL	2075.7	2255.8	8.7
4. Chemical	1723.7	1845.3	7.1
5. Pharmaceutical products	136.9	236.2	72.5
6. Fertiliser	1338.9	1111.8	-17.0
7. Tanning & dyeing extracts	599.0	583.8	-2.5
8 Plastics & rubber articles thereof	2052.3	1942.7	-5.3
9. Raw Cotton	2295.5	2233.0	-2.7
10. Yarn	1851.2	1959.4	5.8
11.Textile & articles thereof	5742.0	6193.1	7.9
12. Staple fibre	1078.0	1172.4	8.8
D. Capital goods and others	**16385.1**	**17863.4**	**9.0**
1. Iron, steel & other base metal	3265.0	3226.7	-1.2
2. Capital machinery	3320.5	3398.5	2.3
3. Others	9799.6	11238.2	14.7
Total import (cif)	**40703.7**	**42920.8**	**5.4**
Of which EPZ	3138.1	3272.6	4.3
Total import (fob)	**37662.0**	**39715.0**	**5.5**

^{P} Provisional.
Source: Complied by Statistics Department, BB using data of NBR.

Imports

11.18 Total import in FY16 stood at USD 39715.0 million (Table 11.2) registering a positive growth of 5.5 percent compared to USD 37662.0 million in FY15. Import of food grain recorded significant negative growth of 29.1 percent (rice 77.9 percent and wheat 3.8 percent) in FY16 mainly due to decrease of rice import. Import (landed) for food grains stood at USD 1057.6 million in FY16 compared to USD 1490.6 million in FY15. Import of other food items' increased by 17.8 percent to 3511.2 million in FY16 from USD 2980.4 million in FY15. Except negative growth of milk & cream (22.4 percent) and sugar (17.4 percent), all other items showed positive growth. Consumer and intermediate goods increased by 3.2 percent to USD 20488.6 million in FY16 from USD 19847.6 million in FY15. Capital goods and others categories grew by 9.0 percent to USD 17863.4 million in FY16. Imports by EPZ increased by 4.3 percent to USD 3272.6 million in FY16 compared to USD 3138.1 million in FY15.

Terms of Trade

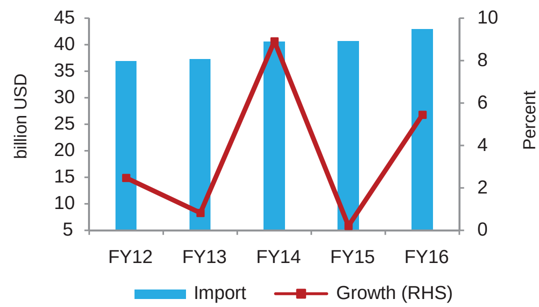
11.19 The terms of trade was 85.88 in FY16 compared to 85.86 in FY15 (base year FY06). Both the export price index and import price index increased by 7.5 and 7.4 percent respectively during the year (Table 11.3).

Bilateral and multilateral Relations

11.20 Bangladesh continued strengthening its foreign trade ties in FY16 through bilateral, regional and multilateral negotiations and agreements. Bangladesh participated in a number of key negotiations with a view to protecting the country's trade and economic interests.

11.21 Recently, Japan Committed to undertake economic cooperation under the initiative of "Bay of Bengal Industrial Growth Belt" (BIG-B). The BIG-B has emerged as important pillar of Japanese strategy in

Chart 11.5 Trends of import payments



Source: Complied by Statistics Department, BB using data of NBR.

Table 11.3 Terms of trade of Bangladesh

(base: FY06=100)

Year	Export price index	Import price index	Commodity terms of trade
FY07	104.85	103.64	101.17
FY08	116.34	131.42	88.53
FY09	125.13	140.35	89.16
FY10	132.64	148.32	89.43
FY11	146.41	166.51	87.93
FY12	151.71	176.44	85.98
FY13	163.04	189.62	85.98
FY14	172.09	200.37	85.89
FY15	182.34	212.37	85.86
FY16	195.98	228.19	85.88

Source: Bangladesh Bureau of Statistics.

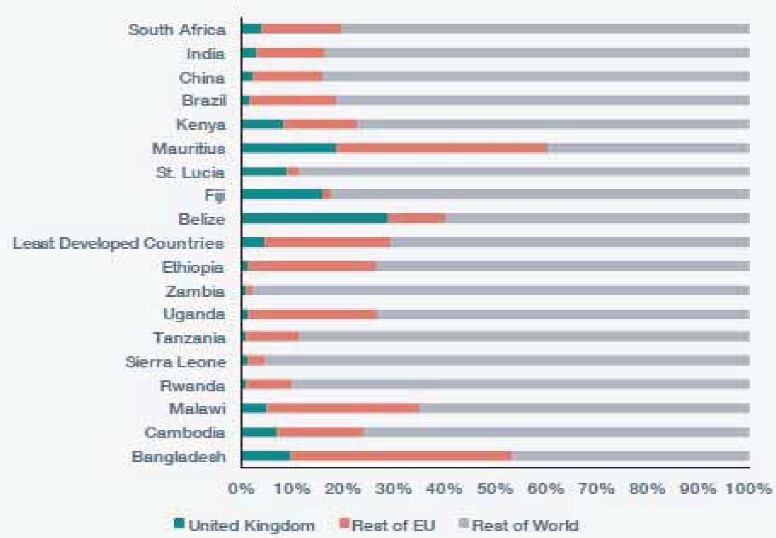
Bangladesh, covering 3 areas- Industry and Trade, Energy and the Transportation. FY16 also witnessed improvement in regional cooperation - with the ratification of the Bangladesh, Bhutan, India and Nepal Motor Vehicle Agreement (BBIN-MVA). The BBIN-MVA is expected to streamline the inter-country movement of motor vehicles carrying passengers and cargo among these nations, contributing to increased economic integration of the region. However, Bangladesh need to work on similar agreements with other regional blocs, particularly the Association for South East Asian Nations (ASEAN). This could support a higher growth trajectory.

Box 11.3 Impact of BREXIT on External Sector Performance in Bangladesh

After 43 years of membership, the UK voted to leave the European Union (EU) on 23 June 2016 creating some sort of uncertainties about the near-term outlook of the British economy. The immediate reactions were that the Britain's exit (BREXIT) from the EU would affect different countries (including the UK itself) in different ways, depending on the nature and magnitude of relationship among them. Other than the host of indirect linkages, the direct pathways of impacts are thought to be through trade, financial flows and investments, aid, migration, remittance flows and others social as well as economic connections.

Overseas Development Institute (ODI) estimates, 10% devaluation of the pound in the first week of post-BREXIT, coupled with 3% lower GDP in the UK resulting in reduction of UK's imports in the short-term. As 90 percent of Bangladeshi exports to the UK are in textiles and garments, with the UK representing 10 percent of Bangladeshi exports, it will make Bangladeshi garments and other exporters difficult to retain the current market shares. As per Mendez-Parra et al. (2016) estimates, total Bangladeshi exports are expected to fall by 0.9 percent as a result of the weaker pound. As a result of weak pound, however, Bangladeshi imports from the UK will be relatively cheaper, which may results in a relatively higher import volume from the UK.

Chart 1 Selected developing country exports by destination, 2014



Source: Mendez-Parra et al., (2016).

A slowdown in NRBs' remittances from UK due to BREXIT is also pretty much expected. At present (FY16) 5.8 percent of total remittances of Bangladesh amounting USD 863 million came from UK. Stevens & Kennan (2016) estimate that the observed devaluation of pound will reduce the value of UK aid by roughly USD 1.9 billion. The UK's contributions, (the fifth largest amount of ODA to Bangladesh at USD 342.85 million, OECD Database, 2015), might be negatively affected in near future.

Countries like Bangladesh with strong links to the UK need to be mindful of the reserve and exchange rate implications of BREXIT. Allowing domestic currencies to appreciate against the pound could harm our competitiveness and further exacerbate any capital losses that could stem from possible new UK trade arrangements. Additionally, any chance of drastic fall in the pound value might create some pressure on the stability of Bangladeshi Taka.

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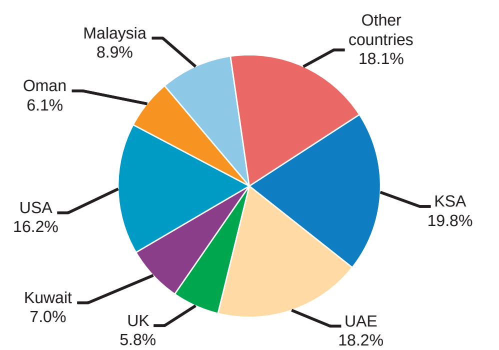
Workers' Remittance

11.22 The inflow of remittance from Bangladeshi nationals working abroad has been playing an important role in strengthening the current account balance. The remittance witnessed a fair earnings of USD 14931.16 million in FY16 which is, however, 2.52 percent lower compared to USD 15316.92 million in FY15. The shortfall of remittance is due mainly to the prolonged decline in oil prices and economic downturn in the GCC countries. Bangladesh Bank is encouraging remittance through the formal channel and working on simplifying the remittance distribution networks including easing the approval policy of drawing arrangements between foreign exchange houses abroad and domestic banks. At present, commercial banks have 1142 drawing arrangements with more than 320 exchange houses all over the world for collecting remittances. Banks are being encouraged to open new exchange houses/branch offices. Banks have already established 33 exchange houses/subsidiaries abroad to collect remittances.

11.23 Some Micro Finance Institutions (MFIs) have facilitated the delivery of inward remittances. Banks are now using the branch networks of the MFIs and Bangladesh Post Office as the sub-agent for remittance distribution. As of 30 June 2016, 26 MFIs support remittance distribution through their branches in remote areas. Banks are instructed to ensure the delivery of remittance to the beneficiaries within 2 (two) working days. Several banks are now allowed to distribute remittance using the countrywide outlets of mobile operators like Grameenphone, Banglalink and Robi. Some banks are given permission to distribute remittances through designated outlets of Singer Bangladesh Ltd.

Chart 11.6 Wage earners' remittances in FY16



Source: Bangladesh Bank.

11.24 To increase competition among the money transmitters, commercial banks have been encouraging to have contracts Multinational Money Remitters/ Exchange Houses that allow them the flexibility of choices.

11.25 Almost 20 percent remittance came from KSA, 18.2 percent from UAE and 16.2 percent from USA. The share of major source countries in the remittance receipt of FY16 are shown in Chart 11.6.

Foreign Aid

11.26 Total official foreign aid disbursement increased by 13.3 percent to USD 3450 million in FY16 from USD 3044 million received in FY15 (Table 11.4). Food aid disbursements stood at USD 32 million in FY16 which was 38 million in FY15. The disbursement of project assistance stood at USD 3418 million in FY16, which was USD 3006 million in FY15. It should be mentioned that no commodity aid was received in FY16 as in the preceding year. Total outstanding official external debt as of 30 June 2016 stood at USD 25963 million (11.7 percent of GDP in FY16) against USD 23901 million as of 30 June 2015 (12.3 percent of GDP in FY15). Repayment of official external debt stood at USD 1045 million (excluding repurchases from the IMF) in FY16, which was USD 52 million or 4.7 percent less than the repayment of USD 1097 million in FY15. Out of the total repayments, principal payments amounted to USD 842 million while interest payments stood at USD 202 million in FY16, against USD 910 million and USD 188 million respectively during FY15. The debt-service ratio as percentage of exports was 3.1 percent in FY16.

Foreign Exchange Market Operations and Exchange Rate Movements

11.27 The domestic foreign exchange market remained liquid throughout the FY16, supported by export receipts and remittance

Table 11.4 Foreign aid receipts and debt repayments*

(million US dollar)

Head of transaction	FY14	FY15^R	FY16^P
1. Receipts	**3122**	**3044**	**3450**
i) Food aid	38	38	32
ii) Project aid	3084	3006	3418
2. Repayments (MLT)	**1208**	**1097**	**1045**
i) Principal	1018	910	842
ii) Interest	190	188	202
3. Outstanding external debt as of end June	**24388**	**23901**	**25963**
4. Outstanding debt as percentage of GDP	14.1	12.3	11.7
5. External debt services (MLT) as percentage of exports	4.1	3.6	3.1

* Excluding transactions with the IMF.
^{P} Provisional, ^{R} Revised.
Source: Economic Relations Division, Ministry of Finance.

and low import growth. In FY16, inter-bank foreign exchange transactions was USD 19.0 billion (spot, forward and swap) which was slightly lower compared to USD 19.5 billion in FY15. The non-USD inter-bank foreign exchange transactions (spot, forward and swap) stood at 17.7 billion (mostly in JPY) during the same period. At the end of June 2016, exchange rate of USD against Bangladesh Taka stood at Taka 78.4, which posted a depreciation of 0.77 percentage point from a year earlier, indicating exchange rate stability. BB encourages exchange rate flexibility while reducing large market movements. In FY16, BB purchased USD 4.13 billion from local inter-bank foreign exchange market with the aim of ensuring stability of exchange rate of Taka by absorbing excess liquidity, as against USD 3.4 billion in the previous fiscal year.

Foreign Exchange Reserves

11.28 The gross foreign exchange reserves held by BB comprises foreign exchange, holdings of gold, and Special Drawing Rights (SDR). Foreign exchange reserves grew steadily (20.55 percent) over FY16, which crossed the USD 30 billion mark on 27 June 2016, hitting a new record. As of 30 June FY16, reserves stood at USD 30.17 billion. BB prioritised capital preservation while increasing returns by diversifying the foreign asset portfolio in bonds (issued by sovereign, supranational and highly reputed foreign commercial banks), Treasury Bills and Treasury Notes of US Government and in short term deposits with internationally reputed foreign commercial banks. In addition, BB opened a new window called Long Term Financing (LTF) to support manufacturing sector of the country with the financial assistance of International Development Association (IDA).

Reserve Management Strategy

11.29 BB's reserve management strategy and operational procedures broadly reflects the global market conditions and macroeconomic developments, while respecting the parameters set in the reserve management guidelines. BB's reserve management mechanism has incorporated international best practices. Currently reserve management operations are carried out following the Reserve Management Guidelines (RMG) approved by the Board of Directors of BB. Reserves are held to provide external stability, to ensure smooth external payments, and to maintain confidence in the external value of Taka. To contain counterparty risks at minimum, BB has invested its reserves with a number of internationally reputed central and commercial banks having strong credit ratings from the international rating agencies (Standard and Poor's, Moody's & Fitch).

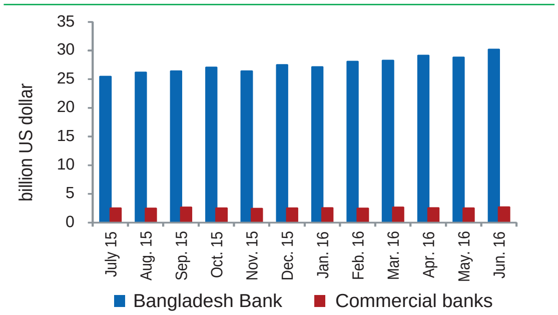
Table 11.5 Gross foreign exchange reserves of Bangladesh Bank

(End month, million US dollar)

Months	FY12	FY13	FY14	FY15	FY16
July	10381	10570	15534	21384	25469
August	10914	11435	16252	22070	26175
September	9884	11252	16155	21837	26379
October	10338	12340	17346	22313	27058
November	9285	11754	17106	21590	26408
December	9635	12751	18095	22310	27493
January	9386	13077	18119	22042	27139
February	10067	13848	19151	23032	28059
March	9579	13971	19295	23053	28266
April	10193	14829	20370	24072	29106
May	9520	14531	20268	23708	28803
June	10364	15315	21508	25025	30168

Source: Accounts and Budgeting Department, BB.

Chart 11.7 Liquid foreign exchange holdings abroad



Source: Bangladesh Bank.

11.30 With a view to minimising exchange rate risk and ensuring the value of reserves, currency composition has been diversified. Investment duration and currency benchmark, as set out in the RMG, are carefully followed to minimise interest rate risks, while reserve management and investment functions have been segregated among three independent reporting units viz., Front Office, Middle Office and Back Office to minimise operational risks. In line with the current reserve management guideline, BB has diversified its portfolio investments into gold, T-bills, repos, short-term deposits, and high-rated sovereign, supranational, and corporate bonds. BB has been maintaining a prudent and vigilant approach regarding placement of funds in banks and investments in securities of countries affected by Euro debt crisis.

Transactions under the Asian Clearing Union (ACU)

11.31 Total transactions of Bangladesh under the Asian Clearing Union (ACU) during FY16 have decreased in terms of net volume compared with the preceding year. Receipts significantly increased from ACUD 115.49 million (Taka 8.99 billion) to ACUD 127.79 million (Taka 10.02 billion) and import payments decreased from ACUD 5748.87 million (Taka 447.26 billion) to ACUD 5579.88 million (Taka 437.46 billion) with the ACU member countries during the FY16. The ACU transaction shows that Bangladesh remained a net debtor during FY16. Bangladesh's receipts and payments under ACU arrangement during the last three years are shown in Table 11.6.

Transactions with the IMF

11.32 The IMF Executive Board approved a three-year arrangement for Bangladesh under the Extended Credit Facility (ECF) in April 2012. A total amount of SDR 640.0 million is to be disbursed in seven equal installments under the facility. However, the IMF has released 6th installment (amount of SDR 182.85 million) of ECF in FY16 while the outstanding principal liabilities of ECF stood at SDR 639.96 million as on 30 June 2016. Under the PRGF loan, Bangladesh has reimbursed a total amount of SDR 26.92 million in FY16 and the outstanding principal liabilities under PRGF stood at SDR 3.36 million at the end of FY16. The total outstanding principal liabilities to the IMF stood at SDR 643.32 million at the end of FY16 and the total Service charges paid to the IMF during FY16 amounted to SDR 0.28 million (Table 11.7). Under the 14th General Review of Quotas, Bangladesh's Quota was doubled from SDR 533.30 million to SDR 1066.60 million. The Quota is fully paid and now Bangladesh's Quota to IMF stood at SDR 1066.60 million in FY16.

Table 11.6 Receipts and payments of Bangladesh under the ACU

(million US Dollar)

Head of transaction	FY14	FY15	FY16	% change
1. Receipts	79.74	115.49	127.79	10.65
(export)	(6.19)	(8.99)	(10.02)	
2. Payments	5706.90	5748.87	5579.88	(-)2.94
(import)	(443.03)	(447.26)	(437.46)	
Net: Surplus (+)/	-5627.16	-5633.38	-5452.09	(-)3.22
deficit (-)	(-436.84)	(-438.28)	(-427.44)	

1 ACUD = 1 USD; 1 USD = 78.40 Taka.
Note: Figures in parentheses indicate Taka in billion.

Table 11.7 Outstanding principal liabilities against the facilities received from the IMF

(million SDR)

Facility	Amount drawn/ purchased up to June 2016	Outstanding principal liability as of end June 2015	Instalment repayment in FY16	Outstanding principal liability as of end June 2016
PRGF, June 2003	-	30.28	26.92	3.36
ECF April 2012	182.85	457.11	-	639.96
Total	**182.85**	**487.39**	**26.92**	**643.32**

Source: Forex Reserve and Treasury Management Department, BB.

Changes in Foreign Exchange Regulations

11.33 Bangladesh Bank in its ongoing endeavor to ease the foreign exchange regulations has embarked upon the following changes during FY16.

- **Foreign Exchange Regulation (Amendment) Act, 2015:** The Foreign Exchange Regulation Act, 1947 has been amended as of 6 September 2015 by the Foreign Exchange Regulation (Amendment) Act, 2015, where (10) sections have been amended (Box 11.4).

- **Bringing gold or silver bullion/ingot by incoming passengers into Bangladesh:** BB has issued a notification allowing incoming passengers irrespective of their resident status to bring into Bangladesh gold or silver in bullion/ingot from up to the prescribed limit in terms of relevant baggage rules in force issued under the Customs Act, 1969.

- **Regarding sales of releasable cash foreign currency by Money Changers to be carried with by Hajj Pilgrims:** Money Changers have been allowed to sell releasable foreign currency of USD 1000 or equivalent other foreign currency to be carried by each Hajj pilgrim.

- **Releasing foreign exchange to the resident Bangladesh nationals intending to travel abroad without visa:** ADs have been allowed to release foreign exchange without visa to the resident Bangladesh nationals proceeding to the countries/zones with provision of visa on port entry/arrival basis upto the unused annual travel quota entitlement applicable for country concerned subject to complying with other relevant instructions. The facility will also be applicable for official visits abroad by the officials of Government/Semi-Government and Autonomous bodies. Earlier, ADs were allowed to issue upto USD 200 in such cases.

- **Deposit in foreign currency to blocked accounts abroad:** To facilitate study abroad by Bangladeshi students in permissible courses, general permission has been given to deposit foreign currency to be blocked in designated bank accounts or student accounts abroad for visa/admission processing.

- **Remittances on account of visa processing fees through international card or virtual card:** Besides traditional mode of payment, visa processing fees may be remitted through online using international cards or virtual cards.

- **Submission of TM (Travel and Miscellaneous) Form to Bangladesh Bank:** From January 2016, requirement to submit the TM (Travel and Miscellaneous) Forms and supporting documents related to such forms with the monthly/periodic returns to Bangladesh Bank by ADs have been waived by Bangladesh Bank. Presently, ADs are required to report such type of transactions properly in the Online TM monitoring System of Bangladesh Bank.

- **Long Term Financing Facility (LTFF)**: Under the financing agreement with the IDA regarding implementation of the Financial Sector Support Project (FSSP), BB will provide long term financing in foreign currency (Long Term Financing Facility- LTFF) to the eligible banks and financial institutions for on-lending/re-financing to mainly small and medium scale enterprises in the country for purchasing capital machinery and

Box 11.4 Notable Amendments of FERA 1947 through FER (Amendment) Act 2015

To update and modernize for making it more investment and business friendly, the Foreign Exchange Regulation Act, 1947 has been amended by the Parliament of Bangladesh on 6 September 2015 and the amendment has been named as Foreign Exchange Regulation (Amendment) Act, 2015. All together ten (10) sections have been amended. The main features of amendments are enumerated below:

1. **Expansion of Scope:** New amendment in FERA extends its scope to the whole of Bangladesh and applies to (a) all citizens of Bangladesh (b) all persons resident in Bangladesh and (c) all persons in the service of the People's Republic of Bangladesh wherever they may be.
2. **Inclusion of definition of some items:** Meaning/interpretation of some important items like "person, person resident in Bangladesh, current account transactions, capital account transactions, import, export, services, goods, etc. has been provided through the amendments.
3. **Permissibility of Capital account Transaction:** The amendments have empowered Government/BB to permit classes of capital account transactions as convertible.
4. **Permissibility of Current account Transaction:** The amendments have declared current account transactions as convertible.
5. **Deletion of 18A:** The amendments have phased out requirement of obtaining permission from BB by local agents acting on behalf of foreign principals under Section 18A.
6. **Simplification of requirement under 18B:** The amendments have phased out requirement of obtaining permission from BB by foreign branch, liaison office, representative office etc. under Section 18B. Those offices have to report only under the new provision
7. **Inclusion of Non-physical items and services under the purview of the Act:** The amendments have included non physical items in the definition of securities, export, import and services under supervision.
8. **Inclusion of provision for administrative fine:** Amendments have empowered BB to impose fine to ADs for violation of terms of authorisation or of general or special directions or instructions.
9. **Increase of the term of imprisonment for violation of the act:** The amendments have expanded the period of imprisonment up to 7 (seven) years from up to maximum 4 (four) years for violation of the act.
10. **Inclusion of provision to seek information regarding assets abroad:** The amendments have empowered Government or Bangladesh Bank to direct person resident in Bangladesh to make a return of their holdings of foreign exchange, foreign securities, and of any immovable property or industrial or commercial undertaking or controlled by him or in which he has any right, title or interest.
11. **Inclusion of provision to seek information from foreign nationals residing in Bangladesh:** BB has been empowered to seek information from foreign nationals residing in Bangladesh for the purpose of this act.

equipment for up-gradation, expansion or for newly set-up manufacturing industries, relocating factories to designated industrial zones, etc. with a maturity from 3 to 10 years.

- **Green Transformation Fund:** Bangladesh Bank has established a revolving fund of USD 200 million named the Green Transformation Fund (GTF) to accelerate sustainable growth in export oriented textile and leather sectors conducive to transformation of green economy in the country. ADs having required eligibility may approach BB for borrowing from the fund for their on-lending/re-financing to the ultimate borrower for importing capital machineries and accessories.

- **Taka loans to Non-Resident Bangladeshis (NRBs) working abroad:** AD banks have been allowed to extend mortgage loans in Taka to NRBs working abroad for the purpose of housing in Bangladesh subject to observance of the existing guidelines of Prudential Regulations for Consumer Financing. The housing finance facility provided to NRBs will not exceed the debt equity ratio of 50:50.

Anti-money Laundering Surveillance

11.34 Across the globe, financial sector is increasingly becoming a major target of Money Laundering (ML) operations and financial crimes due to their variety of financial services and instruments that can be used to conceal the actual source of money.

Strong Anti Money Laundering and Combating the Financing of Terrorism (AML & CFT) measures prevent money launderers from abusing financial channels.

Being the national central agency and coordinator of all kinds of AML/CFT activities, Bangladesh Financial Intelligence Unit (BFIU) has taken a number of initiatives in order to prevent Money Laundering and to combat against Terrorism Financing during FY16. Notable of them are mentioned below:

Reporting Agencies and their Regulatory Regime

- BFIU has given instruction to reporting agencies to implement automated screening mechanism for the persons and entities mentioned in the UN sanction lists and as a result, most of the banks have already implemented this instruction.

- BFIU issued a comprehensive circular regarding instructions to be followed by the DNFBP's (real estate developer, dealer in precious metals or stones, trust and company service provider and lawyer, notary, other legal professional and accountant) for the prevention of Money Laundering and Terrorist Financing on 9 July 2015.

- BFIU issued a comprehensive circular for all NGO/NPOs containing instructions to prevent ML and TF on 2 September 2015.

- BFIU issued a comprehensive circular regarding instruction to be followed by all Money Changers in Bangladesh to prevent ML and TF on 9 September 2015.

- The unit issued a comprehensive circular regarding instruction to be followed by the insurance companies for the prevention of Money Laundering and Terrorist Financing on 10 September 2015.

- BFIU issued a comprehensive circular regarding instruction to be followed by the Cooperative Societies for the prevention of Money Laundering and Terrorist Financing on 7 October 2015.
- BFIU issued a comprehensive circular regarding instruction to be followed by the capital market intermediaries (CMIs) for the prevention of Money Laundering and Terrorist Financing on 19 October 2015.
- BFIU issued Money Laundering and Terrorist Financing Risk Assessment Guidelines for Financial Institutions on 30 July 2015.
- BFIU issued Money Laundering & Terrorist Financing Risk Management Guidelines for Banks on 10 September 2015.

Receiving Suspicious Transaction Report (STR) and dissemination of the same

11.35 BFIU has received 1307 Suspicious Transaction Reports (STRs) during FY16. After analysing them, BFIU disseminated 37 reports to Anti-Corruption Commission (ACC) and Criminal Investigation Department (CID), Bangladesh Police for their necessary action. BFIU has been monitoring the status of these cases from time to time.

National Initiatives

11.36 The Money Laundering Prevention (Amendment) Act, 2012 has been issued on 26 November 2015. In this amendment, BFIU has been declared as the national central agency of Bangladesh to prevent money laundering and terrorist financing. The list of investigation agency has been widened through this amendment.

International Cooperation

11.37 Bangladesh Financial Intelligence Unit has signed 43 (till June 2016) Memorandum of Understanding (MoU) so far to exchange information related to ML/TF with FIUs of other countries, among them 8 MoU have been signed in FY16 (Australia, China, Jordan, Lebanon, Kazakhstan, Nigeria, Uzbekistan, Macau). During FY16 BFIU received 28 requests from the FIU of different countries and provided the information accordingly. BFIU also made 35 requests to the FIU of different countries.

Awareness Building Programme

11.38 Bangladesh Financial Intelligence Unit has continued its effort to create awareness among the officials of different reporting organisations. It has encouraged the banks to conduct a number of training programmes for their officials on AML/CFT in 56 districts and provided its support to make the programme successful. It has also encouraged and provided support to other reporting organisations to arrange training programmes for their officials. Besides, it has arranged workshops for other law enforcing agencies. Annual conferences for Chief Anti-Money Laundering Compliance Officer (CAMLCO) of banks, financial institutions and Insurance companies were arranged separately in FY16.

Participation in different International and local conference/meeting/workshops

11.39 For the prevention of money

laundering (ML) and combating terrorist financing (TF) and proliferation financing (PF), BFIU has been maintaining continued engagement with all the international bodies such as APG, Egmont Group, FATF and BIMSTEC to boost international efforts in this arena. Bangladesh actively participated in various international initiatives undertaken by these organisations and other foreign FIUs in FY16. Furthermore, as the main coordinating agency for preventing ML, TF and PF, BFIU actively participated in a number of local conference/ meeting/workshops arranged by other government agencies.

Mutual Evaluation of Bangladesh

11.40 In FY16, Bangladesh went through the 3rd round Mutual Evaluation (ME) process conducted by the Asia Pacific Group on Money Laundering (APG). The Mutual Evaluation process is a demonstration of the commitment of member states to implement the Financial Action Task Force's (FATF) standards and a remedy against the deficiencies identified in their systems. FATF monitors countries' progress in implementing the FATF Recommendations. Asia pacific Group on Money Laundering (APG), an FATF style regional body, enforces FATF standards on AML/CFT in Asia Pacific Region and conducts mutual evaluation for the countries in this region.

11.41 The Mutual Evaluation process has been completed successfully with the effective coordination among various ministries, divisions and agencies of the Government. Bangladesh Financial Intelligence Unit coordinated all the activities as the National Central Agency for preventing money laundering and terrorist financing. During 11-23 October 2015, APG Mutual Evaluation onsite team visited Bangladesh and conducted about 50 face to face meetings with the officials of various government agencies and ministries and with representatives of reporting agencies and other respective stakeholders. With a view to facing the onsite visit by the APG expert team in an efficient manner, throughout the year, BFIU was involved in the preparatory activities such as revision of respective acts, rules, circulars and circular letters; collection of supplementary information as per the requisition of APG assessment team.