DEBT SUSTAINABILITY ANALYSIS: THE BANGLADESH CASE

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Outline

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I. Macroeconomic Assumptions

- Real GDP growth of around 6½ percent is above the recent historical average of 5.3 percent, but slightly lower than the PRSP projections
- The GDP deflator in US dollar terms increases at around 2 percent
- Imports and exports grow slightly as a share of GDP
I. Macroeconomic Assumptions (cont.)

- The current account balance declines from 1 to -2 percent of GDP to fund investment.
- Net aid inflows increase from 1.2 to 2 percent of GDP, but the share of grants declines.
- The primary deficit as a share of GDP remains close to the historical average.
- The real interest on domestic debt increases slightly to around 4 percent.
II. External Debt Sustainability Analysis

A. Baseline Scenario

- All debt indicators decline over the projection period
- All debt indicators remain well below the debt burden thresholds for “CPIA medium performers”
II. External Debt Sustainability Analysis
A. Baseline Scenario (cont.)

NPV of debt-to-GDP ratio

- **Baseline**
- **Historical scenario**
- **One-time 30 percent depreciation**

Threshold
II. External Debt Sustainability Analysis

A. Baseline Scenario (cont.)

The graph illustrates the NPV of the debt-to-exports ratio over the years FY06 to FY26. The baseline scenario is represented by the blue line, which shows a consistent trend below the threshold. The historical scenario, indicated by the red dashed line, demonstrates a lower trend compared to the baseline. The scenario with lower GDP growth and lower non-debt creating inflows is shown by the grey dashed line, following a trend that is even lower than the historical scenario, maintaining a consistent path below the threshold.
II. External Debt Sustainability Analysis
A. Baseline Scenario (cont.)

Debt service-to-exports ratio

Threshold

Baseline
Historical scenario
Lower GDP growth and lower non-debt creating inflows
II. External Debt Sustainability Analysis
B. Standard Tests

No test breaches the indicative thresholds

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<th>Bangladesh DSA -- Maxima under Standard Stress Tests, 2006-2026</th>
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II. External Debt Sustainability Analysis

C. Country-Specific Tests

- Lower GDP growth
  - Since growth is not very volatile in Bangladesh, the standard test B1 may not be that relevant
  - However, long-term growth could be significantly lower in the absence of structural reforms
  - To what level would the growth rate have to fall over 2007-2016 for one debt indicator to breach the benchmark?
  - The answer was -3.5%, which was deemed a highly unlikely scenario
II. External Debt Sustainability Analysis
C. Country-Specific Tests (cont.)

- Lower Exports
  - Some 75 percent of Bangladesh’s exports are in ready-made garments
  - Although, exports have held up well, this could change when temporary safeguards expire (2008)
  - Staff considered a scenario, where exports grow by a mere 5 percent over 2007-2016.
  - The impact on GDP was assumed to be negligible since the sector accounts for 10 percent of GDP
II. External Debt Sustainability Analysis
C. Country-Specific Tests (cont.)

- Lower Exports (cont.)
  - Under this scenario debt burden indicators again stayed well below the thresholds
  - Export growth would have had to fall to 3.2 each year between 2007 and 2016 for a threshold to be breached, which was deemed highly unlikely.
II. External Debt Sustainability Analysis
C. Country-Specific Tests (cont.)

NPV of debt-to-GDP ratio

Threshold

Baseline
-3.7% growth 2007-2016
5% export growth 2007-2016

FY06 FY08 FY10 FY12 FY14 FY16 FY18 FY20 FY22 FY24 FY26
II. External Debt Sustainability Analysis
C. Country-Specific Tests (cont.)

NPV of debt-to-exports ratio

Threshold

Baseline
-3.7% growth 2007-2016
5% export growth 2007-2016
II. External Debt Sustainability Analysis
C. Country-Specific Tests (cont.)

Debt service-to-exports ratio

- Baseline
- 3.7% growth 2007-2016
- 5% export growth 2007-2016

Threshold
III. Public Debt Sustainability Analysis

- Domestic debt has stayed relatively stable over the past five years (19 percent of GDP)
- Under the baseline scenario all debt burden indicators fall over the next 20 years
- But, the stress tests point to downside risks:
  - Under-pricing of energy has created large quasi-fiscal liabilities in the SOE and banking sector
  - With the budget taking on liabilities equivalent to 10 percent of GDP, debt service would reach 47 percent of revenues, nearly 2.5 times the baseline value of 20 percent.
III. Public Debt Sustainability Analysis (cont.)

NPV of debt-to-GDP ratio

- Baseline
- Historical scenario
  - 10 percent of GDP increase in other debt-creating flows in 2007
III. Public Debt Sustainability Analysis (cont.)

NPV of Debt-to-Revenue Ratio 2/

Baseline
Historical scenario
10 percent of GDP increase in other debt-creating flows in 2007
III. Public Debt Sustainability Analysis (cont.)

Debt Service-to-Revenue Ratio 2/

- Baseline
- Historical scenario
- 10 percent of GDP increase in other debt-creating flows in 2007
IV. Conclusion

- Based on external indicators Bangladesh can be considered at low risk of debt distress
- However, taking into account domestic obligations, the risk of debt distress becomes moderate