Macroeconomic Performance and Prospects

Global Economic Outlook

1.1 The global economic growth has been somewhat disappointing. According to the IMF's latest World Economic Outlook, (WEO, October 2014), global growth in the first half of 2014 fell short from what was anticipated earlier in April 2014. Due to this sluggish performance, the IMF revised its projection for global economic growth for 2014, from 3.7 percent to 3.3 percent. The growth for 2015 is projected to 3.8 percent. In the advanced economies, growth is expected to be 1.8 percent in 2014, and rise to 2.3 percent in 2015. However, in the emerging markets and developing economies, growth is expected to be 4.4 percent in 2014 and 5.0 percent in 2015.

1.2 The projection of global economic growth has been downsized by IMF for observed weak economic performance, particularly in the United States, and a less promising outlook in a number of emerging markets. Growth rate of the United States is forecast to remain unchanged at 2.2 percent in 2014, and expected to rise to 3.1 percent in 2015. In euro area the economic performance is projected to be even more disappointing. The growth is projected to be 0.8 percent in 2014 and 1.3 percent in 2015. The economic growth in Japan is likely to be affected by consumption tax hike; as a result, growth is projected to be 0.9 percent in 2014 and decline further to 0.8 percent in 2015.

Table 1.1 Overview of the World Economic Outlook projections

(annual percentage change)

	2012	2013	Projections 2014	Projections 2015
World output	**3.4**	**3.3**	**3.3**	**3.8**
Advanced economies	1.2	1.4	1.8	2.3
United States	2.3	2.2	2.2	3.1
Euro area	-0.7	-0.4	0.8	1.3
Germany	0.9	0.5	1.4	1.5
France	0.3	0.3	0.4	1.0
Italy	-2.4	-1.9	-0.2	0.8
Spain	-1.6	-1.2	1.3	1.7
United Kingdom	0.3	1.7	3.2	2.7
Japan	1.5	1.5	0.9	0.8
Canada	1.7	2.0	2.3	2.4
Other advanced economies	2.0	2.3	2.9	3.1
Emerging market and developing economies	5.1	4.7	4.4	5.0
Emerging and developing Asia	6.7	6.6	6.5	6.6
China	7.7	7.7	7.4	7.1
ASEAN-5	6.2	5.2	4.7	5.4
South Asia				
Bangladesh	6.3	6.1	6.2	6.4
India	4.7	5.0	5.6	6.4
Pakistan	3.8	3.7	4.1	4.3
Sri Lanka	6.3	7.3	7.0	6.5
World trade volume (goods and services)	**2.9**	**3.0**	**3.8**	**5.0**
Imports				
Advanced economies	1.2	1.4	3.7	4.3
Emerging and developing economies	6.0	5.3	4.4	6.1
Exports				
Advanced economies	2.0	2.4	3.6	4.5
Emerging and developing economies	4.6	4.4	3.9	5.8
Commodity prices (U.S. dollars)				
Oil	1.0	-0.9	-1.3	-3.3
Nonfuel	-10.0	-1.2	-3.0	-4.1
Consumer prices				
Advanced economies	2.0	1.4	1.6	1.8
Emerging market and developing economies	6.1	5.9	5.5	5.6
South Asia				
Bangladesh	6.2	7.5	7.2	6.7
India	10.2	9.5	7.8	7.5
Pakistan	11.0	7.4	8.6	8.0
Sri Lanka	7.5	6.9	3.8	5.4

Source: World Economic Outlook, October 2014, IMF.

Growth in emerging markets and developing economies is projected to be modest in 2015, supported mainly by stronger domestic demand. Growth in these economies is projected to decline to 4.4 percent in 2014 from 4.7 percent in 2013 and then increase to 5.0 percent in 2015. Growth in China is projected to be 7.4 percent in 2014 due to some targeted policy measures to support activity and then decline to 7.1 percent in 2015. Growth in India is expected to pick up gradually after the postelection recovery in business environment, balancing the effect of an unfavourable monsoon on agricultural growth. An overview of the WEO October 2014 projections is reproduced in Table 1.1.

1.3 Inflation in advanced economies has generally remained below the central bank targets, indicating a continued weakening of economic activities in these economies. Consumer prices in these economies are anticipated to rise to 1.6 percent in 2014 and 1.8 percent in 2015 from 1.4 percent in 2013. Inflation has remained more or less stable in emerging markets and developing economies. It is expected to decline from 5.9 percent in 2013 to 5.5 percent in 2014 and then rise to 5.6 percent in 2015 in these economies.

1.4 World trade volume growth is projected to rise from 3.0 percent in 2013 to 3.8 percent in 2014 and then increase further to 5.0 percent in 2015. The growth rate of imports for advanced economies is expected to increase from 1.4 percent in 2013 to 3.7 percent in 2014, to 4.3 percent in 2015. However, in emerging markets and developing economies, growth rate of imports is projected to decline from 5.3 percent in 2013 to 4.4 percent in 2014, and then rise to 6.1 percent in 2015. Exports of advanced economies are expected to grow by 3.6 percent in 2014 and by 4.5 percent in 2015. The same growth in emerging markets and developing economies is expected to be 3.9 and 5.8 percent in 2014 and 2015 respectively.

1.5 The global financial system is undergoing through a number of challenging transitions in its way to greater stability. According to the Global Financial Stability Report (GFSR) of October 2014, the global economic recovery continues to rely heavily on accommodative monetary policies in advanced economies even after six years of global economic and financial crisis. Monetary accommodation remains critical in supporting the economy by encouraging economic risk taking in the form of increased real spending by households and greater willingness to invest and hire by businesses. However, prolonged monetary ease may also encourage excessive financial risk taking. Although economic benefits of monetary ease are becoming more evident in some economies, market and liquidity risks have increased to the levels that could compromise financial stability if left unaddressed. Emerging markets are more vulnerable to shocks from advanced economies, as they now absorb a much larger share of the outward portfolio investment from advanced economies. Capital markets have become more significant providers of credit since the global economic and financial crises, shifting the locus of risks to the shadow banking system. The contribution of shadow banks to systemic risks in the financial system is much larger in the United States than in Euro area and United Kingdom.

1.6 The overall balance of risks to global growth outlook is still dominated by downside risks. Risks of oil price hike, asset price decline, and further economic distress are higher due to increased geopolitical tensions prevailing in many parts of the world. Global financial markets may face a risk of rise in the long-term interest rates, particularly in USA and a reversal of recent risk spread and volatility. There is a risk of secular stagnation and low potential growth in the medium term in major advanced economies. In some advanced economies, protracted low inflation or outright deflation poses risks to activity. In some emerging market economies, especially those with domestic weakness and external vulnerabilities, the effects of the worsening of the financial conditions and negative growth could be more prolonged.

Developments in the Bangladesh Economy

1.7 The Bangladesh economy maintained the growth momentum registering a 6.1 percent growth of GDP in FY14. The growth of industry sector was lower in FY14 compared to the preceding year partly due to political problem and uncertainty. Moderate growth of agriculture sector along with satisfactory growth of services sector helped to achieve the 6.1 percent growth of the overall economy. During FY14, the average inflation showed an upward trend, mainly due to increase in food inflation although the non-food inflation declined during the same period. A cautious but inclusive growth and investment friendly monetary policy stance was implemented during FY14. Policy rates were kept unchanged due to the risks of inflationary pressure and to support economic growth. Broad money (M2) registered 16.1 percent growth in FY14 against the targeted growth of 17.0 percent and the actual growth of 16.7 percent in FY13. Total domestic credit increased from 10.9 percent in FY13 to 11.6 percent in FY14. Private sector credit growth was 12.3 percent in FY14 which was lower against the targeted growth of 16.5 percent mainly due to sluggish credit demand, political uncertainty and stringent lending practices by banks following some scams in some banks. On the other hand, the growth of credit to the public sector declined to 8.8 percent in FY14 against the target growth of 22.9 percent due to significantly lower government borrowing from the banking sector. Instead of borrowing from banks, government collected a good amount of resources through selling National Savings Certificates. Export continued to grow from 10.7 percent in FY13 to 12.0 percent in FY14. Almost imports of all items in the import basket increased last year pushing the overall growth of imports from 0.8 in FY13 to 8.9 percent in FY14.Trade deficit declined to USD 6806 million. Workers' remittances stood lower at USD 14115 million in FY14 compared to the preceding fiscal year, registering a negative growth of 1.6 percent. The current account balance showed a relatively small surplus of USD 1346 million in FY14 which is attributable to the negative growth of remittances. Supported by a significant surplus in the combined capital and financial account, the overall balance recorded a surplus of USD 5483 million in FY14. This contributed to foreign exchange reserves reaching USD 21508 million at the end of FY14, sufficient to meet over seven months of imports. In order to protect Bangladesh's external competitiveness Bangladesh Bank continued its interventions in the domestic foreign exchange market by purchasing foreign currencies as and when deemed appropriate. As a result, Taka-USD exchange rate remained stable during FY14.

Growth Performance

1.8 The growth of agriculture sector increased to 3.4 percent in FY14 from 2.5 percent in FY13 mainly due to favourable weather condition and enhanced government support. The sectoral GDP growth rates are presented in Table 1.2.

1.9 Industry sector growth fell to 8.4 percent in FY14 from 9.6 percent in FY13 due to supply disruptions and weak domestic demand caused by political unrest. The rate of growth in all sub-sectors of industry sector except construction declined in FY14 compared to FY13. The most notable decline is observed in the case of mining and quarrying sub-sectors.

1.10 Services sector growth slightly increased to 5.8 percent in FY14 from 5.5 percent in FY13. This was driven by the higher growth of education, health and social works, and public administration and defence sub-sectors. However, growth of financial intermediations, community, social and personal services sub-sectors remained unchanged. Education sub-sector performed well registering a growth of 8.2 percent in FY14 compared to 6.3 percent in FY13 (Table 1.2).

Savings and Investment

1.11 Gross fixed investment as a percentage of GDP increased marginally to 28.7 in FY14 from 28.4 in FY13 (Chart 1.1). Within gross fixed investment, public investment grew faster than the private investment. As a result, the share of public investment in GDP increased from 6.6 in FY13 to 7.3 percent in FY14, the share of private investment slightly decreased from 21.8 to 21.4 percent of GDP over the same period. The national savings rate remained unchanged during FY14, hovering at around of 30.5 percent of GDP. Domestic savings as a percent of GDP increased from 22.0 in FY13 to 23.4 in FY14, while the foreign savings declined accordingly. The domestic savings-investment gap as a percentage of GDP decreased to 5.3 in FY14 from 6.4 in FY13.

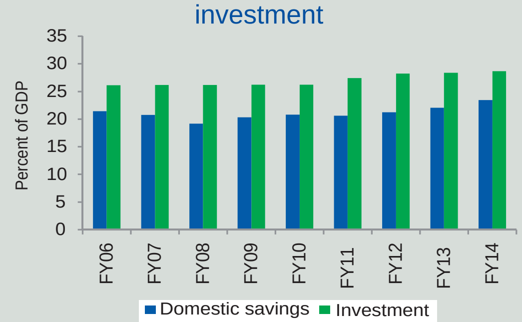
Table 1.2 Sectoral GDP growth rates

(at FY06 constant prices)

	FY06-FY14 (Average)	FY13R	FY14P
1. Agriculture	**4.4**	**2.5**	**3.4**
a) Agriculture and forestry	3.9	1.5	2.5
i) Crops and horticulture	4.0	0.6	1.9
ii) Animal farming	2.4	2.7	2.8
iii) Forest and related services	5.4	5.0	5.1
b) Fishing	6.3	6.2	6.5
2. Industry	**8.5**	**9.6**	**8.4**
a) Mining and quarrying	7.0	9.4	5.2
b) Manufacturing	9.0	10.3	8.7
i) Large and medium scale	9.3	10.7	9.2
ii) Small scale	7.7	8.8	6.6
c) Power, gas and water supply	8.7	9.0	7.4
d) Construction	7.5	8.0	8.6
3. Services	**6.0**	**5.5**	**5.8**
a) Wholesale and retail trade	6.6	6.2	6.6
b) Hotel and restaurants	6.0	6.5	6.7
c) Transport, storage and communication	8.0	6.3	6.5
d) Financial intermediations	9.8	9.1	9.1
e) Real estate, renting and other business activities	3.9	4.0	4.2
f) Public administration and defence	7.9	6.5	7.1
g) Education	7.1	6.3	8.2
h) Health and social works	5.1	4.8	5.0
i) Community, social and personal services	3.1	3.3	3.3
GDP (at FY06 constant market prices)	**6.2**	**6.0**	**6.1**

Source: Bangladesh Bureau of Statistics.
R= Revised, P= Provisional.

Chart 1.1 Domestic savings and investment



Price developments

1.12 The average inflation rate (base: FY06=100) increased to 7.4 percent at the end of FY14 from 6.8 percent at the end of FY13. Such an increase was driven by increase in food inflation, which increased from 5.2 percent at the end of FY13 to 8.6 percent at the end of FY14. On the other hand non-food inflation showed a gradual decline because of weaker domestic demand and stood at 5.5 percent in June 2014 compared with 9.2 percent in June 2013. Though average inflation went up, point-to-point inflation decreased to 7.0 percent in FY14 from 8.1 percent in FY13.

Money and Credit Developments

1.13 In FY14, Bangladesh Bank pursued a cautious but inclusive growth and investment friendly monetary policy against the backdrop of sharp growth of net foreign assets and risk of inflationary pressure. To keep the inflation at targeted level, BB continued to purse a restrained policy stance in both H1 and H2 of FY14 and policy rates namely repo and reverse repo rates were kept unchanged at H2 of FY13 level at 7.25 and 5.25 percent respectively. Besides, Bangladesh Bank increased the cash reserve ratio (CRR) by 50 basis points for banks to 6.5 percent from 24 June 2014.

1.14 Broad money (M2) recorded lower growth of 16.1 percent in FY14 against the target growth of 17.0 percent and 16.7 percent actual growth in FY13.The lower growth in broad money was attributed mainly to the lower growth in net foreign assets and public sector credit. The net foreign assets (NFA) of the banking system grew by 38.6 percent which remained high against the target growth of 9.9 percent in FY14 but low compared with 50.1 percent growth in the preceding year. Lower inflow of remittance is the main reason for it. The credit to public sector increased by 8.8 percent in FY14. The growth rate of the credit to private sector increased moderately from 10.8 percent in FY13 to 12.3 percent in FY14 against the target growth of 16.5 percent. On the other hand, the growth rate of net domestic assets (NDA) declined from 11.1 in FY13 to 11.0 percent in FY14, which was lower than the target growth of 18.6 percent. Sluggish credit demand is mainly responsible for it. Reserve Money (RM) grew at a rate of 15.4 percent in FY14 which was lower than the projected growth rate of 16.2 percent. Decline in lending by BB to the

Chart 1.2 National CPI inflation (12 month average : base FY06=100)

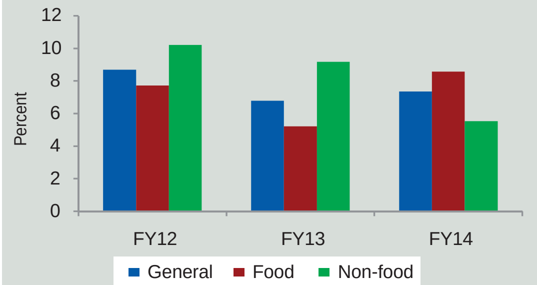


Chart 1.3 Monetary aggregates

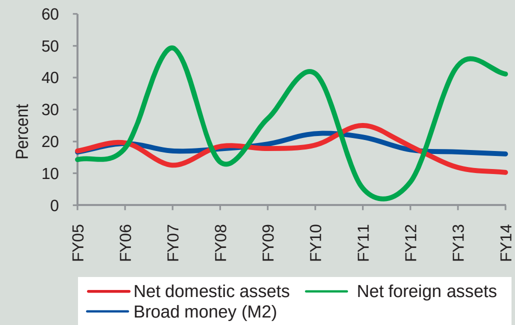
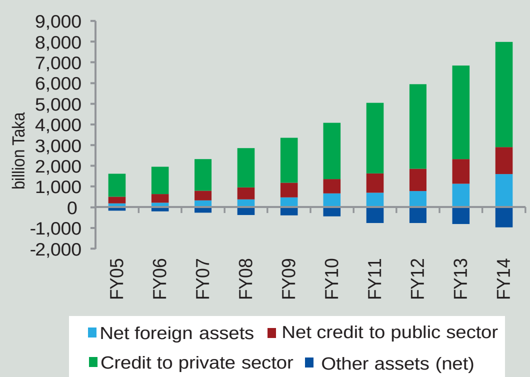


Chart 1.4 Sources of broad money (M2)



Government and the commercial banks contributed to the slower growth of RM during the year.

1.15 The income velocity of money decreased to 1.93 in FY14 from 1.99 in FY13, indicating increased financial deepening in the economy.

1.16 The weighted average interest rate on bank advances and deposits declined to 13.1 percent and 7.8 percent respectively at the end of FY14 from 13.7 percent and 8.5 percent respectively at the end of FY13. However, the spread between them widened slightly to 5.3 percent from 5.1 percent over the same period.

Public Finance

1.17 The Government had undertaken a range of regulatory and structural fiscal measures to strengthen revenue collection along with to widen fiscal space through public expenditure control.

1.18 The overall budget deficit (excluding grants) to GDP ratio increased from 3.8 percent in FY13 to 4.4 percent in FY14. However, domestic financing of the budget deficit increased slightly to 3.0 percent of GDP in FY14 from 2.8 percent of GDP in FY13.

1.19 The growth of total revenue increased from 11.7 percent in FY13 to 22.3 percent in FY14. Consequently, revenue-GDP ratio increased from 10.7 percent to 11.6 percent over the same period.

1.20 Public expenditure as a percentage of GDP increased from 14.5 percent in FY13 to 16.0 percent in FY14. It grew by 24.3 percent in FY14 compared to 14.2 percent in FY13. Current expenditure in FY14 accounted for 8.6 percent of GDP.

Chart 1.5 Revenue receipt, revenue expenditure revenue surplus and budget deficit

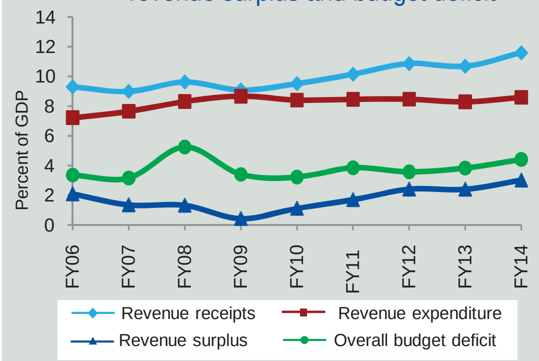
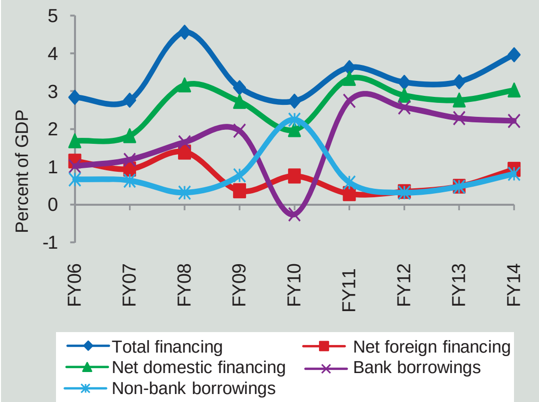


Chart 1.6 Budget deficit financing



External Sector

1.21 The export earnings (including EPZ) continued to increase from USD 26567 million in FY13 to USD 29765 million in FY14. During the same time, total import payments increased from USD 33576 million to USD 36571 million. Trade deficit declined to USD 6806 million in FY14 from USD 7009 million in FY13. The services and income account including primary income and secondary income registered a surplus of USD 8152 million. Current account balance registered a surplus of USD 1346 million in FY14, which was USD 2388 million in FY13. The capital and financial account continued to register surplus and rose to USD 3719 million in FY14 from USD 3399 million in FY13. Enhanced portfolio investment was one of the main driver of this increase. The overall balance of payments registered a surplus of USD 5483 million in FY14, implying a slight decline from the preceding year. Gross international foreign exchange reserves stood at USD 21508 million at end of FY14 representing 7.1 months of import cover.

Chart 1.7 Export and import growth

Chart 1.8 NEER, REER & exchange rate

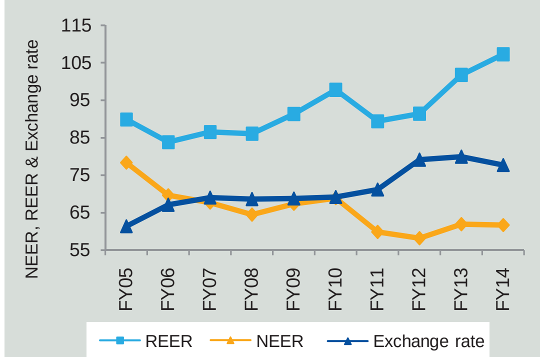
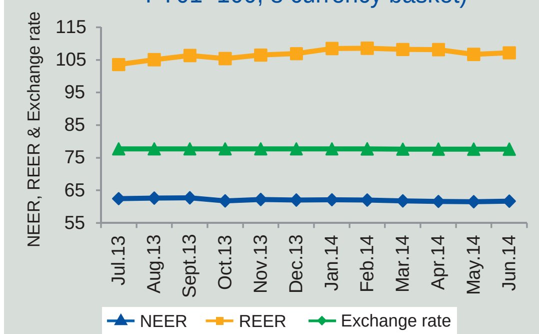


Chart 1.9 Recent movements in NEER, REER & Taka-Dollar exchange rate (base : FY01=100, 8 currency basket)



1.22 The growth of export earnings increased from 10.7 percent in FY13 to 12.0 percent in FY14. Despite this increase of growth, total export earnings as a percentage of GDP slightly decreased from 17.7 to 17.1 over the same period as nominal GDP of the country increased by more than 12.0 percent. Notwithstanding the supply chain disruptions, robust growth of export of ready-made garments continued. While shrimps, leather, knitwear, woven garments, home textile and footwear experienced a positive growth, some of the exports items like fish, petroleum by-products, raw jute, jute goods, specialised textiles and engineering products experienced a negative growth.

1.23 Import payments as a percent of GDP decreased from 22.4 in FY13 to 21.0 percent in FY14. Imports grew at a rate of 8.9 percent in FY14 compared with the 0.8 percent growth in FY13. Total import bills for all items except petroleum and fertiliser has increased in FY14 compared to FY13.

1.24 The workers' remittance inflows experienced negative growth of 1.6 percent in FY14 compared to 12.6 percent positive growth in FY13. There are indications of a reversal of this trend.

1.25 As a result of Bangladesh Bank's vigilance and interventions, the exchange rate of Taka against USD remained almost stable throughout the whole FY14. The nominal exchange rate of USD stood at Taka 77.63 as of end June 2014 compared to Taka 77.77 as of end June 2013. The nominal effective exchange rate (NEER) of Taka, calculated against a trade weighted eight currency basket (base: FY01=100), depreciated by 0.3 percent in FY14. In contrast, the real effective exchange rate (REER) of Taka appreciated by 5.6 percent in FY14 mainly because of high domestic inflation compared to most of the trading partners.

1.26 Outstanding external debt of Bangladesh increased to USD 23626.6 million as of end FY14 from USD 22381.4 million as of end FY13. However, the outstanding debt GDP ratio declined to 13.6 from 14.9 over the same period.

Near and Medium Term Outlook for Bangladesh Economy

1.27 The prospects of the Bangladesh economy over the near and medium terms are reasonably good. The strong domestic demand base, gradually improving investment climate, decreasing uncertainty and reduced inflation are expected to lead to better economic performance. GDP growth is expected to pick up between 6.2 to 6.5 percent in FY15 keeping inflation at a reasonable level provided that macroeconomic policies must continue to support sustained expansion in agriculture and industry together with large investment in infrastructure while striving to enhance government revenue collection.

The risks of high inflation include global food price volatility, any shocks to domestic crop production and the knock-on impact of upward adjustments in public sector wages. Fiscal-monetary coordination will continue and the track record of containing Government borrowing well within budgetary limits is expected to continue. As such there is no risk of crowding out of private sector credit flow.

Bangladesh Bank will continue to focus on containing inflation to its target level of 6.5 percent while providing sufficient space in its monetary programme for lending to activities which support broad-based investment and inclusive growth objectives.

Bangladesh Bank is considering to adopt some macroprudential tools such as countercyclical capital buffer and dynamic provisioning to address pro-cyclicality which would give protection to the banks against a possible downturn that could result from build-up of systemic risks. Besides, Bangladesh Bank will continue strengthening financial supervision within the approach of Integrated Supervision while avoiding regulatory forbearance.

Efforts have been continued to maintain the country's external sector stability. Further build up in foreign exchange reserves in FY15 will continue at a more moderate pace than FY14. BB will continue to support a market-based exchange rate regime while seeking to avoid excessive exchange rate volatility.

Although restrictions in major host countries leading to a reduction in migrant workers outflows resulted in decline of remittance inflows during FY14, it is expected that remittances will increase in FY15. Government is trying to send more people with the help of recruiting countries. Bangladesh Bank projects a 12 and 15 percent growth of export earnings and import bills respectively during FY15. Bangladesh's aspiration to become a middle income country by 2021 is likely to be possible if there is good governance in financial and fiscal fronts, political stability and development of infrastructural facilities.