

Macroeconomic Performance and Prospects

Global Economic Outlook

1.1 Global growth is expected to be tepid at 3.1 percent in 2016, down from 3.2 percent in 2015 (World Economic Outlook, October 2016). Growth, however, is projected to rise up to 3.4 percent in 2017. Advanced economies are expected to grow by 1.6 percent in 2016, 0.5 percentage points lower than in 2015, edging up to 1.8 percent in 2017. However, emerging markets and developing economies are projected to grow by 4.2 percent in 2016, 0.2 percentage points higher than in 2015, rising further to 4.6 percent in 2017.

1.2 The downward growth revisions in advanced economies reflect a deterioration of economic activities in Euro zone following the exit process of UK from EU (Brexit) and its subsequent impact on the US and the Japanese economies. US growth is expected to decrease to 1.6 percent in 2016 from 2.6 percent in 2015 and increase to 2.2 percent in 2017. Reflecting the adverse impact from Brexit, growth in the Euro area has been revised downward to 1.7 percent and 1.5 percent in 2016 and 2017 respectively from 2.0 percent in 2015. Japan is projected to grow by 0.5 percent in 2016 as in 2015 and is expected to grow by 0.6 percent in 2017.

1.3 The growth in emerging market and developing economies in 2016 is expected to improve as a result of buoyant economic

Table 1.1 Overview of the World Economic Outlook projections

	(annual percentage change)		Projections	
	2014	2015	2016	2017
World output	3.4	3.2	3.1	3.4
Advanced economies	1.9	2.1	1.6	1.8
United States	2.4	2.6	1.6	2.2
Euro area	1.1	2.0	1.7	1.5
Germany	1.6	1.5	1.7	1.4
France	0.6	1.3	1.3	1.3
Italy	-0.3	0.8	0.8	0.9
Spain	1.4	3.2	3.1	2.2
United Kingdom	3.1	2.2	1.8	1.1
Japan	0.0	0.5	0.5	0.6
Canada	2.5	1.1	1.2	1.9
Other advanced economies	2.8	2.0	2.0	2.3
Emerging market and developing economies	4.6	4.0	4.2	4.6
Emerging and developing Asia	6.8	6.6	6.5	6.3
China	7.3	6.9	6.6	6.2
ASEAN-5	4.6	4.8	4.8	5.1
South Asia				
Bangladesh	6.3	6.8	6.9	6.9
India	7.2	7.6	7.6	7.6
Pakistan	4.1	4.0	4.7	5.0
Sri Lanka	4.9	4.8	5.0	5.0
World trade volume (goods and services)	3.9	2.6	2.3	3.8
Imports				
Advanced economies	3.8	4.2	2.4	3.9
Emerging and developing economies	4.5	-0.6	2.3	4.1
Exports				
Advanced economies	3.8	3.6	1.8	3.5
Emerging and developing economies	3.5	1.3	2.9	3.6
Commodity prices (U.S. dollars)				
Oil	-7.5	-47.2	-15.4	17.9
Nonfuel	-4.0	-17.5	-2.7	0.9
Consumer prices				
Advanced economies	1.4	0.3	0.8	1.7
Emerging market and developing economies	4.7	4.7	4.5	4.4
South Asia				
Bangladesh	7.0	6.4	6.7	6.9
India	5.9	4.9	5.5	5.2
Pakistan	8.6	4.5	2.9	5.2
Sri Lanka	3.3	0.9	4.1	5.3

Source: World Economic Outlook, October 2016, IMF.

activities in leading Southeast and South Asian countries, modest recovery of oil prices, contained asset price and exchange rate after the Brexit referendum and despite some growth moderation in China. Chinese growth

is revised downward to 6.6 percent in 2016 and 6.2 percent in 2017, from 6.9 percent in 2015. India's economic growth in 2016 and 2017 is expected to continue at 7.6 percent.

1.4 Consumer prices in advanced economies are expected to increase by 0.8 percent in 2016 from 0.3 percent in 2015 and then by 1.7 percent in 2017. On the other hand, consumer prices in emerging markets and developing economies are expected to decrease to 4.5 percent in 2016 from 4.7 percent in 2015 due to the declining oil and other commodity prices. It is projected to further decline to 4.4 percent in 2017.

1.5 World trade volume growth is projected to decrease from 2.6 percent in 2015 to 2.3 percent in 2016 and then increase to 3.8 percent in 2017. Trade balances in advanced economies are expected to deteriorate in 2016 and 2017 since export growth is projected to be weaker than import growth; while those in emerging markets and developing economies are expected to improve in 2016, but deteriorate in 2017. The growth rate of imports for advanced economies is expected to decrease from 4.2 percent in 2015 to 2.4 percent in 2016 and increase to 3.9 percent in 2017. In emerging markets and developing economies, growth rate of imports is projected to increase from negative 0.6 percent in 2015 to 2.3 percent in 2016, and rise further to 4.1 percent in 2017. Exports of advanced economies are expected to grow by 1.8 percent and 3.5 percent in 2016 and 2017 respectively while those of emerging markets and developing economies are expected to grow by 2.9 percent and 3.6 percent respectively during the same period.

1.6 According to Global Financial Stability Report (GFSR) of October 2016, short-term risks have moderated in the past few months as markets have shown resilience to a number of shocks. Pressures on emerging market assets have eased, helped by firmer commodity prices, reduced uncertainty in leading emerging markets, and expectations of lower interest rates in advanced economies. However, medium-term risks are rising in a new environment of increased political and policy uncertainty. Expectations for monetary normalization in advanced economies have shifted even further into the future, and weak growth and low interest rates are increasing the challenges for banks, insurers, and pension funds. Although most advanced economy bank balance sheets are robust, sustainable profitability is weak, reflecting unresolved legacy problems and bank business model challenges. Corporate leverage in many emerging market firms has peaked at high levels, and debt servicing capacity remains weak. These developments have complicated the outlook for attaining a more balanced and potent policy mix, and could lead to a prolonged era of economic and financial stagnation.

1.7 According to October 2016 WEO, downside risks continue to dominate. As global growth remains sluggish, the prospect of an extended shortfall in private demand leading to permanently lower growth and low inflation becomes ever more tangible, particularly in some advanced economies where balance sheets remain impaired. At the same time, a protracted period of weak inflation in advanced economies risks

unmooring inflation expectations, causing expected real interest rates to rise and spending to decline, eventually feeding back to even weaker overall growth and inflation. Though financial conditions in emerging markets have continued to improve in recent months, underlying vulnerabilities (including high corporate debt, declining profitability, and weak bank balance sheets in some cases) remain among some large emerging market economies. In addition a range of additional noneconomic factors such as drought, war and conflict, terrorist activities, famine, resurgence of refugees, etc. continues to influence the outlook in various regions. If these factors intensify, they could collectively take a large toll on market sentiment, hurting demand and activity.

Developments in the Bangladesh Economy

1.8 Bangladesh economy grew by 7.1 percent, exceeding the 7.0 percent growth target and the 6 percent growth trajectory. This strong growth was mainly supported by industry and services sectors. Annual average CPI inflation continued to decline to 5.9 percent in June 2016, below the target of 6.2 percent. The declining trend in average CPI inflation is mainly driven by favourable food inflation.

1.9 In FY16, Bangladesh Bank implemented a cautious but pro-growth monetary policy stance that promotes investments through the strategy of selective easing to support the 7 percent growth target and the 6.2 percent inflation target. Both the targets were fulfilled in FY16. In the H2 of FY16, BB lowered the policy rates by 50 basis points. Market interest rates moderated,

Table 1.2 Sectoral GDP growth rates

(at FY06 constant prices)			
	FY07-FY16 (average)	FY15 ^R	FY16
1. Agriculture	4.1	3.3	2.8
a) Agriculture and forestry	3.5	2.5	1.8
i) Crops and horticulture	3.4	1.8	0.9
ii) Animal farming	2.6	3.1	3.2
iii) Forest and related services	5.3	5.1	5.1
b) Fishing	6.3	6.4	6.1
2. Industry	8.6	9.7	11.1
a) Mining and quarrying	7.9	9.6	12.8
b) Manufacturing	9.1	10.3	11.7
i) Large and medium scale	9.5	10.7	12.3
ii) Small scale	7.5	8.5	9.1
c) Electricity, gas and water supply	8.5	6.2	13.3
d) Construction	7.5	8.6	8.6
3. Services	5.9	5.8	6.3
a) Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	6.7	6.4	6.5
b) Hotel and restaurants	6.3	6.8	7.0
c) Transport, storage and communication	7.6	6.0	6.1
d) Financial intermediations	7.3	7.8	7.7
e) Real estate, renting and other business activities	4.0	4.4	4.5
f) Public administration and defence	8.6	9.8	11.4
g) Education	7.6	8.0	11.7
h) Health and social works	5.4	5.2	7.5
i) Community, social and personal services	3.2	3.3	3.3
GDP (at FY06 constant market prices)	6.2	6.6	7.1

^R Revised.

Source: Bangladesh Bureau of Statistics.

reflecting policy support and liquidity conditions.

1.10 Export grew by 8.9 percent, while import by 5.5 percent in FY16. Remittances, however, ended up with a negative growth of 3.0 percent during the same period. The current account surplus of USD 3.7 billion led to an overall balance of USD 5.0 billion, building net foreign assets.

1.11 Import benefitted from subdued global commodity prices. Despite some initial competitiveness concerns from appreciation in REER, exports held up well, despite weak external demand. Support mechanisms like low cost export development fund (EDF) financing for input imports and cash incentives provide some cushion to

competitiveness. Foreign exchange reserves reached USD 30.2 billion at the end of FY16, around 8 months of prospective import. Bangladesh Bank tried to smooth out any large fluctuations in the exchange rate and nominal Taka-USD exchange rate remained broadly stable.

Growth Performance

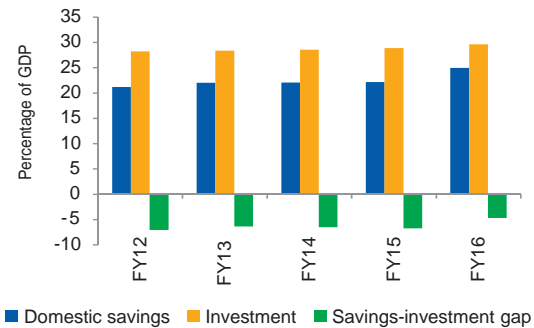
1.12 According to estimates released by the Bangladesh Bureau of Statistics (BBS), the economy grew by 7.1 percent during FY16, compared to 6.6 percent in FY15. The sectoral GDP growth is presented in Table 1.2.

1.13 Agriculture accounts for 15.4 percent of GDP and grew by 2.8 percent in FY16, down from 3.3 percent in FY15 and 4.4 percent in FY14, due mainly to weaker growth in crops and horticulture sub-sector.

1.14 Industry accounts for 31.5 percent of GDP and grew by 11.1 percent in FY16, up from 9.7 percent in FY15, driven by manufacturing sector (contributed 7.8 percentage points to the growth of industry sector), particularly large and medium enterprises.

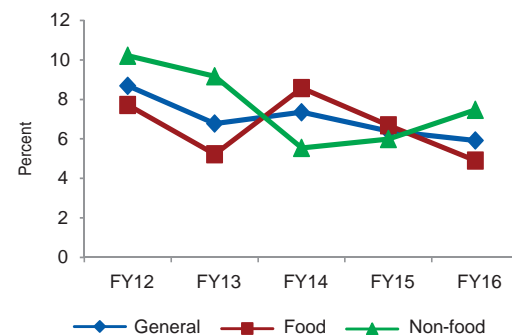
1.15 The services sector holding the largest share (53.1 percent of GDP) grew by 6.3 percent in FY16, compared to 5.8 percent in FY15. The growth of two major services components—wholesale and retail trade repair of motor vehicles, motorcycles, and personal and household goods; and transport, storage and communication largely contributed (1.7 and 1.3 percentage points respectively) to the overall service sector growth. Moreover, public administration and defence; and education sub-sectors grew markedly by 11.4

Chart 1.1 Domestic savings and investment



Source: Bangladesh Bureau of Statistics.

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



Source: Bangladesh Bureau of Statistics and Bangladesh Bank.

and 11.7 percent, respectively. In addition, health and social works; hotel and restaurants; and real estate, renting and other business activities subsectors grew faster in FY16.

Savings and Investment

1.16 Investment as a share of GDP increased at a slower pace in recent years. It improved marginally to 29.7 percent in FY16 from 28.9 percent in FY15 (Chart 1.1). The share of private investment in GDP rose from 22.1 percent in FY15 to 23.0 percent in FY16. In contrast, the share of public investment in GDP declined a little bit from 6.8 to 6.7 percent over the same period.

1.17 The national savings as percentage of GDP improved from 29.0 percent in FY15 to 30.8 percent in FY16. Domestic savings as percentage of GDP also improved from 22.2 to 25.0 percent over the same period. Since domestic savings grew faster than investment, the domestic savings-investment gap as percentage of GDP narrowed to 4.7 percent in FY16 from 6.7 percent in FY15.

Price developments

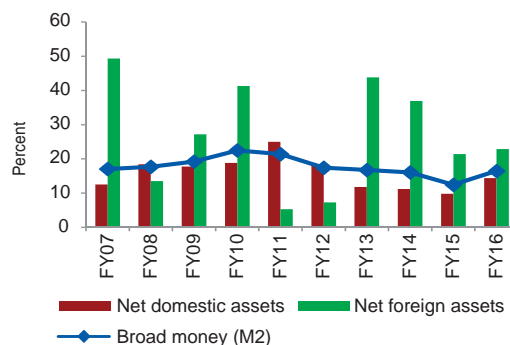
1.18 Average inflation in Bangladesh has declined gradually over the last couple of years. Inflation, which was 7.4 percent at the end of FY14, gradually fell to 5.9 percent at the end of FY16. This decline was mainly attributed to the falling food prices, which more than offset the uptick in non-food prices. Food inflation has gradually come down to 4.9 percent at the end of FY16 from 8.6 percent at the end of FY14. On the other hand, nonfood inflation went up from 5.5 to 7.5 percent over the same period. On the contrary, core inflation, which excludes food and fuel components from the CPI basket, rose from 6.3 percent in July 2015 to 8.0 percent in June 2016.

Money and Credit Developments

1.19 In FY16, Bangladesh Bank pursued a cautious but inclusive and growth supportive monetary policy stance in line with targets of 7.0 percent real GDP growth and 6.2 percent annual average CPI inflation. In the H2 of FY16, BB lowered the policy rates—repo and reverse repo rates by 50 basis points to 6.75 and 4.75 percent respectively.

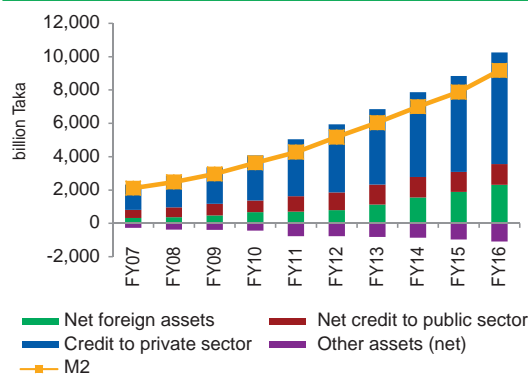
1.20 Broad money (M2) recorded a higher growth of 16.3 percent in FY16 against the

Chart 1.3 Monetary aggregates (growth in percent)



Source: Monetary Policy Department, Bangladesh Bank.

Chart 1.4 Sources of broad money (M2)



Source: Monetary Policy Department, Bangladesh Bank.

targeted growth of 15.0 percent and 12.4 percent actual growth in FY15. The higher growth in broad money is primarily driven by net foreign asset (NFA). NFA grew by 22.8 percent in FY16 against the target of 11.1 percent, and 21.3 percent actual growth in FY15.

1.21 Domestic credit from the banking system grew by 14.3 percent, below the targeted growth of 15.5 percent for FY16 but higher than the actual 10.1 percent growth in FY15. The lower than targeted growth in domestic credit resulted from the lower public sector credit growth, reflecting public

financing mostly through NSD saving instruments and higher profits by state owned Bangladesh Petroleum Corporation (BPC).

1.22 Private sector credit grew by 16.8 percent in FY16, above the targeted growth of 14.8 percent and actual the growth of 13.2 percent in FY15. Lower lending rate, foreign financing facilities, and political stability contributed to higher growth against the target of private sector credit. Resultantly, the growth rate of net domestic assets (NDA) of the banking system stood at 14.3 percent in FY16 against the target of 16.2 percent and actual growth of 9.9 percent in FY15.

1.23 Reserve Money (RM) grew by 30.1 percent in FY16 which was higher than the projected as well as actual growth of 14.3 percent in FY15, reflecting accumulation of foreign assets.

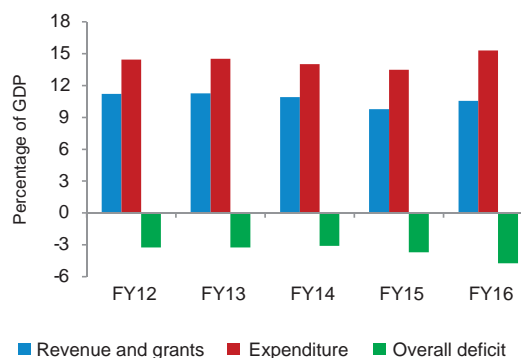
1.24 The weighted average interest rate on both bank advances and deposits declined to 10.39 percent and 5.54 percent at the end of FY16 from 11.67 percent and 6.80 percent respectively at the end of FY15. The spread also narrowed slightly to 4.85 percent from 4.87 percent over the same period. Access to foreign financing facilities at lower rate, the policy rate and liquidity supported the rates.

Public Finance

1.25 The Government has continued to pursue a prudent fiscal policy stance with a view to ensuring macroeconomic stability and sustainable growth. Government has undertaken a wide range of reforms to streamline revenue collection and expenditure management.

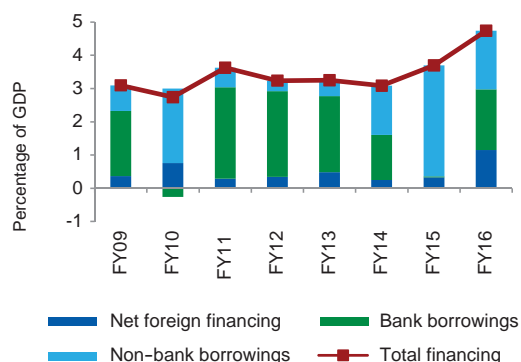
1.26 According to the revised National Budget for FY16, the overall budget deficit

Chart 1.5 Revenue, expenditure and overall budget deficit (as percentage of GDP)



Source: Ministry of Finance.

Chart 1.6 Budget deficit financing



Source: Ministry of Finance.

(excluding grants) as percentage of GDP increased from 3.9 percent in FY15 to 5.0 percent in FY16. The overall budget deficit (including grants) of 4.7 percent of GDP was largely financed by domestic sources, contribution of which increased to 3.6 percent of GDP in FY16 from 3.4 percent of GDP in FY15. The Government's financing from banking system increased from 0.03 percent of GDP in FY15 to 1.8 percent of GDP in FY16, while financing from non-bank sources dropped significantly from 3.3 to 1.8 percent of GDP over the same period (Chart 1.5).

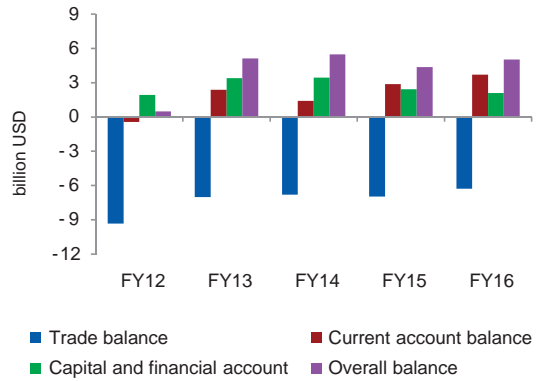
1.27 The growth of total revenue registered a sharp increase from 4.0 percent in FY15 to 21.5 percent in FY16 mainly benefiting from significant expansion of NBR tax revenue, but it remained below the annual target stipulated in the revised budget for FY16. Consequently, revenue-GDP ratio increased from 9.6 percent to 10.2 percent over the same period. Total revenue and grants as a share of GDP improved to 10.5 percent in FY16 from 9.8 percent in FY15.

1.28 Public expenditure as percentage of GDP increased from 13.5 percent in FY15 to 15.3 percent in FY16. It grew by 29.5 percent in FY16 compared to 8.6 percent in FY15. Current expenditure in FY16 stood at 8.7 percent of GDP which was 7.9 percent in FY15.

External Sector

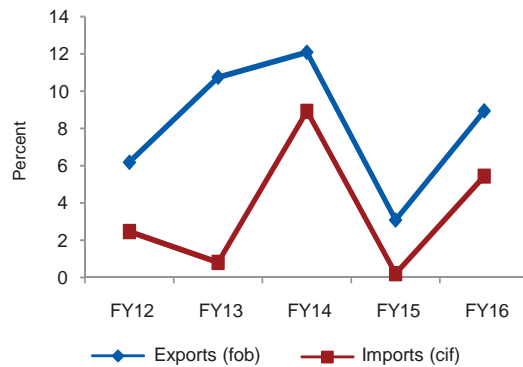
1.29 Exports grew faster than imports in recent years. Exports stood at USD 33441 million in FY16 from USD 30697 million in FY15. During the same period the total import payments also increased to USD 39715 million from USD 37662 million. As export grew more than import, trade deficit shrank to USD 6274 million from USD 6965 million over the same period. The services and income account including primary income and secondary income registered a surplus of USD 9980 million. Current account surplus widened to USD 3706 million in FY16 from USD 2875 million in FY15. The capital and financial account surplus narrowed to USD 2088 million in FY16 from USD 2421 million in FY15. The overall balance of payments registered a surplus of USD 5036 million in

Chart 1.7 Balance of payment



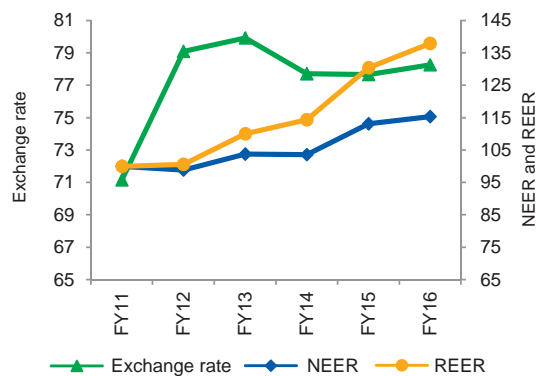
Source: Statistics Department, Bangladesh Bank.

Chart 1.8 Export and import growth



Source: Statistics Department, Bangladesh Bank.

Chart 1.9 NEER, REER and Exchange rate



Source: Monetary Policy Department, Bangladesh Bank.

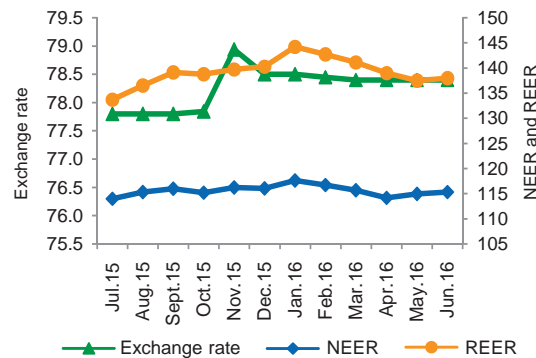
FY16, which was USD 4373 million in FY15. Gross international foreign exchange reserves stood at USD 30168 million at the end of FY16 representing around 8 months of prospective import coverage.

1.30 The growth of export earnings showed an improvement of 8.9 percent in FY16 from 3.1 percent in FY15, although it as percentage of GDP decreased marginally to 15.1 from 15.7 over the same period. Manufactured goods were the main drivers for such higher growth. Among the major sectors of exports, woven garments and knitwear (representing 84.9 percent of total export) petroleum by-products, raw jute, engineering products, vegetables, footwear supported overall export performance in FY16 while shrimps, tobacco, fruits, cut flower, fish and home textile slowed down the pace of that performance.

1.31 Import payments as a percentage of GDP decreased from 19.3 in FY15 to 17.9 in FY16 for the third consecutive year. Imports grew at a rate of 5.5 percent in FY16 compared with the 3.0 percent growth in FY15. Total import bills for edible oil, textile & textile articles thereof, oil seeds, POL, pharmaceutical products, chemicals, yarn, staple fibre, crude petroleum and capital machinery rose in FY16 compared to FY15 while those for the food grains (rice and wheat), fertiliser, sugar, plastic and rubber articles thereof, clinker, milk & cream, raw cotton and iron, steel & other base metals declined during the same period.

1.32 Remittance inflows declined by 3.0 percent at the end of FY16 compared with the positive growth of 7.5 percent in FY15.

Chart 1.10 Recent movements in NEER, REER and Taka-Dollar Exchange Rate (base : FY11=100, 10 currency basket)



Source: Monetary Policy Department, Bangladesh Bank.

1.33 Bangladesh Bank (BB) follows a managed float regime, smoothing out large day-to-day fluctuations. The policy has contributed to the relative stability of the exchange rate. As of end of FY16, Taka had recorded a slight depreciation of 0.77 percent against USD. It stood at Taka 78.40 as of end June 2016 compared to Taka 77.80 as of end June 2015. The nominal effective exchange rate (NEER) of Taka, calculated against a trade weighted 10 currency basket (base: FY11=100), appreciated by 1.95 percent in FY16. The real effective exchange rate (REER) of Taka also appreciated by 5.76 percent in FY16.

1.34 Outstanding external debt stock of Bangladesh increased to USD 25962.7 million as of end of FY16 from USD 23901.0 million as of end of FY15. However, the outstanding debt GDP ratio declined to 11.7 percent from 12.3 percent over the same period.

Near and Medium-Term Outlook for Bangladesh Economy

1.35 The near- and medium-term outlook for Bangladesh economy looks positive,

supported by higher domestic and foreign investments, buoyant trade, capital inflows and favorable inflationary environment.

1.36 Global economic prospects remain sluggish and growth has been revised downward, particularly for the advanced countries (WEO, October 2016). Most of the macroeconomic indicators in Bangladesh are performing well and domestic demand remain buoyant. In recent months, prompt actions taken by the Bangladesh Government in the aftermath of the terrorist attacks in July 2016 helped restore investor confidence. Nonetheless, any fallout from the weaker external demand from a mediocre global growth needs to be closely monitored.

1.37 In 2015, Bangladesh reached the lower middle income country status, and expects to reach upper middle income countries by 2030 or earlier. The government's focus on easing infrastructure bottlenecks and improving business climate would support potential growth and medium-term growth performance. The government's prudent fiscal policy, accompanied by the Bangladesh's Bank monetary policy and effective supervision are expected to support macro-financial stability.

1.38 Aided by pragmatic policy support from the Bangladesh Government and Bangladesh Bank, the low and stable inflation

accompanied by a macroeconomic environment helped Bangladesh become a role model of sustainable finance. In this regard, banks and financial institutions are playing a significant role by providing credit to the un-banked, un-served and underserved people, particularly women supported by the low cost refinance windows of Bangladesh Bank for Micro, Small and Medium Enterprises (MSMEs) output initiatives and eco-friendly green projects. These policies would make finance and growth more sustainable.

1.39 Looking ahead, in FY17 domestic credit is projected to grow by 16.4 percent (y-o-y) with private sector credit growing by 16.5 percent and credit to the public sector by 15.9 percent. In FY17 imports are projected to grow by 8.5 percent, exports by 8.5 percent and remittances by 10 percent. The foreign exchange reserves are projected to reach USD 33.04 billion or higher in FY17 from USD 30.17 billion in FY16.

1.40 From a macro perspective, domestic demand growth is expected to remain robust over the near and medium-term reflecting demographics, investments, and improving infrastructure and cost of doing business. Furthermore, favorable monetary conditions would likely support growth but economic spillovers from weaker external demand need to be closely monitored.