July 2005
IMF Country Report No. 05/241

Bangladesh: 2005 Article IV Consultation, Third Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Performance Criterion, Extension of the Arrangement, and Rephasing—Staff Report; Staff Supplement; Public Information Notice; and Press Release on the Executive Board Discussion.

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2005 Article IV consultation with Bangladesh and third review under the Poverty Reduction and Growth Facility, and request for a waiver of a performance criterion, extension of the Arrangement, and rephasing, the following documents have been released and are included in this package:

- the staff report for the combined 2005 Article IV consultation and third review under the Poverty Reduction and Growth Facility, and request for waiver of performance criterion, extension of the Arrangement, and rephasing, prepared by a staff team of the IMF, following discussions that ended on April 9, 2005, with the officials of Bangladesh on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 7, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff supplement of June 28, 2005 updating information on recent economic developments.
- a Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its June 29, 2005 discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Bangladesh*
Memorandum of Economic and Financial Policies by the authorities of Bangladesh*
Statistical Appendix
Selected Issues Paper

*May also be included in the Staff Report.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

BANGLADESH

Staff Report for the 2005 Article IV Consultation, Third Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Performance Criterion, Extension of the Arrangement, and Rephasing

Prepared by the Asia and Pacific Department

Approved by Steven Dunaway and Anthony Boote

June 7, 2005

- A mission visited Dhaka March 28–April 9 to conduct the 2005 Article IV consultation discussions and to conclude discussions on the third review under the Poverty Reduction and Growth Facility (PRGF) arrangement. The staff team comprised Mr. Weerasinghe (Head), Ms. Liu, and Mr. Berezin (all APD), Mr. Akitoby (FAD), Mr. Moers (PDR), and Ms. Menon (APD Assistant). An MFD technical expert also joined the mission. The mission was assisted by Mr. Dunn, the Resident Representative, and coordinated its work with the World Bank resident mission in the context of a Development Support Credit (DSC).

- The PRGF arrangement, for SDR 347 million (65 percent of quota), was approved on June 20, 2003. The first two reviews were concluded in January and July 2004. With the completion of the second review, the Board approved the augmentation of access under the PRGF arrangement of SDR 53.33 million (10 percent of quota) in accordance with the Trade Integration Mechanism (TIM).

- In completing the second review, Executive Directors noted that determined implementation of policies, especially in tax administration and nationalized commercial bank (NCB) reform, together with credible actions to strengthen governance, are critical for turning initial progress into faster and lasting growth. Such growth should serve to reduce poverty and help the economy to better cope with the lifting of Multi-Fiber Arrangement (MFA) quotas and meet the Millennium Development Goals (MDGs).

- Bangladesh has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange rate system that is free from restrictions on current payments and transfers, except for a remaining restriction on the convertibility and transferability of funds from nonresident taka accounts.

- Bangladesh authorities intend to publish the staff report, LOI, and MEFP; they also plan to publish the Fiscal Transparency Module of the Report on Observance of Standards and Codes (ROSC).

- The principal authors of this report are Mr. Weerasinghe and Ms. Liu, with inputs from other team members.

Contents Page

Annexes

Attachment

Executive Summary

Bangladesh achieved steady economic growth and improvement in social indicators in the 1990s, with modest inflation. Better access to social services, including education and health, has helped Bangladesh to make sound progress toward meeting the MDGs. However, poverty incidence remains one of the highest in the region. Growth continues to be adversely affected by inadequate investment in human capital, infrastructure bottlenecks, the high cost of doing business, and poor governance.

Since the last Article IV consultation in 2003, the authorities have made significant progress in implementing structural reform measures, albeit with delays, while maintaining prudent macroeconomic policies. Meaningful poverty reduction will hinge on achieving a sustained and faster economic growth, with an improved investment climate. The authorities emphasized that the medium-term reform strategy adopted by the government under the PRGF program holds the best prospects for strengthening growth and reducing poverty in Bangladesh. They reiterated their commitment to:

- Macroeconomic policies geared to support low inflation and an orderly exchange market, underpinned by prudent fiscal and monetary policies, while ensuring adequate scope for private sector growth.

- Structural reforms focused on four key areas over the medium term: (i) pursuing further tax administration reform; (ii) continuing divestment of NCBs; (iii) further liberalizing the investment regime, including trade reform; and (iv) undertaking reforms in the energy sector state-owned enterprises (SOEs).

Tackling economic governance remains a high priority. Reform of the NCBs, tax administration, and the trade system, in particular, bear directly on economic governance. Further improvements in transparency and accountability in the management of public resources will foster good governance. To achieve a long lasting impact on improving the investment climate and growth prospects, the authorities will need to demonstrate a strong political will to address governance issues.

Risks to implementation of reforms are significant, both external and domestic. On the external front, the post-MFA shock is starting to unfold, although it appears to be manageable so far. Sustained high world oil prices would adversely affect growth and inflation and exert pressure on the balance of payments. On the domestic front, political confrontation continues and consensus building for reform remains difficult. The investment climate is also being adversely affected by frequent strikes and law and order problems.

I. Introduction and Perspective

1. **Bangladesh's reform efforts since the early 1990s have resulted in significant economic and social improvements with steady GDP growth and manageable inflation.** Real GDP growth accelerated to an average of about 5 percent, from 4 percent in the 1980s. This performance was underpinned by rising agricultural and nonfarm rural output and a rapid expansion in exports of ready made garments (RMG).

2. **Robust GDP growth, together with improved access to education and healthcare, has allowed Bangladesh to make good progress toward meeting some of the MDGs.** During the 1990s, poverty indicators have improved, malnutrition has declined, and gender equality has been enhanced. Enrollment and completion rates for primary school rose sharply and adult literacy rates improved in the past decade. Significant progress was made in reducing child malnutrition, maternal mortality, and rural poverty (Table 1).

3. **Despite these achievements, Bangladesh still remains among the poorest countries in the region, requiring much faster economic growth if the MDGs are to be met by 2015.** Four key structural impediments to growth are: physical infrastructure bottlenecks; inadequate human capital investment; a relatively restrictive trade regime that has an anti-export bias; and the high cost of doing business that has been accentuated by poor economic governance. These problems have discouraged private investment, especially foreign direct investment (FDI), and led to inefficient allocation of public resources, reflected in part by the poor financial conditions of the NCBs and the large SOEs.

4. **Bangladesh's revenue to GDP ratio and tax base remains among the lowest in the world**. As a result, public investment for infrastructure and human capital development has been inadequate as compared to most countries in the region. The budget relies heavily on trade taxes and the development surcharge on energy products, contributing to high production costs for domestic firms and to the weak financial position of energy sector SOEs.

5. **While the role of public banks has waned as private banks have grown, poor lending practices and inefficiency continue in the NCBs.** This has exerted a drag on growth and generated sizable contingent fiscal liabilities for the government. Though some progress has been achieved in improving lending practices, many loans are still disbursed with little commercial merit and minimal subsequent oversight. A legacy of mismanagement and political interference has resulted in a large stock of nonperforming loans (NPLs) in the NCBs.

6. **In June 2003, with the conclusion of the 2003 Article IV consultation, the government adopted a program supported by a PRGF arrangement,** aimed at tackling longstanding structural impediments and steering the economy onto a higher growth path with faster poverty reduction. Priorities are given to:

- Putting public finances on a sound footing through sustained revenue efforts and a shift in spending toward infrastructure and human capital to better support growth and the MDGs, while keeping public debt sustainable.

- Strengthening the banking system through divestment of NCBs in part or in whole, and, in the interim, taking steps to strengthen bank management and restrain lending to help stem the flow of new bad loans.

- Reducing the fiscal burden posed by the SOEs through closing/privatizing SOEs in manufacturing and restructuring SOEs in the energy sector, by first putting in place appropriate pricing and regulatory frameworks, followed by a medium-term restructuring plan.

- Moving to a market-based exchange system and continuing trade reform to reduce external vulnerability.

7. **Since the last Article IV consultation, the authorities have maintained macroeconomic stability and advanced the structural reform agenda**. The thrust of the authorities' economic policies has been broadly consistent with Fund advice. However, the pace of reforms has been slower than envisaged due to a difficult political environment and technical capacity constraints. Political confrontation continues and consensus building for reform remains difficult. The investment climate is also being adversely affected by frequent strikes and law and order problems. In concluding the 2003 Article IV consultation,[1] Executive Directors cautioned that political confrontation posed a significant risk to the implementation of critical reform measures.

II. Recent Developments

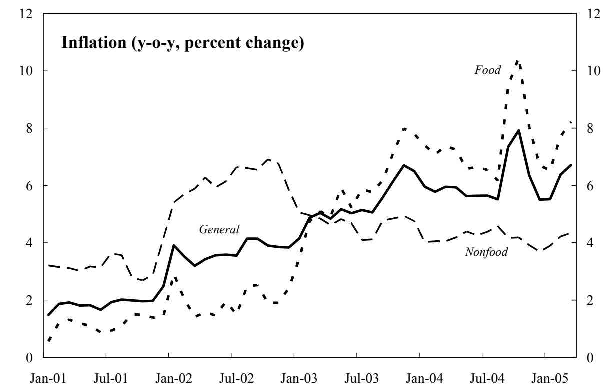
8. **Supportive macroeconomic policies have facilitated economic expansion.** Real GDP growth is projected at 5¼ percent in FY05 (ending June 30), reflecting a slight deceleration from 5½ percent in FY04 due to the impact of devastating floods last July (Table 2 and Figure 1). The floods damaged major crops, particularly rice.[2] This, together with an upswing in global oil and commodity prices, contributed to a surge in inflation in late 2004 (7–8 percent in October–December), though inflation has moderated to 6.2 percent in March 2005 and is projected at an annual average of 6.5 percent in FY05.

---

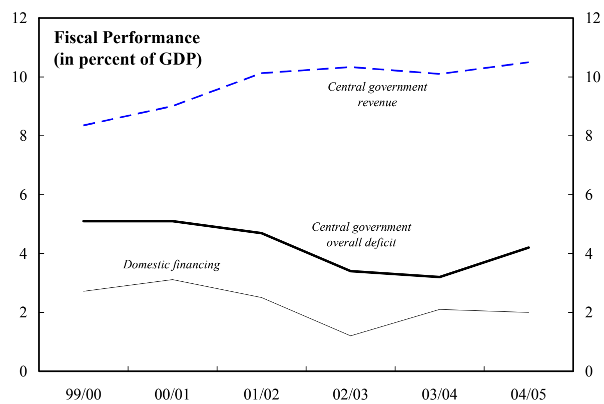
[1] See http://www.imf.org/external/np/sec/pn/2003/pn0384.htm.

[2] The floods caused significant damage to crops, housing, and infrastructure. Total losses to assets and output are estimated (by the World Bank and AsDB) to reach Tk 127 billion (about $2 billion, or 3¾ percent of GDP).

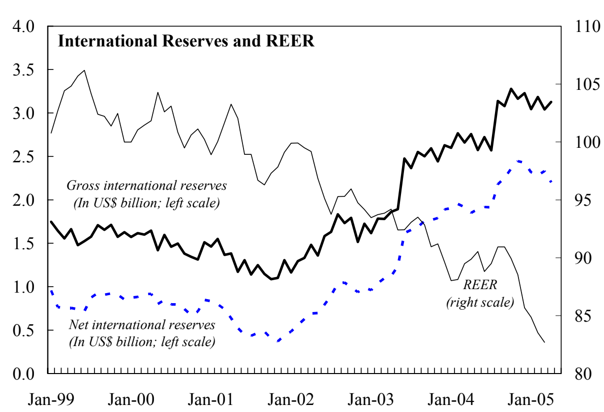
9. **To help mitigate the flood impact, the government provided sizable funds for rehabilitation in the rural areas.** This effort is supported by donor assistance ($200 million from the World Bank, $185 million from the AsDB, and $35 million from DFID to be disbursed in the next two–three years.



10. **As in the previous two years, the fiscal stance has been prudent, with the overall budget deficit estimated at 4.2 percent of GDP in FY05** (from 3.2 percent in FY04), reflecting in part flood relief efforts (Table 3 and Figure 2). Revenue is projected to increase by 16 percent in FY05 (compared to 9 percent in FY04), provided a strong effort is made in the fourth quarter. This outcome, however, still falls short of the revenue effort of 0.4 percentage point of GDP in the revised FY05 budget, reflecting delays in the implementation of tax administrative reforms and lingering weaknesses in audit and collection enforcement. Total spending is projected to be 0.2 percent of GDP lower than in the revised budget, on account of lower-than-projected development expenditure. The structure of deficit financing remains sound, with domestic financing capped at 2 percent of GDP, whereas external financing continues to be on concessional terms.

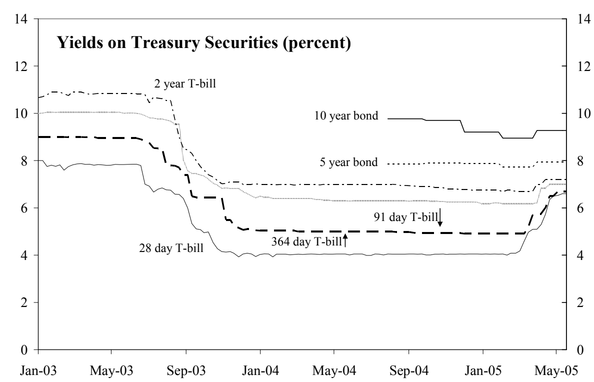


11. **The external position strengthened in 2003–04, but pressures emerged at the beginning of 2005**. Export earnings have moderated since November 2004, reflecting mainly a sharp decline in prices associated with the elimination of MFA quotas on January 1, 2005. Imports have grown rapidly due to higher oil and commodity prices, an increase in food imports, and stronger demand for investment goods (Table 4 and Figure 3). Oil imports are estimated to exceed forecast levels by about $500 million in FY05. Given potential food shortages, the government approved an additional $200 million for imports of rice and wheat in the second half of FY05. The external current account is projected to move to a deficit of $1.1 billion (or 1.8 percent of GDP) in FY05, from near balance in FY04.



12. **Since floating the exchange rate in May 2003, the taka has depreciated by 9 percent and 5 percent in nominal and real effective terms.** The authorities have confined their interventions to building reserves and to countering disorderly market conditions during a period of generally favorable balance of payment conditions. The foreign exchange market, however, had not been truly tested in an adverse situation until early 2005 when the economy was confronted by multiple external shocks. To ease pressure, Bangladesh Bank (BB) sold some foreign exchange reserves in January while allowing the taka to depreciate by 5 percent against the U.S. dollar. As pressures continued, BB resorted to moral suasion through the NCBs to curtail the movement of the exchange rate, while allowing them to run shortfalls in their net open foreign exchange positions. Taking into account higher payments for oil imports, gross international reserves are projected at $2.7 billion at end-June 2005 (2.4 months of imports), after peaking at $3.2 billion at end-2004.

13. **Monetary policy has been supportive of growth, but an accommodative stance in early 2005 contributed to pressures on the exchange market.** Reflecting in part lending to the agricultural sector for flood rehabilitation and strong demand for credit in a low interest rate environment, reserve money growth has accelerated since late 2004, while growth of private sector credit and broad money have also increased sharply (Tables 5–6, Figure 4). A decline in real interest rates led to a slowdown in the net sales of treasury securities by BB, with many banks holding treasury securities only up to the limit under the Statutory Liquidity Requirement.



14. **Good progress has been made in strengthening the banking system**. BB has raised minimum capital requirements, taken steps to reduce insider lending, and has improved the institutional framework for the prudential supervision of the financial system. As part of NCB reform, management teams have been put in place for Sonali and Agrani, and the contract for Janata Bank was signed recently. With these new management teams, plans to improve operational and lending practices, internal controls, and governance of these institutions are currently under review by BB and the government.

15. **Reform of tax administration has advanced, but has yet to translate into revenue gains.** The institutional structures have been set up, including the large taxpayers units (LTUs) for income tax and VAT and the Central Intelligence Cell (CIC), but enforcement, audit and collection efforts remain weak, reflecting capacity constraints and opposition from vested interests. Extensive court injunctions in tax cases have undermined the function of the National Board of Revenue (NBR). Two benches in the High Court have now been created to deal exclusively with tax cases and to expedite the clearing process.

16. **Progress has been mixed in reforming the SOEs and their financial conditions remain weak**. On the positive side, the government adjusted prices for energy products in December 2004 and January 2005, in consultation with the World Bank (2.3 percent for gas, and 15 percent each for diesel and kerosene). This helped reduce the financial losses of energy sector SOEs and improve their viability. On the negative side, after initial success in the closure of manufacturing SOEs in FY03, further closure/downsizing of SOEs stalled due to difficult labor issues. But these loss-making units can no longer resort to bank financing or budgetary resources and have been encouraged to downsize through hiring freezes and a voluntary retirement scheme (VRS).

17. **Significant headway was made on trade reform in FY05 through a reduction in the level and dispersion of duties and a streamlining of quantitative restrictions**. The structure of customs duty rates was simplified to three slabs, with the top rate reduced by 5 percent to 25 percent, and supplementary duties were reduced. These measures have significantly lowered the dispersion of custom duties. Quantitative restrictions were streamlined, with a simplification of administrative procedures and a halving of the number of restricted products starting April 2005.

III. Outlook and Risks

18. **Assuming the continuation of prudent policies, the near-term outlook is favorable.** The forecast for FY05 has been revised to incorporate the flood impact, with a ½ percent downward adjustment in GDP growth (to 5¼ percent) and a 1 percent upward adjustment in inflation (to 6½ percent). GDP growth is projected to recover to 6 percent in FY06, helped in part by expected reconstruction and bumper crops. Inflation is projected to decline moderately with a tightened monetary stance.

- The authorities intend to finance flood-related spending through donor assistance, and keep domestic financing capped at 2 percent of GDP. The overall budget deficit is projected at 4.2 percent of GDP in FY06. Improvements in tax administration are crucial for this fiscal outlook and to support pro-poor and pro-growth development spending.

- The external current account is expected to deteriorate in FY06 to a deficit of 2.2 percent of GDP, reflecting a slowdown in RMG exports and a rise in oil prices. Timely disbursement of donor assistance is critical for international reserves to maintain forecast levels.

19. **A broadly favorable medium-term outlook can be envisaged with continued strong reforms**. Real GDP growth would rise to 6½ percent and inflation decline to 4 percent. This would be supported by increasing private investment (including FDI) and export diversification. The budget deficit would be kept at about 4 percent of GDP, supported by strong revenue efforts, while ensuring adequate poverty-reducing expenditures. Reform of NCBs and energy sector SOEs would improve economic efficiency and help ensure medium-term fiscal sustainability. With exports recovering gradually, the external current account

deficit would stabilize at around 2 percent of GDP. This would allow a further buildup of international reserves to three months of imports by FY09. The medium-term debt dynamics remain favorable and robust to various stress tests (Annex V).

20. **This outlook is subject to several downside risks**, stemming from (i) the unfolding post-MFA shock; (ii) higher-than-expected imports for flood-related reconstruction; and (iii) a further surge in international oil prices. The medium-term prospect also hinges on the authorities' commitment to ensure that reforms do not falter in a politically difficult environment. In particular, political confrontation could be heightened in the run-up to the next general election (about 1½ years away). Moreover, governance problems could hinder NBR and NCB reforms, and infrastructural bottlenecks and energy sector issues may not be adequately addressed. Such an alternative scenario would lead to a weaker investment climate and inefficiency, thereby precluding an acceleration in growth and a reduction in domestic and external vulnerabilities (Table 7 and Annex VI).

IV. Policies for Stronger Growth

21. **The authorities reiterated their commitment to a strategy for enhancing growth, reducing poverty, ensuring fiscal sustainability, and improving governance**. They emphasized that the medium-term reform strategy adopted by the government under the PRGF-supported program holds the best prospects for accelerating growth and reducing poverty in Bangladesh, and making progress towards meeting the MDGs.[3] Against this background, the policy discussions for the 2005 Article IV consultation centered on the commitment of the government to implement structural reforms while maintaining macroeconomic stability. Key reforms on the structural front consist of: (i) further tax administration reform to increase revenue; (ii) divesting NCBs to improve efficiency and contain quasi-fiscal losses; (iii) liberalizing the investment regime, including trade reforms, to attract FDI; and (iv) reforming the energy sector SOEs to secure adequate supply of power while ensuring fiscal sustainability.

A. Fiscal Policy and Reform

22. **The authorities are committed to boosting revenue and reorienting expenditures to support growth and the MDGs, while protecting fiscal sustainability**[4]. The staff underscored the need for (i) strengthening of tax administration to improve revenue performance; (ii) a careful stance on public sector wage policy, particularly in view of the

[3] A comprehensive review of Bangladesh's progress towards meeting the MDGs is currently underway in the context of the Poverty Reduction Strategy Paper (PRSP), which is expected to be published in the second half of 2005.

[4] See Chapter IV of the Selected Issues Paper, 6/14/05 (see www.imf.org), which accompanies this staff report.

recent proposal by the National Pay Commission; (iii) enhancing public expenditure management; and (iv) a framework for improving fiscal transparency.

23. **The authorities agreed that a prudent fiscal stance supported by a strong revenue effort is vital for economic development and poverty reduction without threatening fiscal sustainability.** Consistent with the medium-term fiscal framework, the authorities indicated that they would contain the overall fiscal deficit to 4.2 percent of GDP in FY06 (the same level as in FY05), with domestic financing capped at 2 percent. Revenue measures are to be further strengthened in the FY06 budget. Spending will be contained on both recurrent and development expenditures, while ensuring priorities in MDG-related social spending and maintenance of infrastructure.

24. **The staff supported a comprehensive medium-term reform of tax administration to fundamentally change governance at the NBR**. Modernizing the NBR along functional lines is a critical step toward developing a more effective tax administration. The authorities acknowledged the importance of NBR modernization, and noted that a strategic plan will be developed during 2005, with World Bank assistance. The authorities also noted that they intend to expand the tax base by significantly reducing tax exemptions and holidays. They indicated that most of the existing tax holidays will be allowed to lapse at end-June 2005 and tax exemptions will be reduced in the FY06 budget.

25. **The staff emphasized that the National Pay Commission's recent proposal on public sector wage increases would undermine macroeconomic stability (**a 50-percent average hike in government salaries and pensions). It would also crowd out higher priority spending and have spillover effects on private sector wages. The authorities concurred with this assessment and noted that the overall increase in the government wage bill will be curtailed and phased in over three years. This increase will be partly offset by cuts in nonpriority spending and by a selective hiring freeze.

26. **The staff encouraged the authorities to develop a plan for civil service reform and to align future pay increases to structural improvements of the civil service**. This plan should aim at rationalizing the size of the civil service, introducing a systematic and transparent performance evaluation procedure for merit-based salary increases and promotion, improving recruitment procedures, and minimizing public pension liabilities.

B. Exchange Rate and Monetary Policies

27. **The authorities reiterated their commitment to the floating exchange rate regime, and to use it as a line of defense against external shocks.** However, they emphasized that excessive depreciation is politically unacceptable. They noted that strong demand for imports in the past few months is in part a reflection of investment and structural repositioning of the RMG sector and expansion of industries in anticipation of the expiration of existing tax holidays at end-June 2005. The staff emphasized that, given the elimination of MFA quotas and the deceleration in export growth, a market-based depreciation of the taka is likely and will help protect competitiveness and enhance the resilience of the economy. In

this regard, BB's recent handling of the exchange market pressures in part through nonmarket means was disappointing. While noting that this was an aberration, the authorities confirmed that they would confine interventions to countering disorderly market conditions. The authorities underscored that they would manage the floating exchange rate regime so as to avoid excessive movements of the exchange rate. They also welcomed an MFD expert, who has been advising BB since the launch of the floating system, to return to Dhaka in May to review the operation of the interbank market.

28. **The authorities intend to adopt measures to enhance the operation of the exchange system**. They removed two of the three restrictions subject to Fund jurisdiction. The restrictions on margin requirement and advance payment for imports were removed in December 2003 and December 2004, respectively. They plan to further ease the requirement that forward sales of authorized dealers be fully matched by their forward purchases. The authorities noted, however, that in the current difficult external environment, it would be risky to lift the restriction on the transferability and convertibility of funds from nonresident taka accounts, particularly in view of its implication on portfolio capital movements. The authorities expect to remove this restriction by end-June 2006, with due attention to regulatory safeguards to prevent unauthorized capital outflows.

29. **The staff argued that a tighter monetary policy stance is essential to ensure price stability and orderly exchange market conditions**. In this context, the staff noted that BB's recent monetary tightening came too late and interest rates were adjusted only belatedly. The liquidity expansion in the first quarter of 2005 has posed risks to inflation and external reserves, particularly in an environment of rising international oil prices and increased import requirements for food. The authorities concurred with this assessment and noted that corrective actions have been taken. Since March, BB increased the Cash Reserve Requirement by a half percentage point (to 4.5 percent) and raised interest rates on treasury securities (by 3 percentage points on the 28-day bills). BB continues to actively use repo and reverse-repo facilities to conduct daily monetary operations.

30. **Development of liquid interbank and treasury markets is vital for ensuring BB's effectiveness in monetary operations.** The authorities plan to take further steps to improve the functioning of the interbank and treasury bill markets to help improve BB's capacity in monetary operations, while avoiding excessive fluctuation in interest rates. They intend to introduce measures in this area following a detailed review of the recommendations of the recent MFD technical assistance mission.

C. Improving the Investment Climate

31. **The authorities are well aware that improving competitiveness and the investment climate remains a critical challenge, particularly after the elimination of**

MFA quotas.[5] The World Bank's draft of a comprehensive study on growth and export competitiveness identifies Bangladesh as a poor performer compared to other countries in the region on several components of the investment climate, in particular governance, infrastructure, labor quality, and trade policy. The authorities emphasized that they are taking actions to address problems in specific areas of investment, including the recent removal of restrictions on FDI in the RMG-sector outside the export processing zones. They intend to remove all remaining trade-related quantitative restrictions on imports. Other nontariff barriers will be streamlined in the FY06 budget to further reduce anti-export bias. While the current real effective exchange rate level is assessed to be broadly appropriate, the authorities agreed that they should not resist an orderly, market-based depreciation of the taka.

32. **With intensified competition in the post-MFA world, Bangladesh is likely to face increased pressures from lower prices, and further loss of market share in the United States**. However, discussions with private sector operators seem to suggest that the situation is manageable. So far, there has been no major structural break in the RMG-export climate; orders have held up well, and new investment for planned expansion has been reported. In addition, Bangladesh's advantage in competing for the high-volume, low-margin segment of the world garment market and preferential trade access to the European Union and Canadian markets could help counter the MFA fallout (Table 8).

33. **Nevertheless, the authorities acknowledged that it is still too early to gauge the full extent of the impact.** They have decided to take further measures to address the infrastructural bottlenecks and upgrade the capacity of Chittagong port, with assistance from the AsDB. In addition, a donor-financed action plan of $40 million for the RMG-sector is being finalized. Bangladesh is still seeking duty-free access for RMG-exports to the U.S. market, together with other affected low-income countries.

D. Strengthening the Banking System

34. **While private sector banks have grown significantly in the past few years, NCBs still dominate the banking system with some 40 percent of the market share**.[6] Improved oversight by BB of private banks has created an enabling environment for their growth. The NCB's financial performance is poor and the government has adopted a bank-by-bank strategy for their reform comprising of: strengthening bank management by contracting professional consultants and managers, signing Memoranda of Understanding (MOUs) that set explicit targets on improving operational performance and constraining lending growth, and taking steps to prepare the banks for divestment.

---

[5]See Chapter III of the Selected Issues Paper, 6/14/05 (see www.imf.org), which accompanies this staff report.

[6]See Chapter V of the Selected Issues Paper, 6/14/05 (see www.imf.org), which accompanies this staff report.

35. **The authorities have made significant efforts to strengthen the NCBs.** Special audits based on international accounting standards (IAS) were conducted at all four NCBs in FY04. Since then all NCBs have shown some progress in reducing classified loans, decreasing excess manpower, and rationalizing branch networks. However, cash recovery from defaulters continues to be weak, especially from the largest defaulters. While highlighting the need to strengthen BB's supervisory oversight of the NCBs, the staff encouraged the authorities to consider legislative modifications to grant BB the required regulatory authority over the NCBs.

36. **The staff supported the authorities' strategy for NCB divestment.** The authorities have made good progress with the privatization of Rupali Bank and intend to continue their efforts to divest Agrani and Janata Banks during the next two years. With respect to Sonali (the largest NCB), the authorities consider privatization to be politically untenable. They have pointed to the central role that Sonali plays in providing the government with treasury functions and essential banking services for the rural sector. The authorities have put in place a management support team to provide advice on improving Sonali's performance.

37. **BB agreed that regulatory oversight of the banking system will need to be intensified**. The staff welcomed the issuance of new risk management guidelines for commercial banks, the requirement for banks to conduct systems audits, and the restriction on the number and tenure of directors at banks. BB will further improve its on-site and off-site supervisory capacity and strictly enforce the data reporting requirements of commercial banks. BB is also urged to ensure banks meet all prudential regulations, including on net open limits on foreign exchange transactions.

E. Reform of the Energy Sector SOEs

38. **The authorities acknowledged that reform efforts are needed in the energy sector SOEs so as to contain fiscal risks, reduce infrastructure bottlenecks, and improve service delivery**. The overall approach to energy sector reform has been developed with World Bank and AsDB assistance. The reform agenda is complex, requiring strong political backing to tackle deep-seated governance problems and ensure appropriate pricing. Continued external assistance, both technical and financial, will be critical for the success of energy sector reform.

39. **The authorities noted that the initial approach to energy sector reform has focused on reforming the regulatory framework and pricing of energy products.** They noted their commitment to energy price adjustments to encourage energy conservation and contain financial losses of the energy sector SOEs. However, despite the adjustments in early 2005, domestic prices are lagging behind due to recent increases in international oil prices. The authorities indicated that in view of inflationary pressures from the floods and taking into account social considerations, they would follow a phased approach to price adjustments and plans to adjust energy prices again around mid-2005.

40. **To ensure adequate power supply, the authorities are considering measures to improve investment in power generation**. These include expanding the role of the IPPs, redesigning the power distribution network, and effective resolution of intra-SOE arrears. These actions would help unlock donor financing for further development and reform of the energy sector.

F. Tackling Governance Issues

41. **The staff noted that tackling governance problems through structural reforms while further developing anti-corruption measures with donor support is crucial for improving the investment climate**. Reforms of the NCBs, the tax administration, and the trade system, in particular, bear directly on economic governance and reduce the related scope for corruption. To achieve a lasting impact on improving the investment climate, the authorities will need to demonstrate strong political will to address governance issues. Donors have recently signed an agreement with the government to provide technical assistance on the development of an anti-corruption strategy.

42. **Continued efforts are needed to ensure further improvements in transparency and accountability in the management of public resources**. The 2003 fiscal ROSC report urged the authorities to take early action to report central government contingent liabilities and quasi-fiscal activities of SOEs. The authorities indicated that they require World Bank technical assistance to assess the contingent liabilities of the government and SOE's quasi-fiscal activities. They noted that the capacity of the Ministry of Finance to oversee public expenditure and the Comptroller and Auditor-General's office to carry out independent audits are being strengthened. Transparency and efficiency in procurement are being enhanced with the implementation of the new procurement guidelines introduced in 2003. An update of the fiscal ROSC is expected to be published by end-June 2005.

43. **The government established in November 2004 the Anti-Corruption Commission (ACC) as required under the Anti-Corruption Commission Act**. The ACC has been granted powers to conduct enquiries and investigations into specific acts of corruption, file cases based on its findings, and submit recommendations to the President that may be adopted to prevent corruption. The authorities are currently receiving assistance from the AsDB to make the ACC fully effective.

V. Third Review under the PRGF

44. **In the attached letter dated May 26, 2005 and the Memorandum of Economic and Financial Policies** (MEFP—Attachment I), the government of Bangladesh outlines the progress that has been made under the program, and requests completion of the third review under the PRGF arrangement, a waiver for the nonobservance of a structural performance criterion, rephasing of the undisbursed amounts, and extension of the arrangement.

45. **All quantitative performance criteria for end-September 2004 were met** (Table 9). Indicative targets for end-December 2004 and end-March 2005 were also met except for the end-March net domestic assets of BB. The structural performance criterion on

making the large tax payer units large taxpayer units (LTU) for VAT operational (end-September 2004) was missed, but corrective actions were taken, and the LTU for VAT became functional in December 2004. The financial advisors at Rupali Bank have provided strong support to the government to bring Rupali to the point of divestment and an Information Memorandum (IM) was issued on May 14 (a prior action, Table 10). The final prior action for the third review, the official public announcement that the overall increase of the government wage bill will be phased in over three years, with the total amount contained to about Tk 40 billion (Tk 8 billion in FY05, and Tk 16 billion each for FY06 and FY07), was completed on May 16.

46. **In line with the updated macroeconomic framework for FY05, the monetary program for FY05 has been revised.** Given the additional impact of oil imports (about $500 million), the floor on net international reserves (NIR) for June 2005 has been lowered by $300 million. NDA growth is projected to remain robust (15 percent by end-June), particularly on account of private credit growth, while broad money is projected to grow at 14 percent consistent with the inflation and growth objectives.

47. **Policies under the PRGF-supported program in FY06 will focus on further strengthening of tax administration, continuing reform of NCBs, and improving the performance of energy sector SOEs**:

- Tax administration measures will be strengthened to ensure an additional revenue effort of ½ percent of GDP in the FY06 budget. The quarterly revenue targets for NBR taxes in FY06 will constitute indicative targets under the program. Measures include making the LTU system more effective in the near term through faster processing of tax cases pending at the High Court and introducing a turnover threshold above which taxpayers will be included in the LTU. The authorities intend to create an independent audit unit by end-November 2005 (a structural performance criterion) in the NBR to enhance enforcement and audit operations (MEFP ¶16–19).

- NCB reform efforts will be continued. With regard to the privatization of Rupali Bank, its board of directors has been reconstituted, and the government has specified the modalities of recapitalization in the IM. Continued efforts will be needed to bring Agrani and Janata to the point of divestment during the next two years. With respect to Sonali (the largest NCB), the management support team will continue to provide advice on improving the bank's performance, supported by an enhanced MOU with BB, which focuses on restricting the bank's commercial lending operations and stepping up NPL recoveries (MEFP, ¶28–29, Annex I).

- Reform of energy sector SOEs will be stepped up. The Energy Regulatory Commission will be fully operational by June 2005, which would facilitate proper pricing for electricity and gas. They have agreed to closely monitor oil market developments and adjust energy prices around mid-2005, in the context of the World Bank's DSC. They will work with the World Bank and AsDB to define a restructuring plan to improve the operational and financial performance of the energy sector SOEs, with emphasis on improving the distribution structure, particularly those under the current network of the Dhaka Electricity Supply Authorities (DESA), and intensifying efforts in bill collection (MEFP, ¶22).

48. **Given the delay in concluding the third review, the authorities have requested that the arrangement be extended by six months and the purchases under the arrangement be rephased accordingly** (Table 10). The fourth, fifth, and sixth reviews will be scheduled to take place by mid-December 2005, mid-June 2006, and mid-December 2006, respectively. Understandings have been reached on modification of indicative targets on NIR for end-March and end-June, and establishment of quantitative performance criteria for end-September and indicative targets for end-December 2005 (MEFP, Table 2). Key structural benchmarks and structural performance criteria for FY06 will continue to cover fiscal and NCB reforms (MEFP, Table 3). Technical assistance, coordinated closely with the World Bank and DFID, will remain essential to help build capacity and ensure successful implementation of reforms.

VI. Other Issues

49. **The government has made significant progress in further articulating its reform strategy in the PRSP, which is expected to be published in the second half of 2005**. The focus of the PRSP is to prioritize policies in key sectors and develop anti-poverty programs; incorporate costing of proposed sectoral projects into the medium-term budgetary framework; improve monitoring and evaluation mechanisms for social development; and initiate a poverty and social impact assessment of the reform strategy.

50. **Consistent with the Fund's safeguards assessment policy, an updated safeguards assessment of the BB was completed in January 2005**. The assessment confirms that progress had been made to strengthen BB's safeguards framework in a number of areas, including through the publication of BB's FY04 financial accounts (based on international financial reporting standards (IFRS)), the reconciliation of monetary data reported to the Fund with the audited accounts, and improvements in foreign reserve management. Weaknesses remain, however, in the legal structure, financial reporting, internal audit, and internal control areas. BB indicated its commitment to address the remaining weaknesses and vulnerabilities and implement the safeguards recommendations. The government has appointed auditors for BB in April 2005, and they will prepare BB's FY05 audit in accordance with IFRS and help improve internal audit systems.

51. **Bangladesh's statistical base is adequate to conduct effective surveillance and for program monitoring.** Further improvements could focus on improving the compilation and reporting of external financing data for the budget and the system for debt stock and repayments. The STA data ROSC mission (February–March 2005) recommends, amongst other things, that the government enact a comprehensive statistical law that embodies the general policy of government with regard to the collection, processing, compilation, and dissemination of statistics; introduce a comprehensive data collection program for national

accounts; and expand fiscal data coverage to include local government and all externally financed development projects in budgetary accounts.

VII. Staff Appraisal

52. **Since the last Article IV consultation and the adoption of the PRGF program, the authorities have made significant progress in advancing structural reforms and have maintained macroeconomic stability.** Economic growth is expected to remain strong even with the modest slowdown in the aftermath of the devastating floods. Inflation, which increased due to a temporary surge in food prices and the rise in international oil prices, has been kept in check. The external position has strengthened although it has recently come under pressure from high oil prices and the phasing out of MFA quotas. Notwithstanding a difficult political environment, the authorities have persevered with the structural reform agenda, albeit with delays in some areas.

53. **The economic outlook is favorable but subject to significant downside risks, particularly in light of the unfolding post-MFA shock, high international oil prices, and the politics of confrontation.** Against this background, the authorities' emphasis that their medium-term reform strategy espoused under the PRGF-supported program holds the best prospects for enhancing growth and reducing poverty is appropriate. Steadfast implementation of the reform measures, together with credible action to strengthen governance and a less confrontational political environment, will be essential to improving the investment climate and shifting the economy to a higher growth path.

54. **The fiscal strategy should balance the need to support growth and poverty reduction, while protecting fiscal sustainability.** This will require current expenditures to be contained, and the authorities are urged to curtail the public sector wage increases proposed by the National Pay Commission and phase it in over three years. These increases should be partly offset by cuts in nonpriority spending to preserve pro-poor expenditures. Improved execution of development expenditures will be needed, particularly through better project selection, improved procurement management, and timely compliance with policy conditions for project financing.

55. **Notwithstanding the progress with tax administration reforms, the revenue performance has been disappointing**. The authorities are urged to make a strong effort at revenue collection in the last quarter of FY05, and also to adhere to the quarterly NBR revenue targets in FY06 to ensure an additional revenue effort of ½ percent of GDP. Effective execution of tax administration measures and strict enforcement is vital to the revenue effort and will require strong political backing. The recent steps taken to expedite tax cases pending at the High Court are welcome. Intensified efforts are needed for establishing an independent audit unit in NBR. The authorities are also encouraged to proceed with the modernization of the NBR along functional lines.

56. **The floating exchange rate system has worked well for Bangladesh, and the authorities should allow it to operate as intended including in times of market**

pressures. In view of external sector developments and the unfolding impact of the MFA phaseout, an orderly market-based depreciation of the taka is likely and is consistent with the need to maintain macroeconomic stability and improve external competitiveness. The authorities are advised to confine their interventions in the exchange market to countering disorderly conditions and to manage the floating exchange rate regime in a market-based manner. In this regard, BB's recent resort in part to nonmarket means for handling the exchange market pressures was disappointing. BB will need to monitor the operations of the foreign exchange market with MFD technical assistance and ensure that it is working effectively.

57. **A monetary tightening is warranted in the immediate months to contain inflationary pressures**. In this context, BB should actively use open market operations to ensure adequate liquidity management, and allow interest rates to increase in a market-based manner. BB is encouraged to implement further improvements in the functioning of the interbank and treasury bill markets, as recommended by the recent MFD technical assistance mission. Reactivating the primary dealer system and deepening the secondary market for treasury securities are important for effective open market operations.

58. **The authorities are making good progress with NCB reforms**. Taking Rupali Bank to the point of divestment is a significant demonstration of their commitment in this regard. The privatization should be carried out in an open and transparent manner to ensure credibility and to attract quality investors. Success of the Rupali case should help improve market sentiment and pave the way for subsequent divestments of Agrani and Janata. In the meantime, close monitoring should continue to ensure adherence to the strengthened MOUs for all NCBs.

59. **The authorities' commitment to further trade reform is encouraging, particularly in view of the competitive challenges in a post-MFA environment.** The reduction and rationalization of trade taxes in FY05 have helped to enhance competitiveness and reduce anti-export bias. The recent removal of restrictions on FDI in the RMG sector outside the EPZs and streamlining of quantitative restrictions are welcome steps. Moreover, upgrading the capacity of the Chittagong port, with AsDB assistance, will help reduce infrastructural bottlenecks.

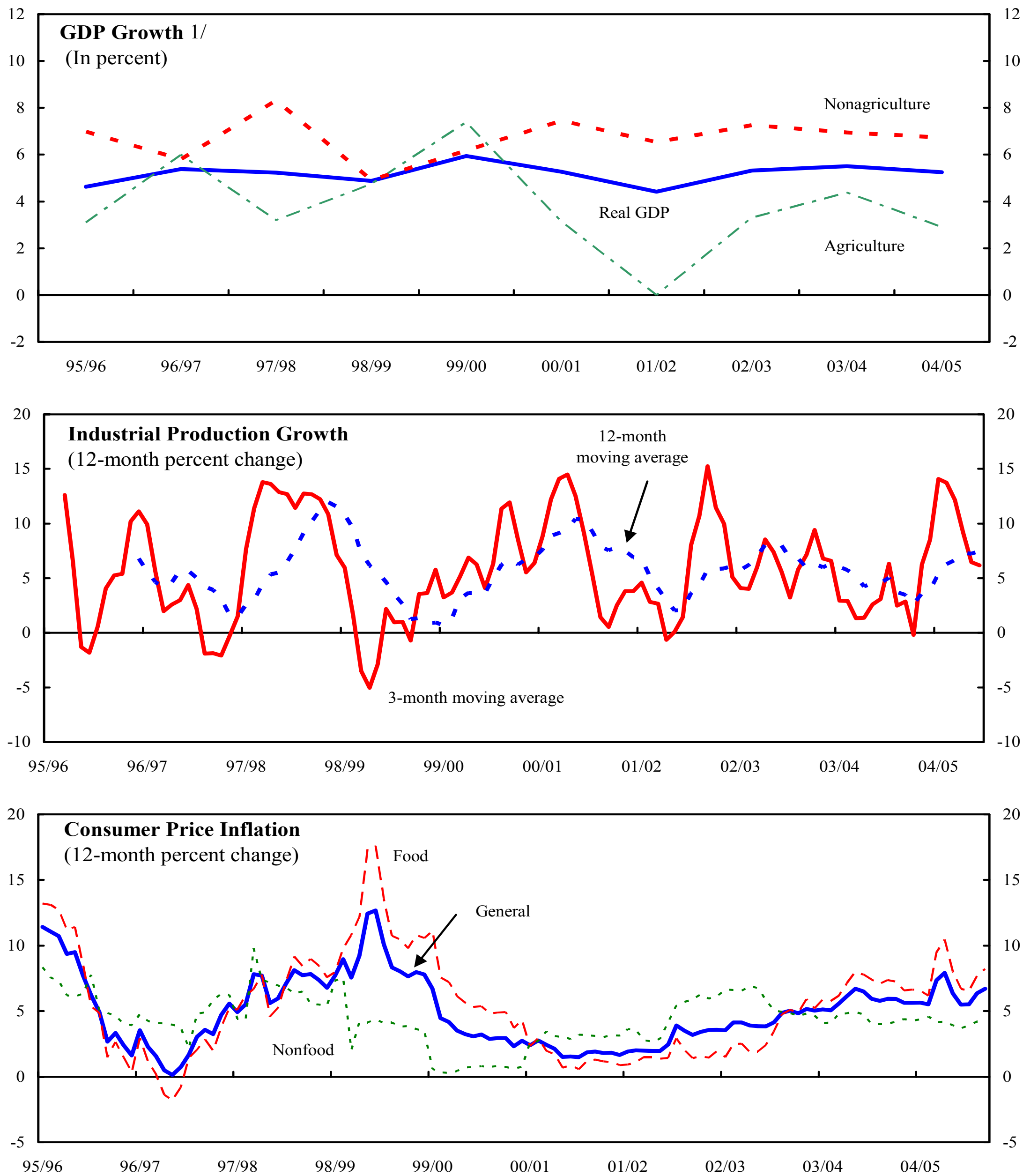
60. **Reform of the energy sector SOEs is essential to address infrastructural bottlenecks to growth, contain potential fiscal costs, and improve economic governance.** The authorities are encouraged to work with the World Bank and AsDB to define a restructuring plan to improve the operational and financial performance of the energy sector SOEs. Measures to reform the power sector distribution structure, particularly those under DESA's current network, and intensified efforts in bill collection are key to this strategy. The authorities' decision to adjust domestic energy prices in early 2005 was appropriate. Nevertheless, domestic energy prices will need to be kept under close review in light of increasing international oil prices and adjusted as necessary.

61. **The recent establishment of the ACC under the Anti-Corruption Commission Act is an important step in the right direction.** Concerted follow-up actions are required to make the ACC function effectively so as to enhance its credibility. In addition, developing an anti-corruption strategy with technical assistance from donors would be another important step to tackle governance issues and help improve the investment climate.

62. **Bangladesh's overall record under the program has so far been satisfactory,** and the MEFP sets out an ambitious agenda going forward. Although risks to program implementation remain considerable, deriving from resistance of vested interests and a difficult political environment, they should be manageable in view of the continued strong commitment of the government to the reform program. To mitigate these risks, the authorities should remain vigilant on policies, while technical assistance from the donor community should be continued. Given the strength of the program and corrective actions taken, the staff recommends approval of the requested waiver for the nonobservance of the structural performance criterion; the rephasing of purchases and extension of the arrangement; and the completion of the third review.

63. **It is recommended that the next Article IV consultation with Bangladesh** be held in accordance with the provisions of Board Decision No. 12793-(02-76) approved on July 15, 2002.

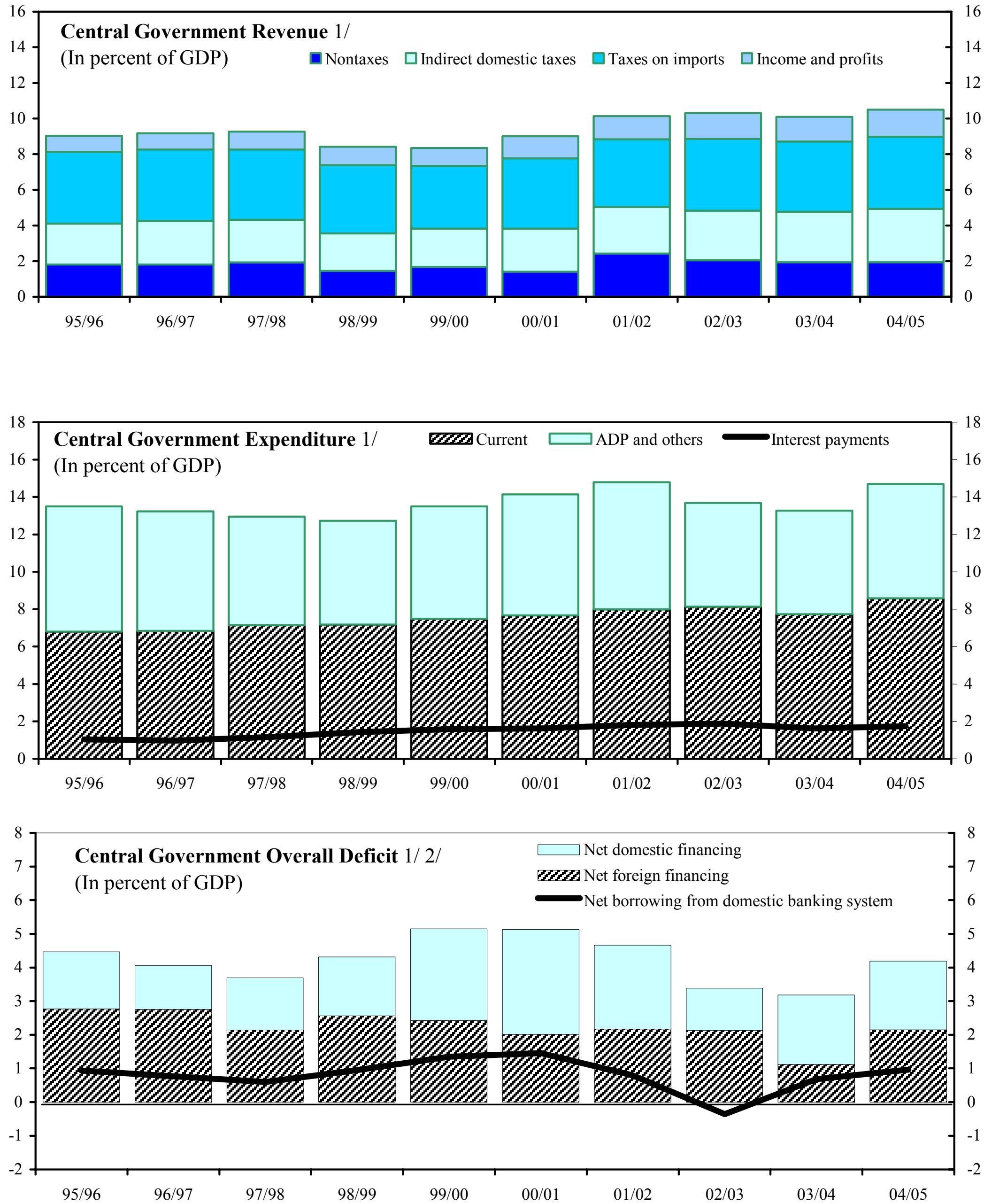
Figure 1. Bangladesh: Real Sector Indicators, FY1996-2005



Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Estimates for 2003/04; Projections for 2004/05.

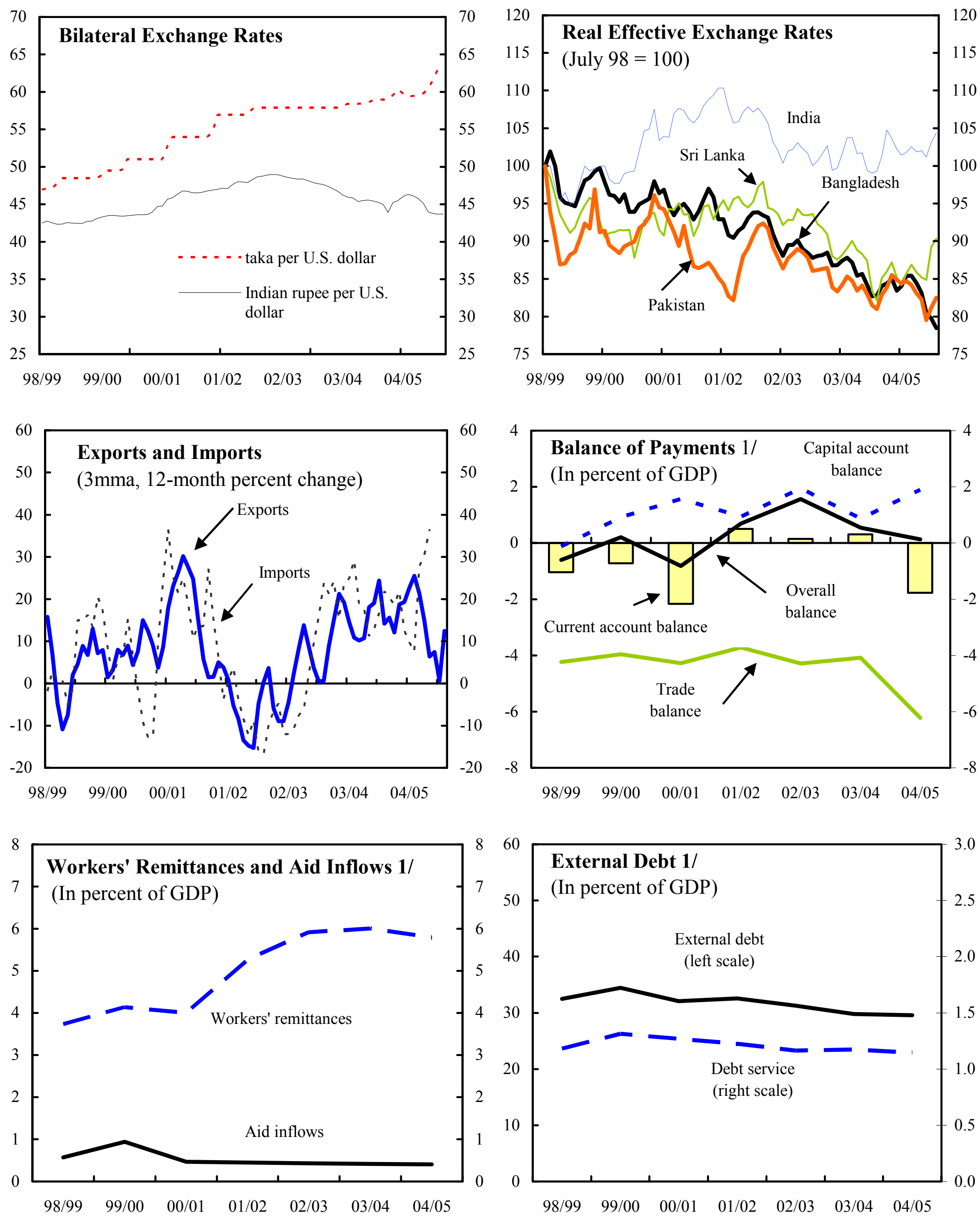
Figure 2. Bangladesh: Fiscal Sector Indicators, FY1996-2005



Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Projections for 2004/05.
2/ The decline in net foreign financing in 2003/04 is attributable to a one-time delay in the disbursement of the World Bank loan under the DSC.

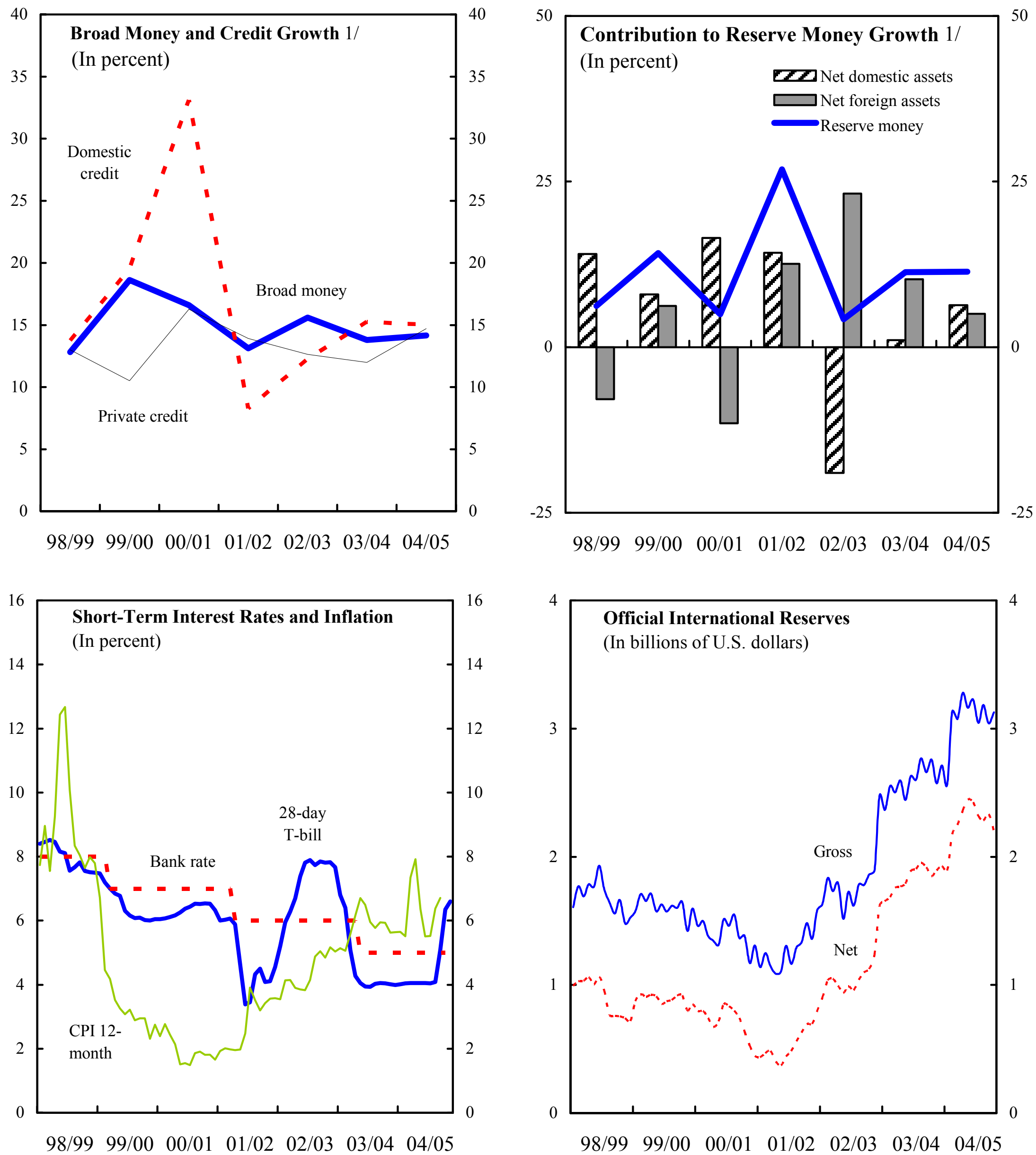
Figure 3. Bangladesh: External Sector Indicators, FY1999-2005



Sources: Data provided by the Bangladesh authorities; IMF, Information Notices System, *International Financial Statistic*; and Fund staff estimates and projections.

1/ Estimates for 2003/04; Projections for 2004/05.

Figure 4. Bangladesh: Monetary Sector Indicators, FY1999-2005



Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections for 2004/05.

1/ Projections for 2004/05.

Table 1. Bangladesh: Millennium Development Goals, 1990-2003

	1990	1994	1997	2000	2003
Goal 1. Eradicate extreme poverty and hunger					
Target 1: Halve 1990 US$1 a day poverty and malnutrition rates					
1. Population below US$1 a day (percent)	35.9	28.6	26.7	...	...
2. Poverty gap at US$1 a day (percent)	8.8	6.0	5.1	...	...
3. Share of income or consumption held by poorest 20 percent (percent)	…	...	...	...	...
Target 2:					
4. Prevalence of child malnutrition (percent of children under 5)	65.8	…	56.3	47.7	...
5. Population below minimum level of dietary energy consumption (percent)	…	35.0	38.0	32.0	30.0
Goal 2. Achieve universal primary education					
Target 3: Net enrollment to 100					
6. Net primary enrollment ratio (percent of relevant age group)	71.2	…	93.6	87.7	85.1
7. Percentage of cohort reaching grade 5 (percent)	…	...	54.7	65.5	...
8. Youth literacy rate (percent of ages 15-24)	42.0	44.5	46.5	48.4	49.7
Goal 3. Promote gender equality					
Target 4: Education ratio to 100					
9. Ratio of girls to boys in primary and secondary education (percent)	77.1	76.1	96.5	102.3	106.8
10. Ratio of young literate females to males (percent of ages 15-24)	65.5	67.3	68.7	70.0	71.1
11. Share of women employed in the nonagricultural sector (percent)	17.6	20.5	22.2	22.9	25.0
12. Proportion of seats held by women in national parliament (percent)	10.0	…	9.0	9.0	2.0
Goal 4. Reduce child mortality					
Target 5: Reduce 1990 under 5 mortality by two-thirds					
13. Under 5 mortality rate (per 1,000)	144.0	116.0	...	82.0	69.0
14. Infant mortality rate (per 1,000 live births)	96.0	75.0	...	54.0	46.0
15. Immunization, measles (percent of children under 12 months)	65.0	78.0	72.0	76.0	77.0
Goal 5. Improve maternal health					
Target 6: Reduce 1990 maternal mortality by three-fourths					
16. Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	...	380.0	...
17. Births attended by skilled health staff (percent of total)	...	9.5	8.0	12.1	14.0
Goal 6. Combat HIV/AIDS, malaria, and other diseases					
Target 7: Halt, and begin to reverse, AIDS, etc.					
18. Prevalence of HIV, female (percent of ages 15-24)	...	...	...	0.01	...
19. Contraceptive prevalence rate (percent of women ages 15-49)	39.9	44.9	49.2	53.8	...
20. Number of children orphaned by HIV/AIDS	…	...	...	2,100.0	...
Target 8: Halt, and begin to reverse, AIDS, etc.					
21. Incidence of tuberculosis (per 100,000 people)	246.1	246.0	246.0	245.9	245.9
22. Tuberculosis cases detected under DOTS (percent)	…	6.7	18.1	23.5	33.0
Goal 7. Ensure environmental sustainability					
Target 9: Various (see notes)					
23. Forest area (percent of total land area)	9.0	…	...	10.2	...
24. Nationally protected areas (percent of total land area)	…	...	0.8	0.8	0.8
25. GDP per unit of energy use (PPP $ per kg oil equivalent)	10.1	10.3	10.4	10.9	10.5
26. CO2 emissions (metric tons per capita)	0.1	0.2	0.2	0.2	...

Table 1. Bangladesh: Millennium Development Goals, 1990-2003 (concluded)

	1990	1994	1997	2000	2003
Target 10: Various (see notes)					
27. Access to an improved water source (percent of population)	71.0	94.0	...	97.0	75.0
Target 11: Various (see notes)					
28. Access to improved sanitation (percent of population)	23.0	41.0	...	48.0	48
29. Access to secure tenure (percent of population)	…	...	...	...	...
Goal 8. Develop a global partnership for development					
Target 12: Various (see notes)					
30. Youth unemployment rate (percent of total labor force ages 15-24)	2.5	…	7.0	10.7	...
31. Fixed line and mobile telephones (per 1,000 people)	2.0	2.2	3.2	5.8	15.6
32. Personal computers (per 1,000 people)	…	...	0.2	1.5	7.8
General indicators					
33. Population (millions)	110.0	118.0	124.4	131.1	138.1
34. Gross national income (in billions of U.S. dollars)	31.0	36.6	43.5	49.8	55.2
35. GNI per capita (in U.S. dollars)	280.0	310.0	350.0	380.0	400.0
36. Adult literacy rate (percent of people ages 15 and over)	34.2	36.5	38.3	40.0	41.1
37. Total fertility rate (births per woman)	4.1	...	3.3	...	2.9
38. Life expectancy at birth (years)	54.8	...	59.8	...	62.4
39. Aid per capita (current US$)	19.0	14.8	8.1	8.9	10.1
40. Debt services (percent of exports)	34.8	15.0	12.0	11.0	8.0
41. Investment (percent of GDP)	17.1	18.4	20.7	23.0	23.4
42. Trade (percent of GDP)	19.7	22.9	30.0	33.2	34.2

Sources: World Bank; and Fund staff estimates.

Note: In some cases the data are for earlier or later years than those stated.
Goal 1 targets: Halve, between 1990 and 2015, the proportion of people whose income is less than US$1 a day.
Halve, between 1990 and 2015, the proportion of people who suffer from hunger.
Goal 2 target: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.
Goal 3 target: Eliminate gender disparity in primary and secondary education preferably by 2005 and to all levels of education no later than 2015.
Goal 4 target: Reduce by two-thirds, between 1990 and 2015, the under-five mortality rate.
Goal 5 target: Reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio.
Goal 6 targets: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS. Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.
Goal 7 targets: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources.
Halve, by 2015, the proportion of people without sustainable access to safe drinking water. By 2020, to have achieved a significant improvement in the lives of at least 100 million slum dwellers.
Goal 8 targets: Develop further an open, rule-based, predictable, nondiscriminatory trading and financial system.
Address the special needs of the least developed countries. Address the special needs of landlocked countries and small island developing states.
Deal comprehensively with the debt problems of developing countries through national and international measures in order to make debt sustainable in the long term. In cooperation with developing countries, develop and implement strategies for decent and productive work for youth.
In cooperation with pharmaceutical companies, provide access to affordable, essential drugs in developing countries. In cooperation with the private sector, make available the benefits of new technologies, especially information and communications.

Table 2. Bangladesh: Key Economic Indicators (Program Scenario), FY2003-09 1/

	2002/03	2003/04 Rev. Prog.	2003/04 Act.	2004/05	2005/06	2006/07	2007/08	2008/09
				Projections				
National income and prices (percent change)								
Real GDP	5.3	5.5	5.5	5.2	6.0	6.0	6.5	6.5
GDP deflator	4.4	5.5	5.5	6.0	5.5	4.9	4.0	4.0
CPI inflation (annual average) 2/	4.4	5.9	5.8	6.5	6.0	5.0	4.0	4.0
Central government operations (percent of GDP)								
Total revenue	10.3	10.6	10.1	10.5	11.0	11.2	11.4	11.6
Tax	8.3	8.5	8.2	8.6	8.9	9.2	9.3	9.5
Nontax	2.0	2.1	1.9	1.9	2.0	2.0	2.1	2.1
Total expenditure	13.7	14.4	13.3	14.7	15.2	15.3	15.3	15.4
Current expenditure	8.1	8.2	7.7	8.6	8.4	8.6	8.7	8.7
Of which : Interest payments	1.9	1.7	1.6	1.8	1.6	1.7	1.7	1.7
Annual Development Program	5.4	5.4	5.0	5.3	5.7	5.7	5.7	5.7
Other expenditures 3/	0.2	0.8	0.6	0.8	1.1	1.0	0.9	1.0
Overall balance (excluding grants)	-3.4	-3.8	-3.2	-4.2	-4.2	-4.1	-3.9	-3.8
Primary balance	-1.5	-2.1	-1.6	-2.4	-2.6	-2.4	-2.2	-2.1
Financing (net)	3.4	3.8	3.2	4.2	4.2	4.1	3.9	3.8
Domestic	1.3	2.3	2.1	2.0	2.0	1.9	1.9	1.7
External	2.1	1.5	1.1	2.2	2.2	2.2	2.0	2.1
Total central government debt (percent of GDP)	51.0	50.3	48.3	47.9	48.3	47.9	47.1	46.2
Money and credit (end of year; percent change)								
Net domestic assets	12.2	11.8	13.4	14.8	13.5	13.8	13.5	13.1
Private sector	12.6	10.3	12.0	14.7	13.2	13.0	12.8	12.8
Broad money (M2)	15.6	11.9	13.8	14.2	12.8	13.1	13.0	13.0
Balance of payments (in billions of U.S. dollars) 4/								
Exports, f.o.b.	6.5	7.4	7.5	7.8	8.0	8.4	9.1	9.9
(Annual percent change)	9.5	13.3	15.8	4.1	2.0	5.1	7.9	9.0
Imports, f.o.b.	8.7	10.1	9.8	11.6	12.3	13.1	13.9	14.9
(Annual percent change)	13.0	15.8	13.0	18.0	6.2	6.0	6.6	7.1
Gross official reserves (in billions of U.S. dollars)	2.5	2.6	2.7	2.7	2.7	3.0	3.4	3.9
In months of imports of goods and nonfactor services	2.9	2.6	2.8	2.4	2.2	2.3	2.5	2.7
Memorandum item								
Nominal GDP (in billions of taka)	3,005	3,345	3,345	3,731	4,171	4,637	5,135	5,686

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1.
2/ CPI has recently been rebased using FY96 weights.
3/ Consists of other capital, net lending, and food accounts (including check float and discrepancy).
4/ Balance of payments is presented on the basis of BPM5.

Table 3. Bangladesh: Central Government Operations, FY2003–09 1/

	2002/03	2003/04	2004/05		2005/06		2006/07	2007/08	2008/09
			Budget Rev.	Prog.	Budget Prel.	Prog.		Proj.	
					(In billions of taka)				
Total revenue	309.7	337.4	392.0	392.0	457.2	457.2	517.5	583.4	657.2
Tax revenue	248.2	272.7	319.5	319.5	373.1	373.1	424.9	476.2	538.2
NBR taxes	237.6	260.3	305.0	305.0	356.5	356.5	405.7	456.1	514.9
VAT, supplementary duties, excises	124.8	140.4	163.2	163.2	192.3	192.3	220.3	247.0	277.3
Customs duties	66.9	70.9	81.0	81.0	91.0	91.0	103.0	115.0	129.6
Taxes on income and profits	43.7	46.1	56.8	56.8	69.5	69.5	78.5	90.0	103.5
Other NBR taxes	2.2	3.0	4.0	4.0	3.5	3.5	3.8	4.1	4.5
Non-NBR taxes	10.7	12.4	14.5	14.5	16.6	16.6	19.1	20.1	23.3
Nontax revenue	61.5	64.7	72.5	72.5	84.1	84.1	92.6	107.2	119.0
Total expenditure	411.4	443.9	556.3	548.3	642.5	633.5	707.3	785.1	875.8
Current expenditure	244.5	258.6	320.3	320.3	351.4	351.4	397.9	444.4	494.4
Pay and allowances	71.2	76.6	90.6	90.6	106.6	106.6	122.6	122.6	135.7
Goods and services	42.5	45.1	57.8	57.8	64.1	64.1	73.3	92.3	108.4
Interest payments	56.6	54.5	65.0	65.0	67.2	67.2	77.9	87.3	95.8
Subsidies and transfers	70.2	78.9	101.7	101.7	101.4	101.4	112.9	130.0	141.0
Subsidies	13.5	11.9	12.0	12.0	13.4	13.4	14.9	15.5	17.2
Transfers	56.7	67.0	89.7	89.7	88.0	88.0	98.0	114.5	123.9
Block allocations	4.0	3.6	5.1	5.1	12.1	12.1	11.3	12.2	13.5
Food account surplus(-)/deficit(+)	-2.7	3.5	1.7	1.7	3.5	3.5	3.5	3.5	3.5
Annual Development Program (ADP)	163.0	167.9	206.0	198.0	247.9	238.9	263.3	291.0	324.1
Non-ADP capital and net lending	6.6	16.0	25.6	25.6	32.2	32.2	32.6	34.2	41.6
Extraordinary expenditures	12.3	7.8	2.7	2.7	7.5	7.5	10.0	12.0	12.2
Check float plus discrepancy	-12.2	-10.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (excluding grants)	-101.7	-106.4	-164.3 2/	-156.3 2/	-185.3	-176.3	-189.8	-201.6	-218.6
Primary balance (excluding grants)	-45.1	-51.9	-99.3	-91.3	-118.1	-109.1	-111.9	-114.3	-122.9
Net financing	101.7	106.4	164.3	156.3	185.3	176.3	189.8	201.6	218.6
External	64.2	37.4	88.3 2/	80.3 2/	102.0	93.0	101.6	106.0	119.4
Domestic	37.5	69.0	76.0	76.0	83.3	83.3	88.2	95.6	99.2
Bank	-10.7	23.0	36.0	36.0	36.3	36.3	37.0	40.0	40.0
Nonbank	48.2	46.0	40.0	40.0	47.0	47.0	51.2	55.6	59.1
					(In percent of GDP)				
Total revenue	10.3	10.1	10.5	10.5	11.0	11.0	11.2	11.4	11.6
Tax revenue	8.3	8.2	8.6	8.6	8.9	8.9	9.2	9.3	9.5
NBR taxes	7.9	7.8	8.2	8.2	8.5	8.5	8.7	8.9	9.1
Non-NBR taxes	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Nontax revenue	2.0	1.9	1.9	1.9	2.0	2.0	2.0	2.1	2.1
Total expenditure	13.7	13.3	14.9	14.7	15.5	15.2	15.3	15.3	15.4
Current expenditure	8.1	7.7	8.6	8.6	8.4	8.4	8.6	8.7	8.7
Pay and allowances	2.4	2.3	2.4	2.4	2.6	2.6	2.6	2.4	2.4
Goods and services	1.4	1.3	1.5	1.6	1.5	1.5	1.6	1.8	1.9
Interest	1.9	1.6	1.7	1.7	1.6	1.6	1.7	1.7	1.7
Subsidies and transfers	2.3	2.4	2.7	2.7	2.4	2.4	2.4	2.5	2.5
Subsidies	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Transfers	1.9	2.0	2.4	2.4	2.1	2.1	2.1	2.2	2.2
Block allocations	0.1	0.1	0.1	0.1	0.3	0.3	0.2	0.2	0.2
Annual Development Program	5.4	5.0	5.5	5.3	6.0	5.7	5.7	5.7	5.7
Non-ADP capital and net lending	0.2	0.5	0.7	0.7	0.8	0.8	0.7	0.7	0.7
Other expenditures	0.3	0.3	0.1	0.1	0.3	0.3	0.3	0.3	0.3
Check float plus discrepancy	-0.4	-0.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (excluding grants)	-3.4	-3.2	-4.4 2/	-4.2 2/	-4.5	-4.2	-4.1	-3.9	-3.8
Primary balance (excluding grants)	-1.5	-1.6	-2.7	-2.4	-2.8	-2.6	-2.4	-2.2	-2.2
Net financing	3.4	3.2	4.4 2/	4.2 2/	4.5	4.2	4.1	3.9	3.8
External financing (net)	2.1	1.1	2.4	2.2	2.5	2.2	2.2	2.1	2.1
Domestic financing	1.2	2.1	2.0	2.0	2.0	2.0	1.9	1.9	1.7
Banks	-0.4	0.7	1.0	1.0	0.9	0.9	0.8	0.8	0.7
Nonbank	1.6	1.4	1.1	1.1	1.1	1.1	1.1	1.1	1.0
Memorandum items:									
Nominal GDP (in billions of taka)	3,005	3,345	3,731	3,731	4,171	4,171	4,637	5,135	5,686
Overall balance, including grants (in percent of GDP)	-2.3	-2.7	-4.0	-3.6	-3.7	-3.5	-3.3	-3.1	-3.1
Government wage bill and pensions (in percent of GDP)	3.8	3.7	3.8	3.8	3.8	3.8	3.8	3.7	3.6

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates.

1/ Fiscal year ends June 30.

2/ Including externally financed flood-related expenditure.

Table 4. Bangladesh: Balance of Payments, FY2003-09 1/

(In millions of U.S. dollars, unless otherwise indicated)

		Est.	Proj.				
	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Trade balance	-2,215	-2,319	-3,783	-4,346	-4,676	-4,876	-5,053
Exports (f.o.b)	6,492	7,521	7,827	7,983	8,389	9,053	9,864
Of which : RMG sector	4,912	5,686	5,857	5,798	5,943	6,347	6,868
Imports (f.o.b)	-8,707	-9,840	-11,610	-12,328	-13,065	-13,929	-14,917
Services	-691	-874	-1,141	-1,313	-1,400	-1,506	-1,628
Income	-458	-374	-354	-346	-353	-365	-394
Transfers	3,440	3,743	4,200	4,633	4,999	5,197	5,292
Official current transfers 2/	82	61	52	70	71	73	76
Private transfers	3,358	3,682	4,148	4,563	4,928	5,125	5,217
Of which: Workers' remittances	3,062	3,372	3,824	4,206	4,543	4,724	4,809
Current account balance	76	176	-1,077	-1,372	-1,431	-1,550	-1,783
Capital and financial account balance	1,009	492	1,153	645	886	1,039	1,237
Capital account	428	319	309	366	452	474	488
Financial account	581	173	845	279	434	565	749
Foreign direct investment	376	385	410	429	450	471	512
Portfolio investment	2	6	0	0	0	0	0
Net aid flows 3/	634	242	931	228	365	491	633
Aid disbursements	1,070	734	1,373	686	857	1,014	1,183
Debt amortization	-436	-492	-442	-458	-492	-523	-550
Other long-term loans (net)	-20	-41	-45	0	0	0	0
Other short-term loans (net)	142	13	150	0	0	0	0
Other assets (net)	-125	-125	-200	-149	-117	-155	-140
Trade credits (net)	-499	-321	-375	-208	-213	-192	-205
Commercial banks (net)	71	14	-26	-21	-50	-50	-50
Errors and omissions	-274	-355	0	0	0	0	0
Overall balance	811	313	76	-727	-545	-511	-546
Financing items	-811	-313	-76	0	-235	-329	-452
Bangladesh Bank 4/	-811	-313	-76	0	-235	-329	-452
Financing gap	0	0	0	727	780	840	998
Exceptional Financing (identified)	...	...	...	727	570	455	450
World Bank	...	...	...	492	395	355	350
AsDB	...	...	...	200	150	100	100
Other	...	...	...	35	25	0	0
Residual financing gap	...	...	...	0	210	385	548
Memorandum items:							
Current account balance (percent of GDP)	0.1	0.3	-1.8	-2.2	-2.1	-2.1	-2.3
Export growth rate (percent)	9.5	15.8	4.1	2.0	5.1	7.9	9.0
Import growth rate (percent)	13.1	13.0	18.0	6.2	6.0	6.6	7.1
Gross official reserves (US$ million) 5/	2,471	2,714	2,709	2,710	2,951	3,395	3,865
(In months of imports of goods and services)	2.9	2.8	2.4	2.2	2.3	2.5	2.7
Net international reserves (US$ million)	1,604	1,917	1,993	1,993	2,228	2,557	3,008
Medium and long-term external public debt (US$ million)	16,519	16,761	17,802	18,757	19,901	21,231	22,862
(In percent of GDP)	31.9	29.5	29.3	29.8	29.7	29.2	28.9
Debt-service ratio 6/	5.6	4.3	5.0	4.9	4.8	4.8	4.8
Nominal GDP (US$ million)	51,744	56,842	60,805	62,867	67,016	72,767	78,982

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1. Balance of payments is presented on the basis of BPM5.
2/ Excludes official capital grants.
3/ Loans only. For FY05 includes flood-related donor assistance of US$123 million, plus World Bank loans (DSC II and education) totaling another US$300 million that were originally planned for FY04.
4/ Includes Asian Clearing Union balances.
5/ Gross foreign reserves of Bangladesh Bank, including resident foreign currency deposits.
6/ In percent of current earnings defined as the sum of exports of goods, nonfactor services, and private transfers.

Table 5. Bangladesh: Central Bank Balance Sheet, June 2004-June 2006

	Jun-04		Sep-04		Dec-04		Mar-05		Jun-05	Sep-05	Dec-05	Mar-06	Jun-06
	Prog.	Actual New Format 4/	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Program for FY06			
	(End of Period; in billions of taka)												
Net international reserves 1/	110	116	123	134	135	144	134	145	128	134	134	135	136
Net international reserves 2/	110	115	122	134	134	136	132	132	113	...	...	...	...
Net international reserves 3/	...	...	...	...	...	...	...	145	125	130	128	126	125
Net domestic assets 1/	122	123	114	109	118	106	122	116	138	138	145	151	157
Net domestic assets 2/	122	124	115	109	119	114	125	129	153	...	...	...	...
Net domestic assets 3/	...	...	...	...	...	...	...	...	140	142	151	160	167
Net credit to central government	53	110	75	76	83	82	86	96	116	113	121	128	134
Credit to other nonfinancial public sector	1	1	1	1	1	0	1	0	1	1	1	1	1
Credit to deposit money banks	53	55	54	54	56	56	57	58	60	61	62	62	63
Other items, net 1/	15	-43	-16	-21	-23	-32	-22	-37	-39	-37	-38	-39	-40
Reserve money	232	239	237	243	253	250	256	261	266	272	279	286	293
Currency	167	173	170	179	186	186	188	192	194	200	206	211	215
Reserves	66	66	67	64	67	64	68	69	72	72	73	75	78
	(Change since start of fiscal year; in billions of taka)												
Net international reserves 1/	17	22	7	18	19	29	18	29	12	6	6	7	8
Net domestic assets 1/	1	2	-9	-14	-5	-17	-1	-7	15	0	7	13	19
Net domestic assets 2/	...	...	-9	-15	-5	-10	1	5	29	...	...	...	...
Net domestic assets 3/	...	...	...	...	...	...	...	...	...	2	11	19	27
Net credit to central government	-10	13	-35	-34	-27	-28	-24	-14	7	-3	4	11	17
Credit to other nonfinancial public sector	0	0	0	0	0	-1	0	-1	0	0	0	0	0
Credit to deposit money banks	5	6	-1	-1	2	1	2	3	5	1	2	2	3
Other items, net	6	-16	27	21	20	10	21	5	4	2	1	0	-1
Reserve money	18	24	-2	5	14	11	17	22	27	6	13	20	27
Currency	13	19	-3	6	13	13	15	19	21	6	11	16	20
Reserves	5	5	1	-2	1	-2	2	3	6	1	1	4	6
Memorandum items:													
Reserve money (year-on-year percent change)	8.4	11.3	11.7	14.6	14.2	13.1	13.2	15.0	11.4	11.9	10.1	9.6	10.1
Net international reserves (in millions of U.S. dollars) 1/	1,825	1,915	2,025	2,257	2,248	2,412	2,200	2,288	1,993	2,063	2,028	2,008	1,993
Flow since start of fiscal year (in millions of U.S. dollars) 1/	221	311	200	341	331	497	283	372	78	70	35	15	0
Net international reserves (in millions of U.S. dollars) 2/	1,871	1,944	2,071	2,275	2,277	2,302	2,229	2,232	1,919	...	...	...	...
Flow since start of fiscal year (in millions of U.S. dollars) 2/	...	...	200	331	331	358	285	288	-25	...	...	...	...
Net international reserves (in millions of U.S. dollars) 3/	...	...	...	...	...	...	...	2,288	1,974	2,044	2,009	1,989	1,974
Flow since start of fiscal year (in millions of U.S. dollars) 3/	...	...	...	...	...	...	...	...	...	70	35	15	0
Required domestic cash reserves (in millions of taka)	48	49	49	50	50	53	53	60	62	64	66	68	70
Excess domestic cash reserves (in millions of taka)	14	17	18	14	17	11	15	9	10	9	7	8	8

Sources: Data provided by the Bangladeshi authorities; and Fund staff estimates and projections.

1/ Calculated from monetary data using end of period exchange rates.
2/ Calculated using program exchange rates (rates for FY05 as of end-March 2004).
3/ Calculated using program exchange rates (rates for FY06 as of end-March 2005).
4/ In April 2004, Bangladesh Bank revised its accounting standards in line with IAS best practises.

Table 6. Bangladesh: Monetary Program, June 2004-June 2006

	Jun-04		Sep-04		Dec-04		Mar-05		Jun-05	Sep-05	Dec-05	Mar-06	Jun-06
	Prog.	Actual New Format 1/	Prog.	Actual	Prog.	Actual	Prog.	Actual	Prog.	Program for FY06			
(End of period; in billions of taka)													
Net foreign assets	158	163	172	187	183	190	184	191	179	187	188	191	193
Bangladesh Bank	110	116	123	134	135	144	134	145	128	134	134	135	136
Commercial banks	48	47	49	53	48	45	50	46	51	53	54	56	57
Net domestic assets	1,118	1,134	1,139	1,147	1,219	1,216	1,255	1,219	1,302	1,337	1,380	1,427	1,477
Domestic credit	1,152	1,219	1,223	1,234	1,300	1,313	1,341	1,337	1,402	1,439	1,485	1,534	1,587
Net credit to central government	204	204	202	189	214	209	222	201	240	236	244	255	276
Credit to other nonfinancial public sector	59	69	59	68	73	68	76	71	76	78	79	81	82
Credit to private sector	889	946	963	977	1,011	1,037	1,043	1,065	1,086	1,125	1,162	1,198	1,229
Other items, net 1/	-34	-85	-84	-87	-81	-97	-86	-117	-100	-103	-105	-108	-110
Broad money (M2)	1,276	1,297	1,311	1,334	1,402	1,406	1,439	1,410	1,481	1,524	1,568	1,617	1,671
(Change since start of fiscal year; in billions of taka)													
Net foreign assets	18	23	9	24	20	27	21	28	16	8	10	12	14
Bangladesh Bank	17	70	7	18	19	29	18	29	12	6	6	7	8
Commercial banks	1	-2	2	6	1	-2	3	-1	4	2	4	5	7
Net domestic assets	118	134	5	13	85	82	121	85	168	35	78	125	175
Domestic credit	118	123	4	15	80	94	122	118	183	37	83	132	185
Net credit to central government	31	13	-2	-15	10	5	18	-3	36	-4	4	15	36
Credit to other nonfinancial public sector	4	13	-10	0	5	-1	7	2	8	2	3	5	6
Credit to private sector	83	97	17	31	65	91	97	119	139	39	76	112	143
Other items, net	0	11	1	-2	4	-12	-1	-33	-15	-3	-5	-8	-10
Broad money (M2)	136	157	14	37	105	109	142	113	184	43	88	137	190
(Year-on-year percent change)													
Net foreign assets	13.0	16.3	15.4	25.2	17.4	21.4	17.7	22.1	9.8	0.2	-0.7	-0.4	8.0
Net domestic assets	11.8	13.4	11.0	11.8	15.7	15.5	17.6	14.3	14.8	16.5	13.5	17.0	13.5
Domestic credit	11.4	11.9	8.3	14.6	14.5	19.8	17.3	14.2	15.0	16.6	13.1	14.8	13.2
Net credit to central government	17.7	7.8	17.1	9.6	17.5	24.6	24.2	20.6	17.7	24.8	17.0	26.9	15.1
Credit to other nonfinancial public sector	6.9	23.8	9.0	25.2	19.7	10.8	19.7	13.7	11.1	14.6	17.3	15.1	7.9
Credit to private sector	10.3	12.0	12.7	14.3	13.5	18.0	15.8	19.4	14.7	15.2	12.0	12.5	13.2
Other items, net	-0.5	-32.3	-18.3	42.8	-32.5	68.5	2.0	12.9	18.1	17.7	8.2	-8.3	10.0
Broad money (M2)	11.9	13.8	11.5	13.5	16.0	16.3	17.7	15.3	14.2	14.2	11.6	14.7	12.8
(In billions of taka, unless otherwise noted)													
Memorandum items:													
Broad money multiplier	5.49	5.43	5.53	5.48	5.54	5.62	5.61	5.49	5.57	5.60	5.63	5.65	5.71
Broad money velocity	2.62	2.58	2.61	2.58	2.52	2.51	2.52	2.54	2.52	2.52	2.51	2.50	2.49
Net domestic financing of central govt. (since beginning of FY)	76	60	4	-6	33	16	53	19	76	8	28	51	83
Bank	31	13	-5	-15	10	5	18	-3	36	-4	4	15	36
Nonbanks	45	46	9	9	23	11	35	22	40	12	24	36	47

Sources: Data provided by the Bangladeshi authorities; and Fund staff estimates and projections.
1/ In April 2004, Bangladesh Bank revised its accounting standards in line with IAS best practises.

Table 7. Bangladesh: Key Economic Indicators (Low Case Scenario), FY2003-09 1/

	2002/03	2003/04	Projections 2004/05	2005/06	2006/07	2007/08	2008/09
National income and prices (percent change)							
Real GDP	5.3	5.5	5.2	5.0	5.0	5.0	5.0
GDP deflator	4.4	5.5	6.0	6.3	6.7	6.1	6.1
CPI inflation (annual average) 2/	4.4	5.8	6.5	6.8	6.7	6.1	6.1
Central government operations (percent of GDP)							
Total revenue	10.3	10.1	10.5	10.4	10.3	10.2	10.2
Tax	8.3	8.2	8.6	8.5	8.4	8.3	8.3
Nontax	2.0	1.9	1.9	1.9	1.9	1.9	1.8
Total expenditure	13.7	13.3	14.7	14.8	14.6	14.4	14.3
Current expenditure	8.1	7.7	8.6	8.7	9.0	9.1	9.1
Of which : Interest payments	1.9	1.6	1.8	1.9	1.9	2.0	2.0
Annual Development Program	5.4	5.0	5.3	5.3	4.8	4.7	4.5
Other expenditures 3/	0.2	0.6	0.8	0.8	0.8	0.6	0.7
Overall balance (excluding grants)	-3.4	-3.2	-4.2	-4.3	-4.3	-4.2	-4.1
Primary balance	-1.5	-1.6	-2.4	-2.5	-2.4	-2.2	-2.1
Financing (net)	3.4	3.2	4.2	4.3	4.3	4.2	4.1
Domestic	1.3	2.1	2.0	2.6	2.6	2.9	2.9
External	2.1	1.1	2.2	1.7	1.7	1.3	1.2
Total central government debt (percent of GDP)	51.0	48.3	47.9	49.0	48.7	48.2	47.6
Money and credit (end of year; percent change)							
Net domestic assets	12.2	13.4	14.8	15.9	16.0	16.1	16.0
Private sector	12.6	12.0	14.7	12.9	12.7	12.6	12.6
Broad money (M2)	15.6	13.8	14.2	14.5	15.2	15.5	15.3
Balance of payments (in billions of U.S. dollars) 4/							
Exports, f.o.b.	6.5	7.5	7.8	7.8	8.1	8.5	9.0
(Annual percent change)	9.5	15.8	4.1	0.0	3.1	5.0	6.0
Imports, f.o.b.	8.7	9.8	11.6	12.2	12.8	13.5	14.2
(Annual percent change)	13.0	13.0	18.0	4.9	5.1	5.1	5.3
Gross official reserves (in billions of U.S. dollars)	2.5	2.7	2.7	2.6	2.6	2.4	2.0
In months of imports of goods and nonfactor services	2.9	2.8	2.4	2.2	2.0	1.8	1.5
Memorandum item							
Nominal GDP (in billions of taka)	3,005	3,345	3,731	4,166	4,674	5,208	5,805

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1.
2/ CPI has recently been rebased using FY96 weights.
3/ Consists of other capital, net lending, and food accounts (including check float and discrepancy).
4/ Balance of payments is presented on the basis of BPM5.

Table 8. Bangladesh: Projected Balance of Payments Impact of the Removal of MFA Quotas, FY2004-07 1/
(In millions of U.S. dollars, unless otherwise indicated)

	Projections			
	2003/04	2004/05	2005/06	2006/07
Projections under the 1st PRGF review 2/				
Trade balance	-3,109	-3,082	-3,107	-3,088
Exports	6,959	7,389	7,940	8,600
(in percent change)	7.2	6.2	7.5	8.3
Of which : RMG exports	5,379	5,675	5,987	6,316
(in percent change)	9.5	5.5	5.5	5.5
Imports (fob)	10,068	10,471	11,047	11,688
Services (net)	-1,211	-1,356	-1,388	-1,479
Overall balance	270	-307	-272	-328
NIR accumulation	270	300	310	254
Financing gap	0	607	582	582
Post-MFA, without policy adjustment (TIM baseline)				
Trade balance	-2,718	-3,422	-4,131	-4,165
Exports	7,353	7,110	6,706	6,937
(in percent change)	13.3	-3.3	-5.7	3.4
Of which : RMG exports	5,600	5,081	4,502	4,813
(in percent change)	14.0	-9.3	-11.4	6.9
Imports (fob)	10,071	10,532	10,838	11,101
Services (net)	-1,075	-1,391	-1,376	-1,398
Overall balance	221	-872	-1,480	-1,530
NIR accumulation 3/	221	103	-102	62
Financing gap	0	975	1,379	1,592
Post-MFA, with policy adjustment (2nd PRGF review program baseline)				
Trade balance	-2,718	-3,124	-3,598	-3,675
Exports	7,353	7,566	7,429	7,786
(In percent change)	13.3	2.9	-1.8	4.8
Of which : RMG exports	5,600	5,628	5,313	5,384
(in percent change)	14.0	0.5	-5.6	1.3
Imports (fob)	10,071	10,690	11,027	11,461
Services (net)	-1,075	-1,390	-1,419	-1,465
Overall balance	221	-521	-828	-765
NIR accumulation	221	350	-190	89
Financing gap	0	870	637	854
Post-MFA, with policy adjustment (revised program baseline)				
Trade balance	-2,319	-3,783	-4,346	-4,676
Exports	7,521	7,827	7,983	8,389
(In percent change)	15.8	4.1	2.0	5.1
Of which : RMG exports	5,686	5,857	5,798	5,943
(in percent change)	15.8	3.0	-1.0	2.5
Imports (fob)	-9,840	-11,610	-12,328	-13,065
Services (net)	-874	-1,141	-1,313	-1,400
Overall balance	313	76	-727	-545
NIR accumulation	313	76	0	235
Financing gap	0	0	727	780

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ The removal of quotas is not expected to materially affect balance of payments entries not explicitly included in the table.
2/ These projections incorporated very preliminary estimates of the potential MFA impact, based on partial data.
3/ For maintaining about three months of import cover.

Table 9. Bangladesh: Quantitative Targets and Performance Criteria Under the PRGF Arrangement, June 2004-June 2006 1/

(Cumulative flows, end of period) 2/

	Jun-04		Sept-04		Dec-04		Mar-05		Jun-05	Sept-05	Dec-05	Mar-06	Jun-06
	Indicative Targets		Performance Criteria		Indicative Targets		Indicative Targets		Indicative Targets	Proposed PCs	Proposed Indicative Targets		
	Target	Actual	Target	Actual	Target	Actual	Target	Actual					
	(In billions of taka)												
Ceiling on net domestic assets of Bangladesh Bank 4/	12 3/	13	-7	-15	-5	-10	1	8 7/	29	2	11	19	27
Ceiling on net domestic financing of central government 4/	76 3/	60	4	-6	33	16	53	19	76	8	28	51	83
Ceiling on net central government bank borrowing 4/	31 3/	13	-5	-15	10	5	18	-3	36	-4	4	15	36
Taxes collected by National Bureau of Revenue 5/	...	...	...	...	...	...	...	...	...	73	154	244	356
	(In millions of U.S. dollars)												
Floor on cumulative increase of net international reserves of Bangladesh Bank 4/	105	196 3/	200	331	220	358	200	237 7/	-25 8/	70	35	15	0
Contracting or guaranteeing of short-term external debt by the central government 6/	0	0	0	0	0	0	0	0	0	0	0	0	0
Contracting or guaranteeing of nonconcessional medium- and long-term debt by the central government 4/	250	8	100	8	150	8	200	8	250	100	150	200	250
Of which: External debt with an initial maturity of over one year and up to five years 6/	0	0	0	0	0	0	0	0	0	0	0	0	0
Accumulation of external payments arrears 6/	0	0	0	0	0	0	0	0	0	0	0	0	0

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates.

1/ The aggregates are defined in the Technical Memorandum of Understanding dated May 2003 (IMF Country Report No. 03/205).
2/ Cumulative flow since start of financial year beginning July 1.
3/ Including the bridge financing of Tk 16 billion for delay of the World Bank's DSCII and education loans (US$300 million) into July 2004.
4/ Performance criteria assessed on a periodic basis under the program period.
5/ Indicative targets assessed on a quarterly basis under the program period.
6/ Performance criteria assessed on a continuous basis under the program period.
7/ Corrected for shortfall in net open position of nationalized commercial banks.
8/ Relative to the actual NIR in June 2004, representing an increase of $48 million relative to the June 2004 program target.

Table 10. Bangladesh: Proposed Schedule of Disbursements Under the PRGF Arrangement and Augmentation of PRGF Access in Accordance with the Trade Integration Mechanism (TIM)

Original Amount	Augmentation	Total	Available Date	Conditions for Disbursement
SDR 49.5 million (9.3 percent of quota)		SDR 49.5 million (9.3 percent of quota)	June 25, 2003	Observance of the end-March 2003 quantitative benchmark, implementation of prior actions, and Board approval of arrangement.
SDR 49.5 million (9.3 percent of quota)		SDR 49.5 million (9.3 percent of quota)	December 15, 2003	Observance of the end-September 2003 performance criteria and structural performance criteria for end-September and end-November 2003, and completion of the first review.
SDR 49.5 million (9.3 percent of quota)		SDR 49.5 million (9.3 percent of quota)	July 28, 2004	Observance of the end-March 2004 performance criteria and structural performance criteria for end-December 2003 and end-April 2004, and completion of the second review.
SDR 49.5 million (9.3 percent of quota)	SDR 17.78 million (3.33 percent of quota)	SDR 67.28 million (12.63 percent of quota)	end-June, 2005	Observance of the end-September 2004 performance criteria and structural performance criteria for end-September and end-November 2004, implementation of prior actions, and completion of the third review.
SDR 49.5 million (9.3 percent of quota)	SDR 17.78 million (3.33 percent of quota)	SDR 67.28 million (12.63 percent of quota)	end-December, 2005	Observance of the end-September 2005 performance criteria and completion of the fourth review.
SDR 49.5 million (9.3 percent of quota)	SDR 17.78 million (3.33 percent of quota)	SDR 67.28 million (12.63 percent of quota)	mid-June, 2006	Observance of the end-March 2006 performance criteria and completion of the fifth review.
SDR 50.0 million (9.4 percent of quota)		SDR 50.0 million (9.4 percent of quota)	mid-December, 2006	Observance of the end-September 2006 performance criteria and completion of the sixth review.
Total SDR 347.0 million (65 percent of quota)	SDR 53.33 million (10 percent of quota)	SDR 400.33 million (75 percent of quota)		

Bangladesh: Fund Relations
(As of April 30, 2005)

I. **Membership Status:** Joined August 17, 1972; accepted the obligations under Article VIII, Sections 2, 3, and 4 on April 11, 1994.

II. **General Resources Account:**	SDR million	Percent Quota
Quota	533.30	100.00
Fund holding of currency	533.10	99.96
Reserve position in Fund	0.21	0.04

III. **SDR Department:**	SDR million	Percent Allocation
Net cumulative allocation	47.12	100.00
Holdings	0.54	1.15

IV. **Outstanding Purchases and Loans:**	SDR million	Percent Quota
PRGF arrangements	148.50	27.85

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	6/20/03	6/19/06	400.33	148.50
ESAF	8/10/90	9/13/93	345.00	330.00
SAF	2/06/87	2/05/90	201.25	201.25

VI. **Projected Payments to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	2005	2006	2007	2008	2009
Principal	0.00	0.00	0.00	4.95	14.85
Charges/interest	1.60	1.91	1.91	1.91	1.86
Total	1.60	1.91	1.91	6.86	16.71

VII. **Safeguards Assessment**

Under the Fund's safeguards assessment policy, the Bangladesh Bank is subject to a safeguards assessment with respect to an augmentation of access under the PRGF Arrangement approved on July 28, 2004. The assessment was completed on January 24, 2005 and concluded that safeguards in place at the BB require further improvement. Weaknesses were identified in the legal, financial reporting, internal audit and internal control areas, and the safeguards assessment recommended measures to address them.

VIII. Exchange Arrangement

Exchange regime. The exchange regime is characterized as a managed float with no preannounced path for the exchange rate. Until May 31, 2003, the taka was fixed to the U.S. dollar, but was periodically adjusted. It was devalued on three occasions during 2000–02, when the trading band for BB's transactions was correspondingly widened or raised. From January 2002 until May 30, 2003, the official band for the taka remained unchanged at Tk 57.4–58.4 per U.S. dollar. Authorized dealer (AD) banks set their own buying and selling rates for the U.S. dollar and other currencies generally within the band until October 2002. From November 2002, however, AD banks have set rates outside the band. Effective May 31, 2003, BB no longer announced a trading band for its foreign exchange transactions.

At the last Article IV consultation (June 2003), the Executive Board approved the maintenance by Bangladesh of margin requirements for the opening of letters of credit for the import of goods until November 30, 2003, and also approved the maintenance of restrictions for advance payments for imports and on the convertibility and transferability of proceeds of current international transactions in nonresident taka accounts until the conclusion of the second review under the PRGF arrangement or June 30, 2004, whichever is sooner. The former restriction was fully lifted as of end-December, 2004. The latter restriction is expected to be removed by end-June 2006.

IX. Article IV Consultation

The next Article IV consultation will be held subject to the provisions of the decision on consultation cycles approved on July 15, 2002. Prior to the Article IV consultation described in this report, the last Article IV consultation was held over two missions in January and April 2003, and was concluded on June 20, 2003 (IMF Country Report No. 03/205).

X. Technical Assistance During 2003–05

2003

January and May:	MFD missions advised on preparations for moving to a flexible exchange rate regime.
March–Sept.:	MFD resident adviser assisted BB with liquidity forecasting and monetary and exchange operations.
May:	MFD mission assisted BB with nationalized commercial bank (NCB) reforms; a peripatetic advisor assisted BB with producing its FY03 accounts in accordance with IAS.
August:	MFD mission provided recommendations for reducing interest rates.
August–Sept.:	FAD mission provided recommendations on tax administration.

November: MFD mission provided recommendations to prepare resolution strategies for the NCBs and on the functioning of treasury bill markets.

LEG/MFD mission on revising Bangladesh's foreign exchange regulations.

STA mission provided recommendations to improve monetary and financial statistics.

2004

January–February: STA mission provided recommendations in the area of Government Finance Statistics.

February–May: An MFD expert assisted the Fund mission in monitoring and expanding memoranda of understanding for the nationalized commercial banks.

February–Oct: A peripatetic advisor assisted BB with improving accounting standards in accordance with IAS.

March–April: STA mission provided recommendations to improve balance of payment statistics, particularly in the areas of foreign direct investment, private sector external debt, and related income items.

April–Oct: An MFD expert provided periodic assistance in the area of foreign exchange operations.

2005

February–March: STA mission conducted the data ROSC.

March: MFD expert provided assistance in the area of bond market development.

XI. Resident Representative

The resident representative office was established in 1972. The current Resident Representative, Mr. Jonathon Dunn, took up the post in August 2004.

BANGLADESH: RELATIONS WITH THE WORLD BANK[7]

The World Bank has an expanding assistance program in Bangladesh including investment and policy-based lending, analytical and advisory services, and lending and nonlending technical assistance. The Bank also maintains policy dialogue on a broad range of macroeconomic and sector issues. This Annex, however, focuses on Bank activities that are complementary to those of the Fund.

World Bank-Bangladesh relations and policy dialogue

Since taking office in 2001, the government has made progress on critical areas such as budgetary management, state-owned enterprises (SOEs), central and commercial banking, energy, telecommunications, public procurement, separation of public accounts and audit, and other areas of economic governance. The Bank has regularly interacted with the Government and provided inputs for the design and sequencing of reforms, as requested by the authorities.

The draft Poverty Reduction Strategy Paper (PRSP) was completed in December 2004, building on the broad-based, participatory process followed to prepare the interim PRSP. To obtain inputs for the latter, the government organized a series of national consultation workshops, including various government and nongovernmental organizations, members of civil society, and development partners. Further consultations are planned by the government to finalize the PRSP. The Joint Staff Assessment, prepared by the Bank and the Fund and presented to their Boards on June 2003, concluded that the interim PRSP constituted an adequate framework for enhancing growth and poverty reduction.

As part of its nonlending services, the Bank has completed key reports. These include, inter alia, the *Public Expenditure Review* and the *Poverty Assessment*—prepared jointly with the Asian Development Bank—which provided inputs for the I-PRSP. In addition, an *Investment Climate Assessment* (jointly with the Bangladesh Enterprise Institute) and a report on *Private Provision of Infrastructure* in Bangladesh have been completed. More recently, the Bank completed the *Development Policy Review*, a review of trade policies in south Asia, and the *Bangladesh Development Forum Economic Update*. Other key Bank reports included the *Observance of Standards and Codes* (ROSC), *Promoting the Rural Non-Farm Sector in Bangladesh*. The World Bank study *Attaining the Millennium Development Goals in Bangladesh: How Likely and What Will it Take?* was launched recently and a dialogue was held with economists, academics, and key policy makers.

In response to the government's and development partners' requests, and in recognition of the increasing trend in contracting non-government organizations (NGOs) for service delivery, the Bank is carrying out a study of the NGO sector, focusing on the implementation of NGO activities, government-NGO relations, NGO impact on development outcomes, and

[7]Prepared by World Bank staff.

their long-term financial sustainability. The study on *Strategy for Growth and Employment*, planned for delivery in FY06, will assess the longer-term growth challenges facing Bangladesh.

In response to the government's request, a joint team from the Asian Development Bank and the World Bank conducted an assessment of the damage caused by the floods that affected the country from July to September of 2004. The joint team estimated losses at US$2.2 billion. The joint team also helped outline a recovery program including short- and medium-term rehabilitation and reconstruction needs as well as long-term hazard mitigation priorities. Following this phased approach, the World Bank reallocated US$200 million from existing IDA credits to support recovery in sectors in which it has strong engagement, complementing the assistance from AsDB and other development partners. Specifically, of the total reallocation, US$45 million will help finance imports urgently needed for reconstruction and recovery, US$10 million will finance a micro-credit program for livelihood restoration, and US$145 million will be used for rehabilitation of infrastructure and school facilities. To ensure that the rehabilitation work will be done in a timely manner, the Bank will establish intensified monitoring and supervision mechanisms.

Restructuring SOEs. The Bank has engaged in an extensive dialogue with the authorities on SOE-related issues. A report entitled *Bangladesh: Review of Public Enterprise Performance and Strategy* was discussed widely. In response to a request from the authorities, the Bank provided technical assistance to the Privatization Commission and assisted it in the preparation of the government's new Privatization Policy, which has since been endorsed by Cabinet. Dialogue relating to SOEs in the energy sector has been particularly intensive and the Bank has provided detailed recommendations to the authorities in areas relating to pricing policy and the regulatory regime for energy and other utilities. As part of a wide reform program of rolling back state ownership and control within the economy, the Enterprise Growth and Bank Modernization Project, approved in June 2004, is supporting restructuring of financial and nonfinancial SOEs.

Restructuring the financial system. The Bank has been actively engaging the authorities in a dialogue on financial sector reform. Together with the Fund, the Bank co-managed the Financial Sector Assessment Program report that was prepared in October 2002. With IDA financing, the government is implementing a program to strengthen the Bangladesh Bank. The mentioned Enterprise Growth and Bank Modernization Project is supporting restructuring and eventual divestment of the nationalized commercial banks.

Trade liberalization. In response to requests from the authorities, the Bank has provided regular analytical support to the government. The Bank-supported Export Diversification Project included a component designed to build capacity within the Tariff Commission for tariff analysis and WTO-related negotiations. In addition, the Bank has regularly provided trade-related policy notes as inputs into the annual budget preparation process. A report was also completed last year on trade policy regimes in south Asia and another trade study relating to Bangladesh and India is ongoing. The recently-completed *Bangladesh Growth and Export Competitiveness Study* examined key macro- and microeconomic factors affecting Bangladesh's competitiveness and provided specific recommendations on priority policy and institutional actions. Further, the upcoming Bank study on the *Challenges and Opportunities* *in a Post-MFA World: Strategic Options for Sustained Export Growth* will analyze the key issues facing the Bangladesh ready-made garment sector as it faces a changing world scenario without quotas.

Infrastructure development. Infrastructure development is needed in the country for economic growth in general, and private sector development in particular. In this context, the Bank is helping to prepare a power sector strategy, and is supporting a Power Sector Development Technical Assistance which includes a project preparation facility.

Strengthening governance. The Bank has engaged the government in an active dialogue aimed at improving the investment climate by strengthening accountability and transparency. The Bank has prepared several analytical reports on the subject, including an Institutional and Governance Review, a Country Financial Accountability Assessment, a Country Procurement Assessment, and user surveys on the quality of service delivery. In addition, the Bank is providing technical assistance to the government for improving its procurement systems.

The Bank is currently preparing a series of policy notes on selected aspects of public administration and governance, including policy advice to the Ministry of Finance, National Pay Commission, and the Ministry of Establishment in relation to civil service reform issues, including compensation policy.

As part of the Bank's regular public expenditure work, a set of policy notes is also being initiated, which will form the basis for the Public Expenditure Review in FY2006. A programmatic approach is being taken to allow better cooperation with other donors. The unifying theme of the notes will be the role of public expenditure on growth and poverty reduction and these aim to set the stage for the government to use the evaluation as an input into their budget preparation process. As part of the *Economic Management Technical Assistance Program*, a technical assistance project for the National Board of Revenue will assist in its capacity building; focusing: on organizational restructuring, human resource management; development of ICT capacity, strengthening customs, VAT and income tax administration; training, research, and statistics.

The World Bank's country assistance strategy

A new Country Assistance Strategy (CAS) is being prepared jointly with AsDB and DFID, and with JBIC as an observer. The new CAS, which should be finalized in the first half of FY06, will help align Bank assistance with the country's PRSP.

The FY01 CAS had identified four main strategic thrusts to help Bangladesh's poverty reduction efforts: (i) build stronger institutions and governance across sectors; (ii) consolidate gains in human development; (iii) implement an integrated approach to rural development; and (iv) accelerate and broaden private sector-led growth. The *FY03 CAS Progress Report*, which was discussed by the Board in June 2003, confirmed these thrusts while initiating a shift in Bank assistance toward more programmatic policy-based lending to support I-PRSP goals, and re-engagement in sectors critical to the country's development such as power and water management. Accordingly, the Bank approved the first

Development Support Credit ($300 million) in FY03, complementing a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) approved by the IMF Board in June 2003. The second *Development Support Credit* (US$200 million) was approved in July 2004.

The World Bank's assistance program

The Bank has been assisting Bangladesh since FY1973. As of February 28, 2005, the World Bank Group has approved 200 IDA credits, 4 IDA grants and 1 IBRD loan for Bangladesh totaling US$11.4 billion in original commitments. The active portfolio included 28 projects, representing 2.5 billion in net commitments and US$1.6 billion in undisbursed funds. During FY2004, new commitments totaled $526.5 million and disbursements totaled $230 million. The Bank is currently supporting projects in key sectors, including social and human development, rural development, energy and infrastructure, private sector development, finance, and environment. These operations emphasize policy and institutional reforms in line with the CAS and CASPR objectives.

In FY2004 the Bank approved three IDA credits totaling US$407.1 million and four IDA grants totaling US$119.4 million to support six projects. IDA credits are helping finance the Second Primary Education Development Project (US$150 million), which is part of a Sector Wide Approach (SWAp) supported by a donor consortium led by AsDB; and the Enterprise Growth and Bank Modernization Project (US$250 million). The Power Sector Development TA Project is being financed by an IDA credit of US$7.1 million and an IDA grant of US$8.4 million, while the Bangladesh Water Supply Program ($40 million), the Reaching Out of School Children Project ($51 million), and the Economic Management Technical Assistance Program ($20 million) are being supported with IDA grants.

In FY2005 the Bank plans to approve three IDA credits for a total of US$601 million in projected commitments. Of these, two adjustment credits had already been approved and fully disbursed: the second Development Support Credit (US$200 million) and the Programmatic Education Sector Adjustment Credit (US$100 million). DSC II continued to support the main themes of the I-PRSP—attaining macroeconomic stability, improving governance, enhancing human development and ensuring social protection—and recognized the government's efforts at implementing broad reforms in pursuit of the I-PRSP goals. The remaining project[8] in FY2005 is the Health, Nutrition and Population Sector Program II ($301 million), prepared within a sector-wide approach (SWAp) framework supported by several development partners.

Projected commitments for FY2006 are about US$700 million. About US$300 million of these commitments would support policy-based lending, including the Third Development Support Credit and the second Programmatic Education Sector Adjustment Credit. Investment credits totaling about US$400 million would support projects promoting private

[8] IDA Credit amounts are indicative.

sector participation in infrastructure, agriculture technology, road sector reform, tax and customs administration reform, and possibly, power sector development.

As of December 2004, the International Finance Corporation's (IFC) held portfolio stood at US$160 million in 11 projects, of which US$126.7 million was on IFC's own account and US$33.3 million was in B-loans. Projects span sectors such as power, telecommunications, cement, gas, and financial markets. During FY2004, IFC committed $5 million in a leasing company, ULC, as well as US$40 million to an oil and gas company, Cairn Energy, to support its expenditure needs in Bangladesh and India. In addition, IFC has a second investment in GrameenPhone (US$30 million) and as a small equity investment of US$1.6 million in a local commercial bank, BRAC Bank, focusing on SMEs.

In FY2002, with the support of several donors, IFC started a regional Small-Medium Enterprise (SME) technical assistance facility covering Bangladesh, Bhutan, Nepal, and north-east India. IFC has committed $5 million to the facility for the duration of the initiative. In December 2004, South Asia Enterprise Development Facility (SEDF), Foreign Investment Advisory Service (FIAS), and IFC hosted a roundtable on regulatory reform and economic zones in Dhaka. FIAS expects to release an investment incentives review for the government shortly and is scheduled to begin work on a study on administrative barriers to investment as well as a review of economic zones policy and its implementation.

The Bank Group continues to be involved in providing technical and advisory assistance to the government in a number of areas, including banking, energy, privatization, taxation, tariff and trade policy, poverty monitoring and analysis, and financial management.

World Bank-Fund collaboration

The Bank and the Fund have been working closely in Bangladesh, particularly in areas related to macroeconomic management, financial sector, reform of SOEs, tax policy and administration, public expenditure management, and issues relating to financial accountability. Bank staff routinely participate in Article IV missions and provide feedback, as requested, on the macroeconomic framework and other aspects of the Fund's macroeconomic dialogue with the authorities. The Bank co-managed the Financial Sector Assessment Program report and Fund staff were regularly consulted during the preparation of the Public Expenditure Review. The Bank has also collaborated with the Fund in several areas related to the ROSC and safeguards assessment.

Dialogue between the two institutions has intensified in recent years, especially in the context of the preparation of the country's poverty reduction strategy. In addition, Fund and Bank staffs collaborated closely in preparing the Joint Staff Assessment of the I-PRSP, and in completing the complementary Development Support Credits and PRGF.

BANGLADESH: RELATIONS WITH THE ASIAN DEVELOPMENT BANK

Lending operations

The Asian Development Bank (AsDB) has assisted Bangladesh since 1973. The cumulative commitment, disbursement and outstanding loan to Bangladesh stood at $7.4 billion, $5.18 billion and $4.44 billion respectively on December 31, 2004. The Country Operational Strategy finalized in August 1999 identified poverty reduction as the overarching objective of AsDB's country operations in Bangladesh. The preparation of a new, results-based Country Strategy and Program (CSP) is underway. CSP will be based on WB – AsDB – Japan – DFID joint country strategy to support implementation of the government's poverty reduction strategy.

The Country Strategy and Program Update (CSPU) for 2005–06, approved in August 2004, envisaged an annual average lending level of $495 million to Bangladesh for the two-year period. AsDB supports the government with a substantial aid package subject to resource availability and country performance.

Subsequent to approval of the CSPU for 2005–06, AsDB quickly responded to the devastating floods in Bangladesh during July–September 2004 with an emergency assistance loan for rehabilitation of the flood damage. The emergency loan was approved in January 2005, amounting to $180 million in Asian Development Fund (ADF) resources. Including this emergency loan, the AsDB's firm lending program for 2005 is about $550 million ($230 million Ordinary Capital Resources and $320 million ADF) for the following projects: Assistance to Agribusiness Development ($50 million), Urban Primary Health Care II ($40 million), Southwest Area Integrated Water Resource Management ($30 million), Social Protection for Disadvantaged Women and Children ($15 million), Financial Markets Governance Improvement TA loan ($5 million), Gas Sector Development Project ($230 million), and already approved Emergency Flood Damage Rehabilitation Project ($180 million). In addition, there is a stand-by loan in 2005 program–Railway Sector Development Project ($180 million).

Technical assistance

As of December 31, 2004, the AsDB has provided 297 technical assistance grants for project preparatory and advisory services amounting to $158 million. Seventeen technical assistance grants are programmed for 2005–06, amounting to about $5 million annually.

Economic and sector work program

The AsDB publishes its Asian Development Outlook and its update every year in which it assesses macroeconomic performance. Beginning in 2001, the AsDB has also prepared quarterly economic updates.

In support of AsDB's Country Strategy and Program exercise, several new thematic assessments and sector studies have been undertaken, and have been completed, or nearing completion. These include: thematic assessments for poverty, growth and poverty reduction, private sector development, governance, environment, and gender, and sector studies for transport, information and communications technology, water resource development, agriculture and rural development, fisheries, regional cooperation, finance, industry and trade sectors, and Dhaka-Chittagong economic corridor development.

BANGLADESH: STATISTICAL ISSUES

Bangladesh is a participant in the General Data Dissemination System (GDDS), and its metadata have been posted on the Fund's Dissemination Standards Bulletin Board since March 2001. A ROSC data module mission to Bangladesh was undertaken in March 2005, and the report is being prepared.

Multisector statistics mission

A STA Multisector Statistics mission visited Dhaka during August 14–22, 2002. Its key recommendations were:

- The enactment of legislation to define the role of the Bangladesh Bureau of Statistics (BBS) and to provide it with sufficient powers to fulfill its mandate;
- More resources should be provided to BBS and its management strengthened;
- Both inter-agency cooperation and collaboration within BBS should be improved; and
- An adequately funded unit needs to be established at the Ministry of Finance to collect consistent monthly and annual fiscal data on stocks and flows.

The mission developed an action plan to deal with these broader issues, as well as more specific sectoral recommendations.

National accounts

The weakness of source data remains the primary deficiency. The BBS does not conduct an annual national accounts survey of business enterprises and source data are primarily from benchmark surveys, a census of manufacturing establishments conducted every two years, and biannual household expenditure surveys. Many of the benchmark surveys were conducted over five years ago and are based on outdated sample frames. The multisector 2002 statistics mission recommended that the BBS implement an annual survey to collect data from enterprises and also explore the possibility of tapping administrative data sources.

The deficiencies in the data also affect compilation practices. There is heavy reliance on the use of fixed input-output ratios in estimating current value added. Thus estimates do not always reflect the rapid change in the structure of some industries over time. In addition, the use of price statistics as deflators and some inappropriate deflation techniques may undermine the reliability of the constant price estimates for some industries. A system of price indices for estimating national accounts at constant prices needs to be developed.

Bangladesh lacks quarterly estimates of GDP, and the compilation of quarterly national accounts, with technical assistance from the AsDB, is included in the authorities' GDDS plans for improvement. However, given resource constraints, improving the sources and methodology for annual data should be a short-term priority. Improvement in data sources should pave the way for the compilation of advance indicators of economic activity.

Prices, wages, and employment

Price statistics include a consumer price index (CPI), a producer price index (PPI), a wholesale price index (WPI), and unit value indices for external trade. The CPI and WPI are published with lags of two and three months, respectively, while unit value indices of exports and imports are available on an annual basis. The CPI and PPI weights are outdated, and the August 2002 STA mission recommended that the CPI be compiled using weights derived from a household and expenditure survey completed in 2002.

Data for wages are prepared monthly, but employment and unemployment data are only available at irregular intervals.

Government finance and debt

Fiscal data continue to have major shortcomings. Traditionally, there was no specific unit in charge of compiling fiscal statistics. Recently, a unit at the Comptroller General of Accounts (CGA) was given the responsibility for compiling government finance statistics. A Task Force on Monitoring of Economic Data was established in November 2001, with the purpose of creating an interagency system for monitoring macroeconomic data. The emphasis is on data relevant for dialogue with Fund staff. The task force is chaired by the Joint Secretary in charge of the budget, and includes members from the Ministries of Finance and Planning, CGA, Bangladesh Bank (BB), and the National Savings Directorate. Building on the Reforms in Budgeting and Expenditure Control project and its successor, the Financial Management Reform Program, the task force has helped shorten the lag in availability of budget data from over two months in some cases to five weeks; initiated a framework for monitoring state-owned enterprises and public arrears; enhanced the quality of existing data, including through more systematic reconciliation of data between sources and across agencies; and increased the exchange of information between organizations.

The National Board of Revenue is now able to produce monthly data on revenue of the budgetary central government on a cash basis with a lag of one month, and the CGA produces monthly data on recurrent expenditure with a lag of five weeks. However, the coverage of the above-line items is not consistent with financing data. In addition, some externally funded project aid is underreported, leading to an understatement of government outlays. However, this does not affect the overall budgetary balance, because grants are correspondingly understated. The coverage of government data also excludes local government data.

Annual data on the government's external financing for the budget and foreign grants are available with a lag of nine months. Domestic financing data provided by the National Savings Directorate with a lag of six weeks, were found to have serious shortcomings. Efforts continue to improve the quality and timeliness of the external financing data, which remains weak. External debt monitoring and management remain very weak. External debt stock data by creditor is available with a lag of about 8 to 12 months, and the authorities do not have an automated system for external debt projections. Technical assistance provided by Norway to implement an UNCTAD electronic external debt management system was ended before yielding tangible results. UNDP has committed to provide assistance to complete the project.

There are also other deficiencies in the compilation of government finance statistics (GFS). Although annual GFS data for 2003 were provided by the authorities for inclusion in the *Government Finance Statistics Yearbook* 2004, the coverage of the data was limited to central government since no GFS data are collected on local governments, and there is no capability to compile consolidated data on general government operations. No quarterly or monthly GFS data are reported to the IFS. During the GFS mission in January/February 2004, the authorities adopted a proposed migration plan to implement the *GFSM 2001*.

Monetary accounts

Monthly accounts of the BB and other depository corporations are available with a lag of six weeks. In addition, BB also produces a weekly publication (shared with the Fund) that is available with a lag of about five to six weeks. In line with the 2002 multisector mission's recommendations, BB has begun reporting its monetary accounts to the Fund electronically. The November 2003 monetary and financial statistics mission reported that the authorities have made progress in implementing other recommendations of the multisector mission and embarked on a project to include the accounts of cooperative banks and nonbank depository corporation into the depository corporations survey. The BB has also expressed a strong interest in establishing an integrated database that links monetary statistics to accounting records and yields alternative, transparent, and consistent presentations of monetary statistics for different users.

Balance of payments

Balance of payments data from the first quarter of 1996 are available broadly on the basis of the fifth edition of the Balance of Payments Manual (BPM5). Apart from export shipments data, most other statistics are recorded on a cash basis, with the banking and exchange control records being the primary source of data. Summary balance of payments (BOP) data are compiled and disseminated on a monthly basis. Quarterly statistics for all the major accounts are available, while annual data present a detailed classification. Nontrade activities of companies operating in the export processing zones with the rest of the world are excluded. Data on private sector external borrowing, the transactions of foreign direct investors, and workers' remittances through the informal hundi banking system are not fully incorporated in the official published data. Official foreign direct investments (FDI) may not be fully reported. Data on income and transfers are incomplete. Data on suppliers' credit to the government are available on a monthly basis with a three-month lag, but are not comprehensive. Since August 2002, BB has changed its BOP reporting to be more consistent with BPM5, in line with the recommendations of the multisector statistics mission.

A follow-up BOP mission took place in March/April 2004 and focused on FDI, private sector external debt, and related income items. The mission reported progress in implementing the recommendations of the multisector mission, and provided recommendations to improve FDI surveys and estimation methods in incorporating FDI survey data into the quarterly BOP and annual IIP.

BANGLADESH: TABLE OF COMMON INDICATORS REQUIRED FOR SURVEILLANCE

As of April 25, 2005

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]
Exchange Rates	4/25/05	4/25/05	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	4/25/05	4/25/05	D	D	D
Reserve/Base Money	4/25/05	4/25/05	D	D	M
Broad Money	Jan. 2004	3/14/05	M	M	M
Central Bank Balance Sheet	Jan. 2004	3/14/05	W/M	W/M	M
Consolidated Balance Sheet of the Banking System	Jan. 2004	3/14/05	M	M	M
Interest Rates[2]	4/15/05	4/17/05	W	W	W
Consumer Price Index	Feb. 2005	4/1/05	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	n/a	n/a	n/a	n/a	n/a
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Jan. 2005	3/4/05	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Jan. 2005	3/4/05	M	M	M
External Current Account Balance	Dec. 2004	3/15/05	M	M	M
Exports and Imports of Goods and Services	Feb. 2005/ Jan. 2005	4/2/05	M	M	M
GDP/GNP	2002/03	6/3/04	A	A	A
Gross External Debt	Dec. 2004	2/15/05	A	A/M	A

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

BANGLADESH: DEBT SUSTAINABILITY ANALYSIS[9]

This attachment summarizes the debt sustainability analysis (DSA) for Bangladesh using the new framework for low-income countries. The macroeconomic scenario underlying this DSA is the program scenario discussed in this staff report. Sensitivity of the profile of the debt-to-GDP ratio to a number of standardized shocks is also discussed.

A. Main Assumptions

- Economic growth will accelerate to 6½ percent over the medium term, reflecting surging private investment (including FDI) and export diversification.

- Monetary policy is geared toward achieving the government's objective of lowering inflation and maintaining sound external positions. GDP deflator is projected to decline to 4 percent by FY08 and staying at that level thereafter.

- Reflecting efficiency gains from revenue reform, the tax-GDP ratio would rise steadily from 8.2 percent of GDP in FY04 to 9.5 percent of GDP in FY09.

- The increased domestic revenue mobilization, together with sustained external financing, will allow the government to finance pro-poor and pro-growth spending, with a view to achieving the MDGs. The wage bill will be contained through strict limits on wage increases and civil service reform. The budget deficit is projected to stabilize at around 4 percent.

- Structural reforms in NCBs and SOEs will continue to improve governance, efficiency in resource allocation, and investment climate.

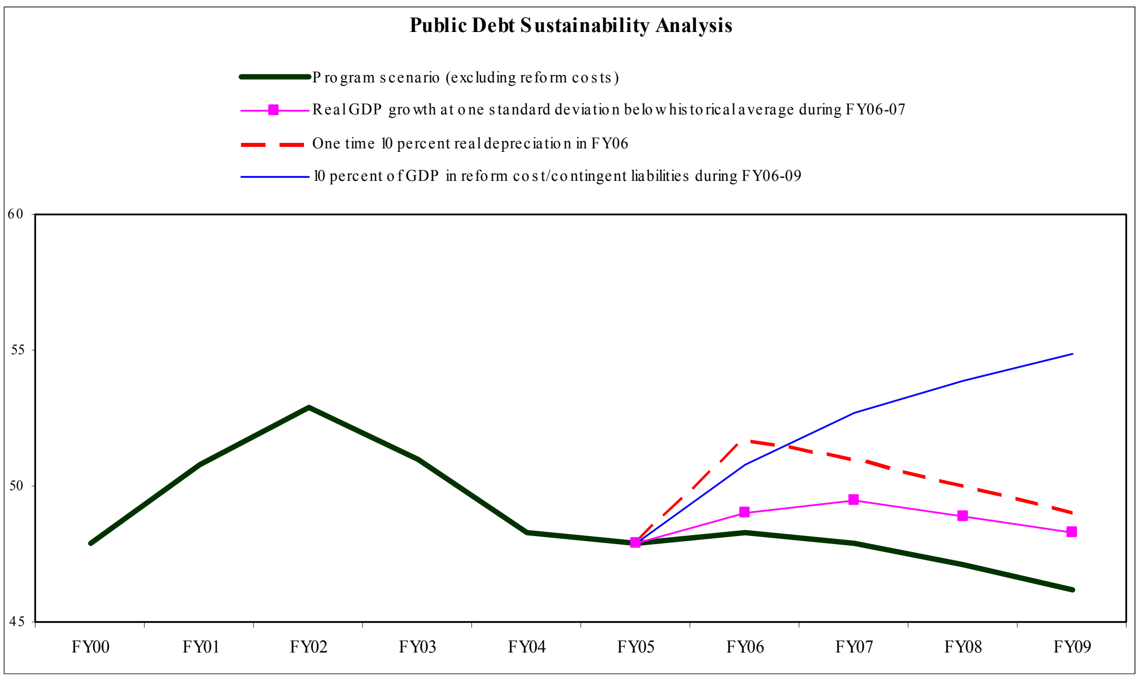
B. Total Public Sector Debt Sustainability

The program scenario projects a gradual decline in central government debt, from about 53 percent of GDP in FY02 to about 46 percent of GDP in FY09, due mainly to the reduction in the budget deficit and improved growth prospects. Similarly, the NPV of public debt would also decline from about 34 percent in FY02 to about 30 percent in FY09. To check the robustness of the conclusions, we subject this scenario to a number of stress tests (see Table 1). These include: (i) the key variables kept at their respective historical averages; (ii) a lower long-run GDP growth; (iii) real GDP and primary balance kept below their historical mean; (iv) one-time 10 percent real exchange rate depreciation; (v) 10 percent of GDP in reform costs/contingent liabilities.

---

[9] As the new procedures on DSAs were only established by the Board after the end of the Article IV consultations, this DSA has not been undertaken jointly with the World Bank.

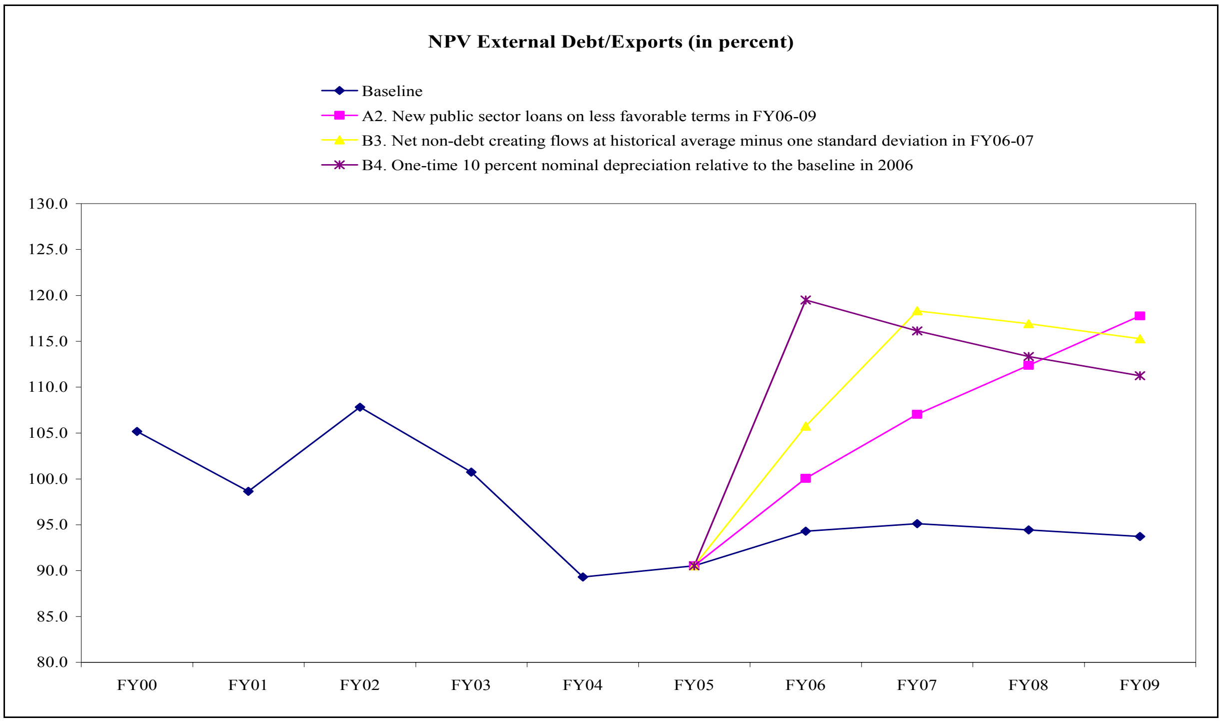
The sensitivity analyses suggest that the program scenario is most vulnerable to a shock to reform cost/contingent liabilities and a large real depreciation of the exchange rate (Table 2 and Chart below). A one-time real exchange rate depreciation of 10 percent would increase the debt–to-GDP to about 58 percent by FY09. Other macroeconomic shocks analyzed would have an impact of up to 2-percenatge point of GDP on the debt dynamics. The potential restructuring costs of SOE and NCB reforms are tentatively estimated at up to 10 percent of GDP (i.e., below the line in the budget for eventual NCB recapitalization and resolution of SOE arrears), which are assumed to be absorbed during FY06–09. This would have a significant, but transitory impact on the public debt ratio to about 55 percent of GDP by FY09.



C. External Debt Sustainability

More than half of the total public sector debt analyzed above concerns external debt. Under the program scenario, external debt is roughly stable around 29 percent of GDP, and in NPV terms it is increasing from 90 to about 94 percent of exports between FY05 and FY09, but still remains relatively low, and comfortably below HIPC thresholds. The increase in the NPV-to-exports ratio is effectively caused by the projected post-MFA decline in export growth. Almost all of Bangladesh's external debt is on concessional terms, with an average grant element of 55 percent. At about 7 percent of exports, debt service payments also remain manageable.

Subjecting the baseline scenario to a number of stress tests indicates that the external debt should remain manageable. The ratio of NPV to exports remains below 120 percent in all cases analyzed. However, a significant increase in NPV ratios does occur in some of the sensitivity analyses (chart below). Contracting of loans on less favorable terms (assuming that the interest rate on new borrowing is 2 percentage points higher than under the baseline scenario) would lead to a steady increase of the NPV ratio to 118 percent of exports in FY09, as opposed to 94 percent under the baseline scenario, confirming the sensitivity of public debt to interest rates. Less nondebt creating flows, such as official and private transfers and FDI, would lead to a similar increase in the NPV ratio, albeit declining at the end of the projection period, showing the important role of continued external inflows. Finally, a one-time 10 percent nominal depreciation would lead to the largest initial shock to the NPV ratio. It would decline thereafter, but remain considerably above the level of the baseline. This supports the argument for keeping exchange-rate depreciations orderly.



Annex V -- Table 1. Bangladesh: External Debt Sustainability Framework 1/
(In percent of GDP, unless otherwise indicated)

	Actual					Historical Average 6/	Standard Deviation 6/	Projections				
	FY00	FY01	FY02	FY03	FY04			FY05	FY06	FY07	FY08	FY09
External debt (nominal) 1/	**32.5**	**33.5**	**34.2**	**31.9**	**29.5**	**...**	**...**	**29.3**	**29.8**	**29.7**	**29.2**	**28.9**
Of which : public and publicly guaranteed (PPG)	32.5	33.5	34.2	31.9	29.5	...	...	29.3	29.8	29.7	29.2	28.9
Change in external debt	-0.1	1.0	0.7	-2.3	-2.4	...	...	-0.2	0.6	-0.1	-0.5	-0.2
Identified net debt-creating flows	-0.9	1.5	-1.6	-3.6	-3.8	...	...	-0.3	-0.2	-0.2	-0.3	-0.1
Noninterest current account deficit	**0.4**	**1.8**	**-0.8**	**-0.5**	**-0.6**	**0.4**	**1.0**	**1.5**	**1.9**	**1.8**	**1.8**	**2.0**
Deficit in balance of goods and services	5.3	6.2	4.8	5.6	5.6	...	...	8.1	9.0	9.1	8.8	8.5
Exports	13.9	15.3	14.3	14.3	14.9	...	...	14.6	14.2	14.0	13.9	13.9
Imports	19.2	21.5	19.0	19.9	20.5	...	...	22.6	23.2	23.1	22.7	22.4
Net current transfers (negative = inflow)	-5.1	-4.6	-5.9	-6.6	-6.6	-5.3	1.0	-6.9	-7.4	-7.5	-7.1	-6.7
Other current account flows (negative = net inflow)	0.1	0.2	0.3	0.6	0.4			0.3	0.3	0.2	0.2	0.2
Net FDI (negative = inflow)	**-0.6**	**-0.7**	**-0.7**	**-0.7**	**-0.7**	**-0.4**	**0.4**	**-0.7**	**-0.7**	**-0.7**	**-0.6**	**-0.6**
Endogenous debt dynamics 2/	**-0.6**	**0.4**	**-0.1**	**-2.4**	**-2.6**	**...**	**...**	**-1.2**	**-1.4**	**-1.4**	**-1.5**	**-1.5**
Contribution from nominal interest rate	0.3	0.3	0.3	0.3	0.3	...	...	0.3	0.3	0.3	0.3	0.3
Contribution from real GDP growth	-1.9	-1.7	-1.5	-1.7	-1.6	...	...	-1.4	-1.7	-1.7	-1.8	-1.8
Contribution from price and exchange rate changes	0.9	1.8	1.1	-1.1	-1.3	...	...	…	…	…	…	…
Residual (3-4) 3/	**0.8**	**-0.6**	**2.4**	**1.3**	**1.4**	**...**	**...**	**0.1**	**0.7**	**0.1**	**-0.2**	**-0.1**
Of which : exceptional financing	0.0	0.0	0.0	0.0	0.0			0.0	-1.2	-1.2	-1.2	-1.3
NPV of external debt 4/	14.6	15.1	15.4	14.4	13.3	...	...	13.2	13.4	13.4	13.1	13.0
In percent of exports	105.2	98.6	107.8	100.7	89.3	...	...	90.5	94.3	95.1	94.4	93.7
NPV of PPG external debt	**14.6**	**15.1**	**15.4**	**14.4**	**13.3**	**...**	**...**	**13.2**	**13.4**	**13.4**	**13.1**	**13.0**
In percent of exports	**105.2**	**98.6**	**107.8**	**100.7**	**89.3**	**...**	**...**	**90.5**	**94.3**	**95.1**	**94.4**	**93.7**
Debt service-to-exports ratio (in percent)	9.2	8.3	8.6	8.1	7.8	...	...	7.0	7.2	7.3	7.3	7.1
PPG debt service-to-exports ratio (in percent)	9.2	8.3	8.6	8.1	7.8	...	...	7.0	7.2	7.3	7.3	7.1
Total gross financing need (billions of U.S. dollars)	0.5	1.1	-0.2	0.0	-0.1	...	...	1.1	1.4	1.5	1.6	1.8
Noninterest current account deficit that stabilizes debt ratio	0.5	0.9	-1.6	1.8	1.8	...	...	1.7	1.3	2.0	2.4	2.2
Key macroeconomic assumptions												
Real GDP growth (in percent)	5.9	5.3	4.4	5.3	5.5	5.1	2.0	5.2	6.0	6.0	6.5	6.5
GDP deflator in US dollar terms (change in percent)	-2.7	-5.2	-3.1	3.3	4.1	-0.8	3.4	1.6	-2.4	0.5	2.0	1.9
Effective interest rate (percent) 5/	1.0	1.0	1.0	1.0	1.0	1.0	0.4	1.1	1.1	1.1	1.1	1.1
Growth of exports of G&S (U.S. dollar terms, in percent)	9.3	9.6	-5.4	8.6	14.4	8.0	38.8	4.8	1.1	5.2	7.5	8.5
Growth of imports of G&S (U.S. dollar terms, in percent)	6.3	11.5	-10.3	13.5	13.2	6.5	38.4	18.3	6.1	6.0	6.5	7.0
Grant element of new public sector borrowing (in percent)	55.0	55.0	55.0	55.0	55.0	55.0	0.0	55.0	55.0	55.0	55.0	55.0
A. Alternative scenarios (NPV external debt/exports, in percent)												
A1. Key variables at their historical averages in FY06-09 7/	...	...	...	...	...	...	...	90.5	89.7	88.8	87.8	86.3
A2. New public sector loans on less favorable terms in FY06-09 8/	...	...	...	...	...	...	...	90.5	100.1	107.0	112.4	117.8
B. Bound tests (NPV external debt/exports, in percent)												
B1. Real GDP growth at historical average minus one standard deviation in FY06-07	...	...	...	...	...	...	...	90.5	96.4	99.3	98.6	97.9
B2. Export value growth at historical average minus one standard deviation in FY06-07 9/	...	...	...	...	...	...	...	90.5	94.9	102.1	101.3	100.5
B3. Net nondebt creating flows at historical average minus one standard deviation in FY06-07 10/	...	...	...	...	...	...	...	90.5	105.7	118.3	116.9	115.3
B4. One-time 10 percent nominal depreciation relative to the baseline in 2006 11/	...	...	...	...	...	...	...	90.5	119.5	116.1	113.3	111.2

Source: Fund staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as $[r - g - \rho(1+g)]/(1+g+\rho+g\rho)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Assumes that NPV of private sector debt is equivalent to its face value.
5/ Current-year interest payments divided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
7/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), noninterest current account in percent of GDP, and nondebt creating flows.
8/ Assumes that the interest rate on new borrowing is 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.
9/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
10/ Includes official and private transfers and FDI.
11/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

Annex V -- Table 2. Bangladesh: Public Sector Debt Sustainability Framework

(In percent of GDP, unless otherwise indicated)

	Actual					Historical	Standard	Projections				
	FY00	FY01	FY02	FY03	FY04	Average 5/	Deviation 5/	FY05	FY06	FY07	FY08	FY09
Baseline medium-term projections												
Public sector debt 1/	47.9	50.8	52.9	51.0	48.3	...	...	47.9	48.3	47.9	47.1	46.2
Of which : foreign-currency denominated	32.5	33.5	34.2	31.9	29.5	...	...	29.3	29.8	29.7	29.2	28.9
Change in public sector debt	2.1	2.9	2.1	-1.9	-2.7	...	...	-0.4	0.5	-0.4	-0.8	-0.9
Identified debt-creating flows	1.5	5.2	0.0	-2.2	-1.5	...	...	0.2	0.1	-1.0	-1.0	-0.9
Primary deficit	1.8	3.1	1.3	0.4	1.1	...	...	1.8	1.9	1.6	1.4	1.4
Revenue and grants	9.9	10.1	11.1	11.4	10.5	...	...	11.1	11.7	12.0	12.1	12.3
Of which : grants	*1.5*	*1.1*	*1.0*	*1.1*	*0.5*	...	...	0.6	0.7	0.8	0.8	0.7
Primary (noninterest) expenditure	11.6	13.1	12.5	11.8	11.6	...	...	13.0	13.6	13.6	13.6	13.7
Automatic debt dynamics	-0.2	2.1	-1.4	-2.6	-2.6	...	...	-1.6	-1.8	-2.6	-2.4	-2.3
Contribution from interest rate/growth differential	-1.6	-1.4	-1.5	-2.3	-2.3	...	...	-2.1	-2.3	-2.3	-2.4	-2.4
Of which: contribution from average real interest rate	1.0	1.0	0.6	0.4	0.4	...	...	0.3	0.4	0.4	0.5	0.5
Of which: contribution from real growth	-2.6	-2.4	-2.1	-2.7	-2.7	...	...	-2.4	-2.7	-2.7	-2.9	-2.9
Contribution from real exchange rate depreciation	1.4	3.6	0.2	-0.3	-0.3	...	...	0.5	0.5	-0.3	0.0	0.0
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	...	...	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	...	...	0.0	0.0	0.0	0.0	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	...	...	0.0	0.0	0.0	0.0	0.0
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	...	...	0.0	0.0	0.0	0.0	0.0
Other (specify, e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	...	...	0.0	0.0	0.0	0.0	0.0
Residual, including asset changes	0.6	-2.3	2.2	0.2	-1.2	...	...	-0.6	0.4	0.6	0.1	0.1
NPV of public sector debt	30.0	32.4	34.1	33.5	32.0	...	...	31.8	31.9	31.6	31.0	30.3
Of which: foreign-currency dominated	14.6	15.1	15.4	14.4	13.3	...	...	13.2	13.4	13.4	13.1	13.0
Of which: external	14.6	15.1	15.4	14.4	13.3	...	...	13.2	13.4	13.4	13.1	13.0
NPV of contingent liabilities (not included in public sector debt)	...	...	...	...	...	...	...	...	...	...	...	...
Gross financing need 2/	4.6	5.0	4.5	3.2	3.4	...	...	4.3	4.2	4.0	3.9	3.8
NPV of public sector debt-to-revenue ratio (in percent) 3/	303.5	321.2	306.4	294.0	303.7	...	...	285.2	273.5	263.8	255.6	246.6
Of which: external	147.8	149.5	138.2	126.2	125.9	...	...	118.4	114.8	111.7	108.2	105.7
Debt service-to-revenue ratio (in percent) 3/ 4/	25.7	25.4	24.2	24.2	21.6	...	...	22.2	20.0	20.1	19.9	19.3
Primary deficit that stabilizes the debt-to-GDP ratio	-0.3	0.2	-0.8	2.4	3.8	...	...	2.2	1.4	2.0	2.3	2.3
Fiscal sustainability	2.1	2.9	2.1	-1.9	-2.7	...	...	-0.4	0.5	-0.4	-0.8	-0.9
Key macroeconomic and fiscal assumptions												
Real GDP growth (in percent)	5.9	5.3	4.4	5.3	5.5	5.1	0.4	5.2	6.0	6.0	6.5	6.5
Average nominal interest rate on forex debt (in percent)	1.1	1.1	1.0	1.0	1.0	1.1	0.1	1.0	1.1	1.1	1.0	1.0
Average real interest rate on domestic currency debt (in percent)	8.2	7.2	5.9	4.6	2.2	2.5	4.7	2.7	2.3	3.3	4.5	4.7
Real exchange rate depreciation (in percent, + indicates depreciation)	4.5	11.6	0.5	-1.0	-1.1	2.0	4.4	1.7	...	...	...	...
GDP deflator in taka terms (change in percent)	1.9	1.6	3.2	4.4	5.5	4.1	1.7	6.0	5.5	4.8	4.0	4.0
Growth of real primary spending (deflated by GDP deflator, in percent)	20.8	18.8	-0.9	-0.2	4.0	4.5	10.0	17.1	11.1	6.0	6.6	7.5
Grant element of new external borrowing (in percent)	55.0	55.0	55.0	55.0	55.0	55.0	0.0	55.0	55.0	55.0	55.0	55.0
A. Alternative scenarios												
A1.Slow reform Scenario	...	...	...	...	...	...	...	47.9	49.0	48.7	48.2	47.6
A2. Historical average scenario	...	...	...	...	...	...	...	47.9	48.1	47.7	47.3	46.9
A3. Lower long-run GDP growth	...	...	...	...	...	...	...	47.9	48.4	48.1	47.4	46.7
B. Bound tests												
B1. Real GDP growth is at one standard deviation below historical average in each of the first two projection years (FY06-07)	...	...	...	...	...	...	...	47.9	49.0	49.5	48.9	48.3
B2. Primary balance is at one standard deviation below historical average in each of the first two projection years (FY06-07)	...	...	...	...	...	...	...	47.9	48.7	48.8	48.0	47.1
B3. Combination of B1-B3 using one-half a standard deviation below historical average in each of the first two projection yea	...	...	...	...	...	...	...	47.9	48.6	48.8	48.0	47.0
B4. One time 10 percent real depreciation in FY06	...	...	...	...	...	...	...	47.9	51.7	51.0	50.0	49.0
B5. 10 percent of GDP in reform costs/contingent liabilities during FY06-09	...	...	...	...	...	...	...	47.9	50.8	52.7	53.9	54.9

Sources: Country authorities; and Fund staff estimates and projections.

1/ Central government debt on gross basis.
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues including grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

BANGLADESH: ILLUSTRATIVE LOW CASE MEDIUM-TERM SCENARIO

While the macroeconomic implications of slower structural reforms can not be gauged with any precision, it is likely that the failure to pursue reforms as envisioned under the program will preclude an acceleration in growth and lead to a weaker macroeconomic climate. Specifically, under the low-case scenario, it is assumed that reforms in NCB and tax administration will be slow; trade reform will stall; a cumbersome regulatory regime will continue to hamper business investment; and efforts to pursue energy sector reform will be weak. This will have the following impact:

Real Sector: While the economy may remain resilient, the failure to accelerate growth as envisioned under the program scenario implies that real GDP per capita will be lower by 5 percent by FY09 relative to the program scenario, and inflation will continue to stay high at 6 percent per year.

Fiscal Sector: Failure to pursue a vigorous reform agenda in tax administration will cause revenue to GDP to decline somewhat over the medium term, leading to a higher overall budget deficit and squeezing poverty reducing expenditures.

External Sector: Donor support will decline, export growth will languish, and the trade and current account deficits will increase. As a result, NIR will decrease well below two months of import cover by FY09, exposing Bangladesh to a heightened risk from external shocks.

Monetary Sector: A higher overall fiscal deficit and lower external financing will put pressure on domestic financing of the budget. This will induce inflation and force the banking system to curtail lending to the private sector.

Deviation from Program under Low Case Scenario, FY2006-09

	2005/06	2006/07	2007/08	2008/09
National income and prices (percent change)				
Real GDP	-1.0	-1.0	-1.5	-1.5
CPI inflation (annual average)	0.8	1.7	2.1	2.1
Central government operations (percent of GDP)				
Total revenue	-0.6	-0.9	-1.2	-1.4
Total expenditure	-0.4	-0.7	-0.9	-1.1
Overall balance (excluding grants)	-0.1	-0.2	-0.3	-0.3
Financing (net)	0.1	0.2	0.3	0.3
Domestic	0.6	0.7	1.0	1.2
External	-0.5	-0.5	-0.7	-0.9
Money and credit (end of year; percent change)				
Private sector	-0.3	-0.3	-0.2	-0.2
Broad money (M2)	1.7	2.1	2.5	2.3
Balance of payments (in billions of U.S. dollars; cumulative change)				
Exports, f.o.b.	-0.2	-0.3	-0.6	-0.9
Imports, f.o.b.	-0.1	-0.3	-0.4	-0.7
Gross official reserves (in billions of U.S. dollars)	-0.1	-0.4	-1.0	-1.9
In months of imports	0.0	-0.3	-0.7	-1.2

Source: Fund staff projections.

Dhaka, Bangladesh
May 26, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C., U.S.A.

Dear Mr. de Rato:

The Government of Bangladesh is committed to implementing the reform strategy set out in our Interim Poverty Reduction Strategy Paper (I-PRSP), endorsed by the IMF Executive Board together with the approval of the arrangement under the Poverty Reduction and Growth Facility (PRGF) in June 2003. This strategy is aimed at moving the economy onto a path of higher sustainable growth and faster poverty reduction. It will be further defined in the Poverty Reduction Strategy Paper (PRSP), which is being finalized.

Based on discussions for the third review under the PRGF arrangement with the Fund staff in October 2004 and February and April 2005, the attached Memorandum of Economic and Financial Policies (MEFP) assesses economic and policy performance so far under the arrangement, updates the macroeconomic framework, and discusses the financial policies and structural reform program for the remainder of FY05 and first half of FY06, supplementing our MEFP dated July 8, 2004. The proposed performance criteria for the remainder of the year are set forth in Tables 2 and 3 of the MEFP and the next review is proposed for completion as specified in paragraph 32 of the MEFP. All prior actions referenced in Table 4 of the MEFP for the completion of the third review have been implemented.

All quantitative performance criteria for end-September 2004 were observed. However, the structural performance criterion on making the LTU for VAT operational (end-September 2004) was not observed. We have taken corrective actions, and the LTU for VAT became functional in October 2004. On this basis, and in view of the policies set out in the attached memorandum, including the strengthening of tax administration and the determined reform of the NCBs, the Government requests a waiver for the nonobservance of the structural performance criterion and the completion of the third review. In light of the delay in completing the third review, the Government also requests that the arrangement be extended until end-December 2006 and the disbursements be rephased accordingly.

We have removed the restriction on advance payment for imports effective December 2004. We have also reviewed the only remaining restriction under Fund jurisdiction pertaining to the convertibility and transferability of funds from nonresident taka accounts. Given the near-term outlook of the balance of payments, we think this is not the appropriate time to remove this restriction. However, we expect to remove this restriction by end-June 2006.

The Government of Bangladesh will provide the Fund with such information as the Fund may request in connection with progress in implementing the economic and financial policies, and achieving the objectives of the program. The Government believes that the policies set out in the attached MEFP are adequate to achieve the objectives of the program, but it will take any further measures that may become appropriate for this purpose. The Government of Bangladesh will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation.

Sincerely yours,

/s/
M. Saifur Rahman
Minister for Finance and Planning
Ministry of Finance

Attachment

BANGLADESH

Memorandum of Economic and Financial Policies for April 2005–June 2006

May 26, 2005

I. Introduction

1. The government has made significant progress in implementing the reform strategy adopted in June 2003 to move Bangladesh to a higher growth path and faster poverty reduction. This strategy is being supported by a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) and further articulated in the Poverty Reduction Strategy Paper (PRSP), which is being finalized. This memorandum assesses economic performance during the first two years under the PRGF arrangement, updates the medium-term policy framework, and lays out the objectives and policies that the government intends to pursue in the remainder of FY05 and the first half of FY06, supplementing our Memorandum of Economic and Financial Policies (MEFP) dated July 8, 2004.

II. Performance Under the Program

2. Bangladesh's economy continues to expand. Real GDP grew by 5½ percent in FY04 (ending June), while industrial production rebounded by 12 percent (MEFP Table 1). The economy has benefited from a healthy expansion in the construction, manufacturing, and service sectors, as well as a strong recovery in exports. Inflation was under control at 5.8 percent in FY04.

3. The floods in July have had devastating effects on the economy. Total losses to assets and output are estimated (by the World Bank and AsDB) to reach Tk 127 billion ($2.2 billion, or 3¾ percent of GDP), with the largest impact stemming from damage to crops, housing, and infrastructure. The overall situation worsened after the September floods (though on a smaller scale) and subsequent heavy rains in October. Inflation, particularly on food-related items, rose during the Ramadan season in October–November. The government took steps to reallocate domestic resources for urgent agricultural relief, reconstruction of housing and infrastructure, and restoring water and power supplies and other basic facilities in the affected areas. While floodwaters had receded since October and intensified efforts were made to replant the crops, the overall yield of the main crops remained substantially below the levels of the previous years. To support the reconstruction efforts, the government has mobilized external donor assistance of $420 million ($200 million from the World Bank, $185 million from the AsDB, and $35 million from DFID) to be disbursed during FY05–07.

4. Macroeconomic management has been broadly on course. The quantitative performance criteria for end-September 2004 were met (MEFP Table 2). The overall budget deficit was contained to 3.2 percent of GDP, about 1 percentage point below the revised budget. Total spending was 1.4 percent of GDP lower than budgeted, on account of lower-

than-projected recurrent and development expenditures. However, tax revenue collections by the National Board of Revenue (NBR) fell short of the revised budget (by an estimated 0.3 percentage point of GDP), with NBR revenue growing by 10 percent (on a 12-month basis) at end-June 2004 compared with a revised budget target of 14 percent. The shortfall reflected initial delays in the implementation of tax administrative reforms and weaknesses in collection enforcement. Fiscal management continues to be prudent in July–March of FY05, but the NBR revenue performance remained weak, falling short of our quarterly revenue targets (estimated by 0.3 percent of GDP).

5. The monetary policy stance has been accommodative in the first three quarters of FY05. Reserve money growth reached 11.2 percent at end-March and credit to the private sector accelerated to 19.5 percent, mainly for agricultural lending and imports of food and capital goods. Broad money also grew 15.4 percent at end-March. To contain the inflationary risks posed from increases in imported food prices and high credit growth, Bangladesh Bank (BB) raised the Cash Reserve Requirement, effective March 1, 2005, by a half percentage point (to 4.5 percent) and also increased the one-month and three-month treasury bill rates by 1 percentage point since early March, to 6.6 percent and 6.7 percent, respectively. However, the net sales of treasury securities to commercial banks have remained broadly constant, with many banks holding treasury securities only up to the SLR limit. Furthermore, BB has actively used the repo and reverse-repo facilities to enhance daily monetary operations.

6. Exports remained robust through October 2004, registering a monthly average of $720 million during July–October 2004 ($600 million in the same period of FY04), driven mainly by the ready-made garments (RMG). However, imports were even stronger. Despite continued strong remittance inflows, the external current account went into deficit in September 2004. Overall, gross official reserves rose to $3 billion (covering three months of imports) at end-September (from $2.5 billion at end-June 2003). The effective exchange rate depreciated by 2 percent and 5 percent in real and nominal terms, respectively, between September 2003 and September 2004. However, export earnings have moderated since November 2004 (a monthly average of $644 million during November 2004–February 2005), particularly for woven garments, while imports continued to rise strongly. Oil imports exceeded the original target by about $370 million at end-March 2005, reflecting higher international oil prices. In addition, the government increased the import targets for rice and wheat by about $200 million to bridge the projected shortfall in domestic production owing to the devastating floods in last July.

7. The exchange market has come under pressure since early 2005. To ease the pressure, BB injected $148 million of foreign exchange to the market through February while allowing the taka to depreciate (by about 5 percent). However, demand for imports remained strong, particularly for capital machinery and raw materials, reflecting in part investment and structural repositioning of the RMG sector and expansion of the industries in anticipation of the expiration of some existing tax holidays at end-June 2005. The current account deficit rose significantly in the third quarter of FY05, and the reserve cushion built in NIR was used to mitigate the impact of the external oil price shock. Accordingly, the end-March indicative target for NIR has been adjusted for higher-than-expected oil imports.

8. Good headway has been made on the fiscal structural reform agenda, although tax administration efforts have yet to translate into revenue gains. On income tax administration, the newly expanded Large Taxpayer Unit (LTU) for income tax and the Central Intelligence Cell (CIC) are in full operation after initial delays. Effective September 1, 2004, the LTU for income tax was expanded to cover 11 withholding taxes. To improve the compliance of taxpayers, a system of universal self-assessment for LTU income taxpayers and higher penalties for late and nonfiling have been introduced. At the same time, the audit program is being strengthened and expanded. All NBR departments are making increased use of information gathered by the CIC to reduce tax evasion. To discourage taxpayers from delaying payment of income tax by filing appeals to the tribunal, they are now required to pay 15 percent of the difference between the contested amount and the admitted tax liability before the court filing. Moreover, to expedite disposal of court cases, two benches in the High Court have been selected to devote exclusively to tax matters. We have also expanded the LTU system to cover domestic VAT and steps were taken by end-December 2004 to transfer files to ensure minimum coverage of 50 percent of total domestic VAT collection by NBR, covering at least the 100 largest VAT filers, and to conduct joint audits for income tax and VAT LTUs to improve tax compliance.

9. The VAT Act and the rules have been amended to improve enforcement. Nationwide inspections in the retail sector to enforce compliance with VAT have also been launched. In addition, the VAT net has been expanded to include more services and VAT enforcement for products at import and domestic stages has been strengthened. In the area of customs administration, the bonded warehouse system has been revamped, although the bank guarantee requirements for imports for domestic consumption have been stayed by the High Court. Adequate records are required at the premises of the bonded warehouses to allow spot inspection. We have also stepped up our efforts to train inspectors.

10. With respect to NCB reform, good progress has been made in strengthening bank management. The management team for Agrani started its operation in October 2004 and is now finalizing its report on management restructuring and operational improvement. The management support team in Sonali Bank has submitted at end-March its recommendations on operational and management improvements. The retendering of the contract for the Janata Bank management team has been completed and the contract was signed in May. The financial advisors at Rupali Bank have provided strong support to the government to bring Rupali to the point of divestment. An Information Memorandum (IM) was issued by the Privatization Commission on May 12. The Memoranda of Understanding (MOUs) have been strengthened for all four NCBs and good progress has been achieved under them, with the exception of cash recoveries from the largest defaulters. However, in the aftermath of the flood, the overall lending limit of 5 percent is likely to be exceeded (but to no more than 7 percent) to ensure adequate support for agricultural sector reconstruction.

11. The weak performance of the energy sector SOEs is due mainly to the Bangladesh Petroleum Corporation (BPC) and the Dhaka Electricity Supply Authority (DESA). BPC incurred significant losses in the last two years due to sharp increases in world oil prices. To reduce the losses of energy sector SOEs and improve their financial viability over the

medium term, the government adjusted prices of kerosene by 17 percent in June 2004, and increased prices for diesel and gasoline by 15 percent in December 2004, and gas price by 2.3 percent in early January 2005, in line with the agreement under the World Bank's DSC. DESA continues to incur significant financial losses stemming from poor bill collections and heavy system losses. This has led to a further accumulation of DESA'a arrears to other SOEs (to a cumulative 1¾ percent of GDP at end-December 2004). Under the World Bank's DSC III, we are now working on reducing DESA's arrears using a combination of loan restructuring and write-offs.

III. Macroeconomic Framework and Policies

12. We remain committed to the reform strategy of private sector-led growth and poverty reduction, as outlined in our PRSP, which is being finalized. The National Steering Committee, which was formed to lead this effort, circulated the draft PRSP for comments in January. Consultations were held at the regional and national levels and with the donor community. Attention is placed on: (i) prioritizing near-term policies in key sectors and anti-poverty programs; (ii) incorporating the costing of the proposed sectoral projects into the medium-term budgetary framework; (iii) improving the monitoring and evaluation mechanism of social development; and (iv) initiating a poverty and social impact assessment (PSIA) of the reform strategy.

13. We have updated the medium-term macroeconomic framework to incorporate the impact of external and domestic shocks. Growth prospects have deteriorated in the wake of the devastating floods in July that submerged about half of the country's districts and affected some 25 percent of the population. Preliminary indications suggest that last year's floods were as devastating as the 1998 floods, which resulted in a decline in real GDP growth of an estimated ½ percent and a significant pickup in inflation.

14. A further challenge is posed by the impact of the phaseout of Multifiber Arrangement (MFA) quotas at end-2004. On the upside, there are indications of fresh investment in the sector and we have retained some competitive edge in the European Union and Canadian markets, given the duty-free access to these markets, as well as some advantage in competing for the high-volume, low-margin segment of the world garment market. On the downside, however, with intensified competition, Bangladesh is likely to face increasing pressures from lower prices, and further loss of market share in the United States. Funding and operational constraints for upgrading infrastructure, particularly for improvement in port operations, remain a major problem.

15. Consequently, real growth for FY05 has been revised downward to 5.2 percent, while the inflation target has been revised to 6.5 percent. The monetary program has also been adjusted to accommodate increased lending to the agricultural sector for post-flood recovery. The external current account deficit is projected to deteriorate to about 2 percent of GDP, and the end-June 2005 target for NIR has been reduced by $300 million in light of higher payments for oil imports. The overall budget deficit for FY05 is projected to increase to 4.4 percent of GDP, including domestic and external flood rehabilitation efforts, while

maintaining domestic financing of the budget as programmed. Public spending on human capital and infrastructure will remain strong, to be met by revenue efforts and external support mainly on concessional terms including donor funds for rehabilitation. With prudent debt management, these projections suggest that the ratios of external debt to GDP and the net present value of debt to exports should remain within comfortable zones over the medium term.

A. Fiscal Policy

16. Our fiscal strategy remains to protect fiscal sustainability while supporting growth and poverty reduction. To this end, we are making strong revenue efforts by expanding the tax base and improving tax administration. We remain fully committed to pursuing a revenue effort of ½ percent of GDP in FY06. This revenue effort is vital for the budget to adequately support human capital, physical infrastructure, and anti-poverty programs without threatening debt sustainability over the medium term. To ensure the needed improvement in revenue, we will convert the quarterly revenue targets for NBR taxes to indicative indicative targets under the program: a cumulative collection of Tk 73 billion by end-September 2005, Tk 154 billion by end-December 2005, Tk 244 billion by end-March 2006, and Tk 356 billion by end-June 2006.

17. Strengthening tax administration will continue to remain a top priority. We will give particular attention to strengthening the near-term effectiveness of the LTU system. To this end, efforts will be made immediately to expedite cases pending at the High Court. In the FY06 budget, we will further strengthen the income tax LTU through defining a turnover threshold above which taxpayers will be included in the LTU. We will also ensure that the LTUs are staffed with sufficiently skilled collection enforcement officers. In addition, an independent audit unit, headed by an advisor with the rank and status of a member reporting directly to the chairman, will be created in the NBR to enhance enforcement and audit operations. The establishment of this unit will constitute a structural performance criterion (end-November 2005) for the completion of the fourth review (MEFP Table 3). Moreover, sustained efforts will be made to identify tax evaders through information gathered by the CIC, and standard and transparent procedures, including notifying delinquent taxpayers and imposing penalties for late payments, will also be put in place. Finally, while we recognize that it may not be possible to address low civil service pay in NBR, we intend to establish performance-based incentives for LTU staff. The VAT LTU staff will continue to be guided by the existing operational manual. However, with the technical assistance of the incoming DFID team, a new operational manual will be put in place by end 2005.

18. We are cognizant that improving revenue performance will depend on bringing additional taxpayers into the tax net, to expand the VAT net to cover more services, and to step up nationwide inspections in the retail sector to enforce compliance with VAT. To this end, most of the existing tax holidays will be allowed to lapse at end-June 2005 and a significant reduction in tax exemptions will be introduced in the FY06 budget. Furthermore, to augment customs collection, we will further strengthen the pre-shipment inspection (PSI), customs valuation process, and the post-clearance audit, with World Bank assistance. We

will also continue to monitor the functioning of the bonded warehouse system. In this regard, we will make further efforts to ensure that inspectors are well trained.

19. Over the medium term, our efforts will focus on the modernization of the NBR along functional lines. With assistance from the World Bank, a strategic plan is being developed and needed technical assistance projects will be approved by the Planning Commission. The plan will include steps for a more rigorous self-assessment system, a risk-based auditing system supported by third-party information, and the use of modern technology, particularly an integrated computer system for handling assessment, audit case selection, and collection. An improved board structure will be critical to enhance the NBR management. By end-December 2005, key personnel will be appointed to facilitate work on tax administration reform, including a tax expert to advise on key aspects of the NBR modernization project, supported by a human resources advisor, an audit advisor, and an IT manager.

20. On the expenditure side, we will ensure that pro-growth and pro-poor spending is given priority, and public sector wages are contained. We have stepped up our efforts to strengthen expenditure management by improving project selection and execution under the ADP, drawing on the recommendations of the fiscal ROSC for Bangladesh. The financial management reform program (FMRP) is assisting in putting in place a medium-term budget framework in four key line ministries. Broad expenditure parameters for the next two years for these four ministries will be presented in the FY06 budget. The government plans to roll out this exercise to more line ministries for preparation of the FY07 budget. The recent floods have necessitated some reallocation of spending from both the revenue and ADP budget towards rehabilitation efforts. The government will continue to undertake an expenditure review to improve public expenditure management with enhanced fiscal transparency and accountability, in consultation with relevant development partners. Meanwhile, we have streamlined the project approval process in consultation with our development partners; implemented new procurement regulations; delegated more financial authority to the line ministries; and required line ministries to strengthen their own project monitoring capacity.

21. The recent proposal by the National Pay Commission on wage increases for the civil service has been reviewed by a committee headed by the Cabinet Secretary. To safeguard macroeconomic stability, the overall increase in the government wage bill will be phased in over three years, totaling about Tk 40 billion (Tk 8 billion in FY05, Tk 16 billion in FY06, and Tk 16 billion in FY07). An official public announcement regarding this wage increase was made on May 16 (a prior action for the completion of the third review; MEFP Table 4). The increased spending on wages will be partly offset by cuts in nonpriority spending to preserve pro-poor expenditures. Moreover, starting in FY06, the government will combine attrition with a selective hiring freeze to reduce employment while eliminating unnecessary and redundant posts. To ensure medium-term fiscal sustainability, we will work with the World Bank on a plan for civil service reform in the context of the EMTAP, aimed at (i) rationalizing government employment; (ii) decompressing the pay scale; (iii) establishing a systematic and transparent performance evaluation procedure for merit-based salary increases and promotion; and (iv) introducing a tighter link between pay and performance.

Keeping up with the regional trend in pension reform, we will initiate the reform of the public pension system.

22. Reform of the energy sector SOEs is key to improving their financial performance and reducing infrastructure bottlenecks to growth. In coordination with the World Bank in the context of the DSCs, we are monitoring oil market developments closely. In view of the substantial and continued price surge in the world oil market since the beginning of FY05, we recognize that further price adjustments are needed for kerosene, diesel, and gas. However, in light of the price increases in early 2005 and the emerging inflationary impact of the floods, further adjustments will need to be made gradually while taking into account social considerations. Nonetheless, we are committed to contain BPC losses through further price adjustments in the first half of FY06. The government is working closely with the World Bank (in the context of DSC III) and the AsDB to formulate a restructuring plan for the energy sector, focusing on improving both the operational and financial performance of the energy SOEs. As agreed with the World Bank and AsDB, the Energy Regulatory Commission (ERC) will be fully operational by June 2005. The government is working closely with DESA and municipal authorities to improve electricity collections and further reduce electricity payment arrears.

B. Monetary and External Sector Policies

23. A cautious monetary policy stance is essential in the next few months to restore stability in the money and exchange markets while supporting economic growth. Bangladesh Bank will continue to actively employ indirect monetary instruments for conducting monetary policy. Interest rates on treasury securities will rise in the next few months to contain domestic demand, subject to due caution against excessive fluctuation. Given the adverse impact on food prices from the floods, and the rise in international oil and commodity prices, there has been a buildup in inflationary pressures. In addition, export growth has been modest since November 2004, while import growth accelerated. Against this adverse background, we are committed to manage these pressures in a market-based manner. In light of developments in the first three quarters of FY05 and in view of the need to contain liquidity, we have revised the end-June targets for private sector credit growth and broad money to 15 percent and 14 percent, respectively.

24. Further steps are being taken to improve the functioning of the interbank and treasury bill markets, including strengthening the primary dealer system, deepening the secondary market for treasury securities, and developing liquidity forecasting. In particular, BB will prepare the ground to move to a volume-based auction, reactivate the primary dealer system, and work closely with them to define the rules and obligations and a minimum announced auction amount to be purchased by primary dealers. Higher rates on treasury securities will stimulate demand for deepening the treasury market and ensure adequate flows for domestic nonbank financing of the budget. Transaction fees by banks for selling NSCs were modified in late 2004 to provide adequate compensation to encourage banks to transact in NSCs. The NSC sales picked up significantly in January. Further improvement will include modifying

the investment guidelines for insurance companies and provident/pension funds to encourage them to invest in government bonds.

25. We are committed to the floating exchange rate regime, and will confine interventions to countering disorderly conditions and building reserves to a more comfortable level. Against the background of recent pressures in the foreign exchange market, we will closely review the operation of the floating exchange rate system with technical assistance from the IMF to ensure that it is working effectively and smoothly, and that the taka exchange rates are market based. We are planning to facilitate forward and swap transactions by further easing the requirement that forward sales of authorized dealers be fully matched by their forward purchases. We removed the restriction on advance payment for imports in December 2004. We have also reviewed the only remaining restriction under Fund jurisdiction pertaining to the convertibility and transferability of funds from nonresident taka accounts. Given the near-term outlook of the balance of payments and recent developments in the exchange market, we think this is not the appropriate time to remove this restriction. However, we expect to remove this restriction by end-June 2006, with due attention given to having regulatory safeguards to prevent illegal transactions and limit the scope for capital outflows.

26. BB is committed to intensifying regulatory oversight of the banking system. We have recently issued new risk management guidelines for commercial banks and are now requiring banks to conduct systems audits. To improve corporate governance, BB is restricting the number of directors at banks and limiting them to two terms of no more than six years each. We are also improving on-site and off-site supervisory capacity and have significantly improved the data reporting requirements of commercial banks. BB will use its improved supervisory capacity to ensure that the NCBs meet all prudential regulations, including on net open limits.

27. In the face of the phaseout of the MFA quotas, we are adopting measures to reduce anti-export bias and improve the investment climate. In particular, we have removed restrictions on FDI in the RMG sector outside the EPZs, and steps are being taken to address infrastructural bottlenecks, particularly to upgrade the capacity of the Chittagong port, with the assistance of the AsDB. At the same time, we are seeking duty-free access for RMG exports to the U.S. market, together with the other LDCs that are facing similar pressure from the removal of quotas. We have reduced the number of regulatory stages involved in the import for and export of RMG and plan to replace all remaining quantitative restrictions by tariffs by end-June 2005, in the context of DSC III, except those on grounds of health, national security, religion, and environmental protection.

C. Reforming the Nationalized Commercial Banks

28. We have adopted action plans to operationalize bank-by-bank resolution strategies for the NCBs (Annex I), a structural performance criterion for end-November. Under these strategies, three NCBs (Rupali, Agrani, and Janata) will be brought to the point of divestment in full or in part in sequence during 2005–07. With respect to Rupali's divestment, we issued

the Information Memorandum (IM) to the public on May 12 (a prior action for the completion of the third review). Safeguarding the integrity of the divestment process is an overriding concern given the governance issues in the NCBs and their poor financial condition. Accordingly, we have reconstituted the board of directors of Rupali, conducted IAS special audits, and worked out a combination of methods for recapitalization through government bonds and loans to the government from Rupali, based on the statutory audit at end-December 2004 and the HVC IAS audit at end-September 2004 (MEFD Annex I-Attachment). In addition, the government will assume liabilities for existing pensioners and for the accrued rights of current employees up to the point of transaction. The majority shareholder will have management control over all aspects of the bank's operations, including on HR policies and pay scale.

29. With respect to the other three NCBs, we are committed to a timetable to bring Agrani to the point of divestment by end-June 2006. The Board will be reconstituted to meet BB's fit and proper test by end-June 2005, the contract for the financial advisors, which will be drafted broadly along the same lines as for Rupali Bank, will be signed by mid-December 2005, and the bank will be corporatized by end-December 2005. For Janata, we will ensure that the contract for the management support team will be signed by end-June and the team in place by end-August. The government will provide timely response to the management support team in Sonali on its proposal for management and operational improvements. This strategy entails restricting its commercial lending operations and stepping up NPL recoveries in the context of an enhanced MOU; corporatizing the bank and reconstituting its board of directors; and leveling the playing field by ensuring free entry into areas where Sonali has a dominant position. To facilitate the broader NCB reform effort, the government will make legislative modifications as needed, including granting BB required regulatory authorities over the NCBs.

D. Other Issues

30. Progress has been made to address the recommendations under the safeguards assessment. A full audit of BB's financial statements for FY04 has been completed, in accordance with international auditing standards, and the audited financial statements, including the audit opinion, have been published. Qualifications in the accounts expressed by the BB's auditors in previous years have been resolved. Monetary data reported to the Fund have been reconciled against BB's audited financial statements and reviewed by the external auditors as part of this annual audit. Furthermore, as part of its medium-term effort to build capacity in BB, technical assistance from the IMF has been provided to strengthen foreign reserve management, adopt and implement a plan for strengthening internal audit functions, and upgrade accounting skills and standards. The government has appointed in April 2005 auditors to prepare BB's FY05 audit in accordance with international financial reporting standards.

31. Faster progress with efforts to improve governance are crucial for enhancing the investment climate. Reform measures in NCBs, tax administration, and trade reform bear directly on governance, and their firm implementation will have a lasting impact. Beyond these, the government is taking concerted actions to develop an anti-corruption strategy and

improve the law and order situation. Technical assistance in this area is being provided by the World Bank, the AsDB, and USAID.

32. In light of the delay in concluding the third review, the fourth, fifth, and sixth reviews under the PRGF arrangement will now be scheduled to take place by end-December 2005, end-June 2006, and mid-December 2006, respectively. The arrangement will therefore need to be extended until end-December 2006 and the disbursements under the arrangement rephased accordingly. With regard to program monitoring, quantitative performance criteria for end-September 2005 and indicative targets for end-December 2005 are being proposed. Key structural benchmarks and structural performance criteria for FY06 center on fiscal and NCB reforms. Technical assistance coordinated closely with the World Bank and DFID will remain essential to building capacity, especially in tax administration and NCB reform.

Attachments

MEFP Table 1.	Key Economic Indicators, FY2003–09
MEFP Table 2.	Quantitative Performance Criteria and Indicative Targets Under the PRGF Arrangement, June 2004–June 2006
MEFP Table 3.	Structural Performance Criteria and Benchmarks Under the PRGF Arrangement, 2005–06
MEFP Table 4.	Prior Actions for the Third Review Under the PRGF Arrangement
MEFP Annex I	Operationalization of NCB Resolution Strategies
MEFP Annex I – Att.	Restructuring and Recapitalization of Rupali Bank
MEFP Annex II	Addendum to the TMU

MEFP Table 1. Bangladesh: Key Economic Indicators, FY2003-09 1/

	2002/03	FY2003/04		FY2004/05	FY2005/06	FY2006/07	FY2007/08	FY2008/09
		Rev. Prog.	Act.	Projections				
National income and prices (percent change)								
Real GDP	5.3	5.5	5.5	5.2	6.0	6.0	6.5	6.5
GDP deflator	4.4	5.5	5.5	6.0	5.5	4.9	4.0	4.0
CPI inflation (annual average) 2/	4.4	5.9	5.8	6.5	6.0	5.0	4.0	4.0
Central government operations (percent of GDP)								
Total revenue	10.3	10.6	10.1	10.5	11.0	11.2	11.4	11.6
Tax	8.3	8.5	8.2	8.6	8.9	9.2	9.3	9.5
Nontax	2.0	2.1	1.9	1.9	2.0	2.0	2.1	2.1
Total expenditure	13.7	14.4	13.3	14.7	15.2	15.3	15.3	15.4
Current expenditure	8.1	8.2	7.7	8.6	8.4	8.6	8.7	8.7
Of which : Interest payments	1.9	1.7	1.6	1.8	1.6	1.7	1.7	1.7
Annual Development Program	5.4	5.4	5.0	5.3	5.7	5.7	5.7	5.7
Other expenditures 3/	0.2	0.8	0.6	0.8	1.1	1.0	0.9	1.0
Overall balance (excluding grants)	-3.4	-3.8	-3.2	-4.2	-4.2	-4.1	-3.9	-3.8
Primary balance	-1.5	-2.1	-1.6	-2.4	-2.6	-2.4	-2.2	-2.1
Financing (net)	3.4	3.8	3.2	4.2	4.2	4.1	3.9	3.8
Domestic	1.3	2.3	2.1	2.0	2.0	1.9	1.9	1.7
External	2.1	1.5	1.1	2.2	2.2	2.2	2.0	2.1
Total central government debt (percent of GDP)	51.0	50.3	48.3	47.9	48.3	47.9	47.1	46.2
Money and credit (end of year; percent change)								
Net domestic assets	12.2	11.8	13.4	14.8	13.5	13.8	13.5	13.1
Private sector	12.6	10.3	12.0	14.7	13.2	13.0	12.8	12.8
Broad money (M2)	15.6	11.9	13.8	14.2	12.8	13.1	13.0	13.0
Balance of payments (in billions of U.S. dollars) 4/								
Exports, f.o.b.	6.5	7.4	7.5	7.8	8.0	8.4	9.1	9.9
(Annual percent change)	9.5	13.3	15.8	4.1	2.0	5.1	7.9	9.0
Imports, f.o.b.	8.7	10.1	9.8	11.6	12.3	13.1	13.9	14.9
(Annual percent change)	13.0	15.8	13.0	18.0	6.2	6.0	6.6	7.1
Gross official reserves (in billions of U.S. dollars)	2.5	2.6	2.7	2.7	2.7	3.0	3.4	3.9
In months of imports of goods and nonfactor services	2.9	2.6	2.8	2.4	2.2	2.3	2.5	2.7
Memorandum item								
Nominal GDP (in billions of taka)	3,005	3,345	3,345	3,731	4,171	4,637	5,135	5,686

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.

1/ Fiscal year begins July 1.
2/ CPI has recently been rebased using FY96 weights.
3/ Consists of other capital, net lending, and food accounts (including check float and discrepancy).
4/ Balance of payments is presented on the basis of BPM5.

MEFP Table 2. Bangladesh: Quantitative Targets and Performance Criteria Under the PRGF Arrangement, June 2004-June 2006 1/

(Cumulative flows, end of period) 2/

	Jun-04		Sept-04		Dec-04		Mar-05		Jun-05	Sept-05	Dec-05	Mar-06	Jun-06
	Indicative Targets		Performance Criteria		Indicative Targets		Indicative Targets		Indicative Targets	Proposed PCs	Proposed Indicative Targets		
	Target	Actual	Target	Actual	Target	Actual	Target	Actual					
	(In billions of taka)												
Ceiling on net domestic assets of Bangladesh Bank 4/	12 3/	13	-7	-15	-5	-10	1	8 7/	29	2	11	19	27
Ceiling on net domestic financing of central government 4/	76 3/	60	4	-6	33	16	53	19	76	8	28	51	83
Ceiling on net central government bank borrowing 4/	31 3/	13	-5	-15	10	5	18	-3	36	-4	4	15	36
Taxes collected by National Bureau of Revenue 5/	...	...	...	...	...	...	...	...	...	73	154	244	356
	(In millions of U.S. dollars)												
Floor on cumulative increase of net international reserves of Bangladesh Bank 4/	105	196 3/	200	331	220	358	200	237 7/	-25 8/	70	35	15	0
Contracting or guaranteeing of short-term external debt by the central government 6/	0	0	0	0	0	0	0	0	0	0	0	0	0
Contracting or guaranteeing of nonconcessional medium- and long-term debt by the central government 4/	250	8	100	8	150	8	200	8	250	100	150	200	250
Of which: External debt with an initial maturity of over one year and up to five years 6/	0	0	0	0	0	0	0	0	0	0	0	0	0
Accumulation of external payments arrears 6/	0	0	0	0	0	0	0	0	0	0	0	0	0

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates.

1/ The aggregates are defined in the Technical Memorandum of Understanding dated May 2003 (IMF Country Report No. 03/205).
2/ Cumulative flow since start of financial year beginning July 1.
3/ Including the bridge financing of Tk 16 billion for delay of the World Bank's DSCII and education loans (US$300 million) into July 2004.
4/ Performance criteria assessed on a periodic basis under the program period.
5/ Indicative targets assessed on a quarterly basis under the program period.
6/ Performance criteria assessed on a continuous basis under the program period.
7/ Corrected for shortfall in net open position of nationalized commercial banks.
8/ Relative to the actual NIR in June, 2004, representing an increase of $48 million relative to the June 2004 program target.

MEFP Table 3. Bangladesh: Structural Performance Criteria and Benchmarks Under the PRGF Arrangement

	Measures	Timing	Status
	I. Performance Criteria and Benchmarks for the Third Review		
1.	Expand the LTU system to cover withholding income tax and VAT, with a minimum coverage of 50 percent of total VAT collection by NBR, covering at least the 100 largest VAT filers 1/	September 30, 2004	Not Observed (met in October, 2004)
2.	Agree on action plans with the managements of Sonali, Janata, and Agrani covering the period to June 2006, to operationalize the resolution strategies for each bank, with key benchmarks as specified in the TMU 1/	November 30, 2004	Observed
3.	Bring Rupali to point of sale by issuing an information memorandum to the public	December 31, 2004	Not Observed (met in May, 2005)
	II. Proposed Performance Criteria and Benchmarks for the Fourth Review		
1.	Establishment in the NBR of an independent audit unit headed by an advisor of the rank and status of a member reporting directly to the Chairman 1/	November 30, 2005	
2.	Reconstitution of Sonali Bank's Board of Directors to meet BB's fit and proper test for board membership, and ensuring that at least two board members have relevant banking experience.	December 15, 2005	
3.	Signature of final contract for appointment of financial advisor for Agrani Bank. 1/	December 15, 2005	

1/ Indicates structural performance criteria.

MEFP Table 4. Bangladesh: Prior Actions for the Third Review Under the PRGF Arrangement

	Prior Actions	Status
1.	Conducting joint audits for income tax and VAT LTUs.	Completed
2.	Transferring files to ensure minimum coverage of 50 percent of total VAT collection by NBR, covering at least the 100 largest VAT filers.	Completed
3.	Bring Rupali to point of sale by issuing an information memorandum to the public.	Completed
4.	Public announcement by the Ministry of Finance that the overall increase in the government wage bill and pensions will be phased in over three years with the maximum increase contained to no more than 15 percent per year.	Completed

Operationalization of NCB Resolution Strategies

1. To operationalize the NCB resolution strategies, a steering committee has been created comprised of the Finance Secretary, Bangladesh Bank Governor, and the Permanent Secretary of Law Ministry to oversee the Working Group and to take key decisions with regards to NCB restructuring and divestment.

2. An International Bank Restructuring Expert and a Local Banking Specialist with experience in banking will be appointed to assist the Working Group in monitoring the performance of the management teams in each of the four NCBs and to help operationalize the NCB strategies.

I. Bank-by-bank Action Plans

A. Rupali Bank

3. The objective is to bring Rupali to the point of sale by end-May 2005 by issuing an information memorandum to the public. To achieve this objective, the following steps will be taken:

- Bringing Rupali's capital to zero level at point of divestment (Attachment to Annex I). Also, investors to be required to inject sufficient capital at the point of divestment to bring Rupali's capital up to CAR. The investors to take a majority stake in Rupali.
- Reconstituting Rupali's Board of Directors by applying BB's fit and proper test for board members, which among various other things precludes board members from serving more than two consecutive three-year terms.
- Specifying that strategic investors will be given full control over HR policy, with staff retrenchment facilitated by a VRS to be financed by the World Bank loan.
- Assuming liability for all pension obligations of Rupali Bank.
- No regulatory forbearance for capital adequacy.
- Freezing all new lending until the strategic investor has assumed full management control.

B. Agrani Bank

4. The objective is to bring Agrani to the point of divestment by end-June 2006 by issuing an information memorandum to the public. To achieve this objective, the following intermediate steps will be taken:

- A financial advisor will be appointed by mid-December 2005 to bring Agrani to the point of divestment.

- The board of directors will be reconstituted and BB's fit and proper test for board membership will be applied by end-December 2005, ensuring that at least two board members have relevant banking experience.

- The bank will be corporatized by end-December 2005.

- The existing Memorandum of Understanding will be extended beyond December 2005.

C. Janata Bank

5. The objective is to bring Janata to the point of divestment by end-June 2007 by issuing an information memorandum to the public. To achieve this objective, the following intermediate steps will be taken:

- The contract with the management support team will be signed by end-June 2005.

- The board of directors will be reconstituted and BB's fit and proper test for board membership will be applied by end-December 2005, ensuring that at least two board members have relevant banking experience.

- The bank will be corporatized by end-June 2006.

- The existing Memorandum of Understanding will be extended beyond December 2005.

- A financial advisor will be appointed by end-December 2006, to bring Janata to the point of divestment.

D. Sonali Bank

6. The objective is to contain Sonali's future losses by restricting the bank's lending activities and restructuring its operations to the point where a minority shareholding can be divested. To achieve this objective, the following intermediate steps will be taken:

- The board of directors will be reconstituted and BB's fit and proper test for board membership will be applied by mid-December 2005, ensuring that at least two board members have relevant banking experience.

- The existing Memorandum of Understanding will be extended beyond December 2005 and maintained until the time of divestment.

- The bank will be corporatized by end-December 2006.

RESTRUCTURING AND RECAPITALIZATION OF RUPALI BANK

As per the statutory audit at end-December 2004 and the HVC IAS audit at end-September 2004, the government will recapitalize Rupali by using a combination of government bonds and loans to the government from Rupali.

1. The government has agreed to convert all SOE NPLs as per HVC IAS audit, after deducting the actual provisions made for these loans, into a single loan and service it at appropriate treasury bill rates.

2. The government has agreed to cover upfront clearly defined government liabilities as per HVC IAS audit through a loan from Rupali to the government that includes: i) liabilities to Rupali stemming from loan forgiveness to private jute mills; ii) advanced tax payments made by Rupali that were not reimbursed by the government, and iii) other government liabilities.

3. The government has agreed to issue government bonds to meet: (i) the capital shortfall in the statutory accounts at end-December 2004, and (ii) the underprovisioning in private loans in the statutory accounts at end-December 2004.

4. Non-SOE loans and other liabilities beyond paragraph 3 above as per statutory audit are subject to further clarification, and provisioning as needed under BB regulatory requirements will be funded by the government.

ADDENDUM TO THE TECHNICAL MEMORANDUM OF UNDERSTANDING

The Technical Memorandum of Understanding (TMU) dated June 4, 2003 (IMF Country Report No. 03/205) will be modified as follows:

- Para. 1, page 80 will be replaced by:

1. For program purposes, any foreign asset, liability, or cash flow denominated in a currency other than the U.S. dollar shall be converted into U.S. dollars by applying the appropriate end-of-period exchange rate for March 31, 2005, as published in the Fund's *International Financial Statistics* (Table 1).

Table 1. Selected End-of-Period Exchange Rates

Taka per U.S. dollar	63.5220	Indian rupee per U.S. dollar	43.7550
SDR per U.S. dollar	1.5108	Pakistani rupee per U.S. dollar	59.1240
Australian dollar per U.S. dollar	1.2955	Swedish kroner per U.S. dollar	7.0526
British pound per U.S. dollar	0.5312	Japanese yen per U.S. dollar	107.3500
Canadian dollar per U.S. dollar	1.2096	Gold price in U.S. dollars per troy ounce (London PM fixed)	433.9000
Euro per U.S. dollar	0.7714		

Source: Fund's *International Financial Statistics.*

- The following additional paragraphs will be added at the end of page 81:

2. The NIR floor will be adjusted downward by $100 million (at end-March 2005 TMU rates) if the World Bank's education loan is not disbursed in the first quarter of FY06.

INTERNATIONAL MONETARY FUND

BANGLADESH

Staff Report for the 2005 Article IV Consultation and Third Review Under the Poverty Reduction and Growth Facility, and Request for Waiver of Performance Criterion, Extension of the Arrangement, and Rephasing

Supplementary Information

Prepared by the Asia and Pacific Department

(In consultation with other departments)

Approved by Steven Dunaway and Michael Hadjimichael

June 28, 2005

I. Introduction

1. Based on information that has become available since the issuance of the staff report (see www.imf.org), this supplement provides an update on the FY06 budget that was presented to parliament on June 9, 2005, and recent economic developments and policy measures as envisaged under the PRGF-supported arrangement. The staff appraisal with respect to the operations of the foreign exchange market is further emphasized. All other information in this supplement does not change the analysis and assessment of the staff report.

II. The FY2006 Budget

2. **The budget for FY2006 is consistent with the fiscal targets set out in the staff report.** The overall fiscal deficit is kept at 4.5 percent of GDP, supported by an additional revenue effort (½ percent of GDP) and a reprioritization of expenditure towards pro-poor spending (Table 1). Domestic financing is capped at 2 percent of GDP, supplemented by external financing which is mostly from concessional resources.

- Revenue measures in the FY2006 budget include further rationalization of the structure of supplementary duties on goods (from five rates to three); reduction in customs and supplementary duties on ready-made garments (RMG)-related and other essential imports (e.g., dairy and poultry); and narrowing the coverage of existing tax holidays. The scope of the existing tax exemption regime has been narrowed, although some new exemptions have been introduced to promote agriculture, RMG, and other export-oriented sectors. Moreover, the budget adopts measures to significantly reduce quantitative restrictions, as agreed under the World Bank's Development Support Credit.

- The budget states the authorities' intention to implement the Strategic Reform Plan for the National Board of Revenue (NBR) over a period of three to five years, with World Bank assistance. The draft plan has been approved by the Minister of Finance and is expected to be endorsed by the Planning Commission by end-June. However, the FY06 budget lacks details in terms of near-term tax administration measures that are critical for ensuring the revenue target in the budget, although the authorities consider this only a presentational tactic. In this respect, the authorities are urged to adhere to the measures agreed in the Memorandum of Economic and Financial Policies (¶17–18).

- The budget announces that the proposed increases in wages and allowances for the civil service by the National Pay Commission will be implemented in three phases as agreed under the program, totaling to Tk 40 billion. Moreover, the budget incorporates a further reordering of priorities toward pro-growth and pro-poor spending, with allocations for the key Millennium Development Goals-related sectors targeted to increase significantly.

- Steps have been taken in the budget to further strengthen expenditure management and improve transparency and accountability. In particular, public expenditure tracking systems will be put in place in the Ministries of Education, Health, and Agriculture; and new procedures for project implementation will be introduced with a view to reducing delays and increasing efficiency. In addition, the medium-term budget framework will be implemented in 11 ministries by FY2007, and thereafter in all ministries. To strengthen procurement procedures, the revised procurement guidelines will soon become law. Moreover, the effectiveness of foreign aid will be enhanced through the harmonization of aid procedures and policies between development partners and the government.

III. Other Policy Developments

The foreign exchange market

3. **An MFD mission visited Bangladesh in mid-May to review the recent developments in the foreign exchange market.** The mission confirmed that, in early 2005, unexpected pressures emerged in the foreign exchange market as a result of a combination of factors including the initial impact of the elimination of Multi-Fiber Agreement (MFA) quotas, a surge in international oil prices, and a large volume increase in post-flood food imports. The exchange rate system was tested under adverse conditions for the first time since the float in May 2003. Initially, the authorities allowed the taka to depreciate within "acceptable" bounds (by 5 percent) to absorb the pressure. However, as the external shock persisted and the foreign exchange market came under continuous pressure, the authorities used suasion to avoid depreciation of the taka. Moreover, nationalized commercial banks

(NCBs) were allowed to exceed the limits on their net open positions (NOPs). As a result, two-tier pricing developed in the market between the NCBs and the other private banks (with a spread equivalent to about 0.6 percent at its peak) and a queue of unsatisfied demand emerged.

4. **Since mid-April, the authorities have taken measures in the right direction to help contain pressure on the exchange market.** Interest rates on treasury securities have been increased (by 2.5 percentage points for the 28 day treasury bill and 1 percentage point for the two-year treasury bill and five-year and ten-year bonds). Limits on the net open positions of banks have been more effectively enforced and broadly adhered to. Moreover, banks are allowed to enter into exchange swaps to facilitate their management of liquidity. Furthermore, in recent weeks, the two-tier pricing between the NCBs and other banks have narrowed down significantly. Finally, the authorities have reaffirmed their commitment to market-based principles in the foreign exchange market and have indicated that they will not resort to suasion for managing exchange market pressures (letter attached).

5. **The taka should be allowed to reflect market forces.** Given the deterioration in the terms of trade stemming from lower RMG prices and record high crude oil prices, together with the recent appreciation of the U.S. dollar against other major currencies, the pressure on the taka continues. Meanwhile, the taka/dollar rate has remained broadly unchanged in recent weeks, although the cross rates of the taka vis-à-vis other major currencies have depreciated by 1–2 percent. The Bangladesh Bank (BB) has sold about $200 million into the market since mid-April.

Divestment of Rupali Bank

6. **Good progress has been achieved with Rupali's divestment.** Responding to the information memorandum issued by the Privatization Commission on May 12, twenty expressions of interest have already been received, with strong representation from regional investors. The bidders will be screened according to stringent fit and proper criteria agreed with the World Bank. To ensure transparency and to provide institutional support, Rupali's divestment is being overseen by an internationally recognized consulting firm.

Adjustment of petroleum prices

7. **The government increased the prices of diesel, kerosene, and gasoline by 13 percent, 9 percent, and 6 percent, respectively, effective on May 25, 2005**. This brought the overall increases in the prices of petroleum products to 30–50 percent since June 2003. Nevertheless, domestic energy prices will need to be kept under close review in light of increasing international oil prices and adjusted as needed.

IV. Recent Economic Developments

8. **All quantitative targets for end-June are likely to be observed.** The 12-month reserve money growth has remained high (at 17 percent in mid-June), due in part to increases in government borrowing from BB. However, BB is taking action to mop up liquidity to

ensure that the target on NDA of BB is observed. Gross official reserves stood at $3 billion and NIR at $2.1 billion in mid-June (compared to $3.2 billion and $2.4 billion, respectively, at end-December 2004), reflecting a deceleration in export growth which has been offset in part by strong remittances.

V. Staff Appraisal

9. Paragraph 56, with respect to the operations of the foreign exchange market, is further emphasized:

> **The authorities are urged to adhere to market-based principles in the foreign exchange market.** The staff welcomes the authority's commitment not to use suasion to control the exchange rate and to allow the exchange rate to reflect market forces. The operation of the foreign exchange market will be reviewed again during the fourth review under the PRGF.

Table 1. Bangladesh: Central Government Operations, FY04–06 1/

	2003/04	2004/05			2005/06		
	Est.	Rev. Budg. Prel.	Rev. Budg. Parl. Subm.	Prog.	Budget Prel.	Budget Parl. Subm.	Prog.
				(In billions of taka)			
Total revenue	337.4	392.0	392.0	392.0	457.2	457.2	457.2
Tax revenue	272.7	319.5	319.5	319.5	373.1	373.1	373.1
NBR taxes	260.3	305.0	305.0	305.0	356.5	356.5	356.5
VAT, supplementary duties, excises	140.4	163.2	163.6	163.2	192.3	192.4	192.3
Customs duties	70.9	81.0	80.0	81.0	91.0	91.0	91.0
Taxes on income and profits	46.1	56.8	58.5	56.8	69.5	69.6	69.5
Other NBR taxes	3.0	4.0	3.0	4.0	3.5	3.5	3.5
Non-NBR taxes	12.4	14.5	14.5	14.5	16.6	16.6	16.6
Nontax revenue	64.7	72.5	72.5	72.5	84.1	84.1	84.1
Total expenditure	443.9	556.3	556.3	548.3	642.5	643.8	633.5
Current expenditure	258.6	320.3	321.3	320.3	351.4	361.8	351.4
Pay and allowances	76.6	90.6	87.6	90.6	106.6	98.8	106.6
Goods and services	45.1	57.8	57.9	57.8	64.1	57.6	64.1
Interest payments	54.5	65.0	65.0	65.0	67.2	70.5	67.2
Subsidies and transfers	78.9	101.7	104.4	101.7	101.4	117.1	101.4
Subsidies	11.9	12.0	21.6	12.0	13.4	16.9	13.4
Transfers	67.0	89.7	82.8	89.7	88.0	100.2	88.0
Block allocations	3.6	5.1	6.3	5.1	12.1	17.8	12.1
Food account surplus(-)/deficit(+)	3.5	1.7	1.6	1.7	3.5	1.7	3.5
Annual Development Program (ADP)	167.9	206.0	205.0	198.0	247.9	245.0	238.9
Non-ADP capital and net lending	16.0	25.6	25.7	25.6	32.2	27.9	32.2
Extraordinary expenditures	7.8	2.7	2.7	2.7	7.5	7.5	7.5
Check float plus discrepancy	-10.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (excluding grants)	-106.4	-164.3	-164.3 2/	-156.3 2/	-185.3	-186.6	-176.3
Primary balance (excluding grants)	-51.9	-99.3	-99.3	-91.3	-118.1	-116.1	-109.1
Net financing	106.4	164.3	164.3	156.3	185.3	186.6	176.3
External	37.4	88.3	88.3 2/	80.3 2/	102.0	103.2	93.0
Domestic	69.0	76.0	76.0	76.0	83.3	83.4	83.3
Bank	23.0	36.0	36.0	36.0	36.3	36.4	36.3
Nonbank	46.0	40.0	40.0	40.0	47.0	47.0	47.0
				(In percent of GDP)			
Total revenue	10.1	10.5	10.5	10.5	11.0	11.0	11.0
Tax revenue	8.2	8.6	8.6	8.6	8.9	8.9	8.9
NBR taxes	7.8	8.2	8.2	8.2	8.5	8.5	8.5
Non-NBR taxes	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Nontax revenue	1.9	1.9	1.9	1.9	2.0	2.0	2.0
Total expenditure	13.3	14.9	14.9	14.7	15.5	15.5	15.2
Current expenditure	7.7	8.6	8.6	8.6	8.4	8.7	8.4
Pay and allowances	2.3	2.4	2.3	2.4	2.6	2.4	2.6
Goods and services	1.3	1.5	1.6	1.6	1.5	1.4	1.5
Interest	1.6	1.7	1.7	1.7	1.6	1.7	1.6
Subsidies and transfers	2.4	2.7	2.8	2.7	2.4	2.8	2.4
Subsidies	0.4	0.3	0.6	0.3	0.3	0.4	0.3
Transfers	2.0	2.4	2.2	2.4	2.1	2.4	2.1
Block allocations	0.1	0.1	0.2	0.1	0.3	0.4	0.3
Annual Development Program	5.0	5.5	5.5	5.3	6.0	5.9	5.7
Non-ADP capital and net lending	0.5	0.7	0.7	0.7	0.8	0.7	0.8
Other expenditures	0.3	0.1	0.1	0.1	0.3	0.2	0.3
Check float plus discrepancy	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance (excluding grants)	-3.2	-4.4	-4.4 2/	-4.2 2/	-4.5	-4.5	-4.2
Primary balance (excluding grants)	-1.6	-2.7	-2.7	-2.4	-2.8	-2.8	-2.6
Net financing	3.2	4.4	4.4 2/	4.2 2/	4.5	4.5	4.2
External financing (net)	1.1	2.4	2.4	2.2	2.5	2.5	2.2
Domestic financing	2.1	2.0	2.0	2.0	2.0	2.0	2.0
Banks	0.7	1.0	1.0	1.0	0.9	0.9	0.9
Nonbank	1.4	1.1	1.1	1.1	1.1	1.1	1.1
Memorandum item:							
Nominal GDP (in billions of taka)	3,345	3,731	3,731	3,731	4,171	4,171	4,171
Overall balance, including grants (in percent of GDP)	-2.7	-4.0	-4.0	-3.6	-3.7	-3.7	-3.5
Poverty reducing Spending (in percent of GDP)	6.1	7.8	7.8	7.8	8.3	8.4	8.3
Government wage bill and pensions (in percent of GDP)	3.7	3.8	3.8	3.8	3.8	3.8	3.8

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates.

1/ Fiscal year ends June 30.

2/ Including externally financed flood-related expenditure.

Date: 26th June 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street, NW
Washington, DC 20431
USA

Dear Mr. de Rato,

Bangladesh remains committed to maintaining a market based flexible exchange rate system. To that end the Bangladesh Bank has taken, and has been taking, steps to strengthen operation of the exchange market with support of the MFD technical assistance missions.

The long persisting divergence between exchange rates quoted by NCBs and other banks has been narrowed down, and stands practically eliminated as of now. Bangladesh Bank is keeping continuous watch to prevent tendency of reemergence of any significant divergence and will ensure that this does not exceed 2 percent.

Bangladesh Bank's interventions in the exchange market are at market exchange rates. Relying on market mechanism to adjust to exchange market pressures, Bangladesh Bank is not now resorting to, and does not intend to resort to suasion for this purpose.

Sincerely,

/s/
(M.A.M. Kazemi)
Deputy Governor

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No.05/90
FOR IMMEDIATE RELEASE
July 18, 2005

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2005 Article IV Consultation with Bangladesh

On June 29, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bangladesh.[1]

Background

Since the last Article IV consultation, Bangladesh's economy has continued to expand, supported by a stable macroeconomic environment and progress in implementing structural reforms, broadly in line with the recommendations made by the Executive Board. Real GDP growth is projected at 5¼ percent in FY05 (ending June 30), reflecting a slight deceleration from 5½ percent in FY04 due to the impact of devastating floods last July. The floods damaged major crops, particularly rice. This, together with an upswing in global oil and commodity prices, contributed to a surge in inflation in late 2004, which has since moderated and is projected at an annual average of 6½ percent in FY05.

As in the previous two years, the fiscal stance has been prudent, with the overall budget deficit estimated at 4.2 percent of GDP in FY05 (from 3.2 percent in FY04), reflecting in part flood relief efforts. Revenue is projected to increase by 16 percent in FY05 (compared to 9 percent in FY04). This outcome, however, falls short of the revenue effort of ½ percentage point of GDP in the FY05 budget, reflecting delays in the implementation of tax administrative reforms and lingering weaknesses in audit and collection enforcement. Total spending is projected to be 0.5 percent of GDP lower than in the revised budget, on account of lower-than-projected development expenditure. The structure of deficit financing remains sound, with domestic financing capped at 2 percent of GDP, whereas

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

external financing continues to be on concessional terms.

The external position strengthened in 2003–04, but pressures emerged at the beginning of 2005. Export earnings have moderated since November 2004, reflecting mainly a sharp decline in prices associated with the elimination of the Multifiber Arrangement (MFA) quotas on January 1, 2005. Imports have grown rapidly due to higher oil and commodity prices, an increase in food imports, and stronger demand for investment goods. Oil imports are estimated to exceed forecast levels significantly. The external current account is projected to move to a deficit of US$1.1 billion (or 1.8 percent of GDP) in FY05, from near balance in FY04.

Since floating the exchange rate in May 2003, the taka has depreciated by 9 percent and 5 percent in nominal and real effective terms, which has helped boost the competitiveness of Bangladesh's export sector. The authorities have confined their interventions to building reserves and to countering disorderly market conditions during a period of generally favorable balance of payment conditions. To ease the pressure from multiple external shocks in early 2005, Bangladesh Bank (BB) sold some foreign exchange reserves in January while allowing the taka to depreciate by 5 percent against the U.S. dollar. Taking into account higher payments for oil imports, gross international reserves are projected at $2.7 billion at end-June 2005 (2.4 months of imports), after peaking at US$3.2 billion at end-2004.

Monetary policy has been supportive of growth, but an accommodative stance in early 2005 contributed to pressures on the exchange market. Reflecting in part lending to the agricultural sector for flood rehabilitation and strong demand for credit in a low interest rate environment, reserve money growth has accelerated since late 2004, while growth of private sector credit and broad money have also increased sharply. A decline in real interest rates led to a slowdown in the net sales of treasury securities by BB, with many banks holding treasury securities only up to the limit under the Statutory Liquidity Requirement.

Good progress has been made in strengthening the banking system. BB has raised minimum capital requirements, taken steps to reduce insider lending, and has improved the institutional framework for the prudential supervision of the financial system. As part of the reforms of the nationalized commercial banks (NCBs), the information memorandum for the divestment of Rupali Bank has been issued, management teams have been put in place for Sonali and Agrani, and the contract for Janata Bank was signed recently. Performance under the Memorandum of Understanding between BB and the NCBs has been satisfactory, although there is scope for further increasing cash recoveries from the largest defaulters.

Reform of tax administration has advanced, but has yet to translate into an acceleration of revenue growth. The institutional structures have been set up, including the Large Taxpayer Units for income tax and VAT and the Central Intelligence Cell, but enforcement, audit and collection efforts remain weak, reflecting capacity constraints and opposition from vested interests. Extensive court injunctions on tax cases have undermined the function of the National Board of Revenue. Two benches in the High Court have now been created to deal exclusively with tax cases and to expedite the clearing process.

Progress has been mixed in reforming the state-owned enterprises (SOEs) and their financial conditions remain weak. On the positive side, the government adjusted prices for energy products in December 2004 and January 2005, in line with pricing formulas agreed with the World Bank. This helped reduce the financial losses of energy sector SOEs and improve their viability. On the negative side, after initial success in the closure of manufacturing SOEs in FY03, further closure/downsizing of SOEs stalled due to difficult labor issues. But these loss-making units can no longer resort to bank financing or budgetary resources and have been encouraged to downsize through hiring freezes and a voluntary retirement scheme.

Significant headway was made on trade reform in FY05 through a reduction in the level and dispersion of duties and a streamlining of quantitative restrictions. The structure of customs duty rates was simplified to three slabs, with the top rate reduced by 5 percent to 25 percent, and supplementary duties were reduced. These measures have significantly lowered the dispersion of custom duties. Quantitative restrictions were streamlined, with a simplification of administrative procedures and a halving of the number of restricted products starting April 2005.

Executive Board Assessment

The Executive Directors commended the Bangladesh authorities' efforts in maintaining economic stability and in advancing the structural reform agenda, in spite of a difficult political environment and external shocks. Directors welcomed the buoyant economic growth, moderate inflation, and the rise in international reserves since July 2004. Looking forward, Directors underscored that Bangladesh faces the key challenges of accelerating growth and maintaining macroeconomic stability while overcoming the potentially significant impact of the MFA phaseout. They also noted that structural weaknesses—including the country's low revenue base, weak infrastructure, and inefficient public enterprises—continue to pose serious obstacles to private sector development. Directors therefore called for the continuation of core reforms in tax administration, banking, and the energy sector, as well as improved governance, to enhance the business environment, promote export diversification, and facilitate economic recovery and poverty alleviation.

Directors welcomed efforts to finalize Bangladesh's National Poverty Reduction Strategy Paper, which will serve as a roadmap for meeting the Millennium Development Goals. They concurred with the PRSP's focus on fiscal reforms and the development of anti-poverty programs within the context of a medium-term budgetary framework. However, they acknowledged that the elimination of the MFA quotas, the country's susceptibility to natural disasters, and a confrontational political environment pose risks towards achieving this goal.

Directors were encouraged by the authorities' resolve to improve revenue mobilization through strengthened tax administration and to support pro-poor expenditures while protecting fiscal sustainability. They stressed that effective implementation of tax administration measures and strict enforcement are vital to the revenue effort, and will require strong political support. Directors noted that modernizing the National Board of Revenue (NBR) along functional lines is also a critical step toward developing a more effective tax administration. They therefore welcomed the authorities' intention to implement the Strategic Reform Plan for the NBR with World Bank assistance. Directors also stressed that current expenditures need to be contained and the development budget strengthened through better project selection, improved procurement management, and timely compliance with policy conditions for project financing. Directors supported the government's intention to curtail and phase over three years the public sector wage increases while protecting pro-poor expenditures. The importance of aligning such increases with civil service reform was emphasized.

Directors expressed support for Bangladesh to maintain a flexible exchange rate system based on market principles. They stressed that the system should be allowed to operate as intended, especially during a time of market pressures. In view of an adverse external environment and exchange market pressures, Directors noted that this would be particularly important for preserving competitiveness. They supported the authorities' intention to continue to confine their interventions in the exchange market to countering disorderly conditions, to abandon the use of suasion, and further develop the operations of the exchange market.

Directors noted that a tight monetary stance is important to contain inflationary pressures. In this context, BB is encouraged to actively use open market operations to ensure adequate liquidity management and to allow interest rates to increase in order to ensure sufficient demand for treasury securities. Directors also encouraged BB to implement further improvements in the functioning of the interbank and treasury bill markets, as recommended by the recent Fund technical assistance mission. Reactivating the primary dealer system and deepening the secondary market for treasury securities are important steps in this regard.

Directors were encouraged by the progress achieved in reforming and divesting the NCBs. Taking Rupali Bank to the point of divestment is a significant demonstration of the authorities' commitment to bank reform. Directors added that recent efforts to improve the supervision and regulation of the banking system will reduce financial vulnerabilities and enhance the allocation of capital. They stressed the importance of ensuring that banks meet all prudential regulations, including on net open limits on foreign exchange transactions.

Directors welcomed the authorities' commitment to further trade reform, particularly in view of the competitive challenges in a post-MFA environment. The reduction and rationalization of trade taxes in FY05 have helped to enhance competitiveness and reduce anti-export bias. The streamlining of the supplementary duty system in the FY06 budget, together with a significant reduction in quantitative restrictions and the removal of restrictions on foreign direct investment in the ready-made-garment sector outside the export processing zones, are steps in the right direction. Directors noted that it would be desirable to further simplify the supplementary duty regime.

Directors encouraged the authorities to work with the World Bank and the Asian Development Bank toward implementing a restructuring plan to improve the operational and financial performance of the energy sector SOEs. Measures to reform the power sector distribution system, particularly those under Dhaka electric system authority's current network, are key to this strategy. This will require intensified efforts to reduce system losses through enhanced monitoring and improved bill collection.

Directors noted that, in light of rising global fuel prices and the weak financial position of energy sector SOEs, the adjustments on domestic fuel prices in the first half of 2005 are appropriate. However, they underscored that the authorities need to keep domestic fuel prices under close review and make further adjustments as needed. The impact of higher domestic fuel prices on the poor can be reduced by well-targeted and transparent transfers to them.

Directors welcomed the recent establishment of the Anti-Corruption Commission. Concerted follow-up actions are required to make the Commission function effectively so as to enhance its credibility. In this respect, developing an anti-corruption strategy with technical assistance from donors would be an important step to tackle governance issues and help improve the investment climate.

Bangladesh: Key Economic Indicators, FY2001-06 1/

	2000/01	2001/02	2002/03	2003/04	Proj. 2004/05	Proj. 2005/06
National income and prices (percent change)						
Real GDP	5.3	4.4	5.3	5.5	5.2	6.0
GDP deflator	1.6	2.7	4.4	5.5	6.0	5.5
CPI inflation (annual average) 2/	1.6	2.8	4.4	5.8	6.5	6.0
Central government operations (percent of GDP)						
Total revenue	9.0	10.2	10.3	10.1	10.5	11.0
Tax	7.6	7.7	8.3	8.2	8.6	8.9
Nontax	1.4	2.4	2.0	1.9	1.9	2.0
Total expenditure	14.8	14.9	13.7	13.3	14.7	15.2
Current expenditure	7.7	8.0	8.1	7.7	8.6	8.4
Of which: Interest payments	1.6	1.8	1.9	1.6	1.8	1.6
Annual Development Program	6.5	5.6	5.4	5.0	5.3	5.7
Other expenditures 3/	0.6	1.3	0.2	0.6	0.8	1.1
Overall balance (excluding grants)	-5.1	-4.7	-3.4	-3.2	-4.2	-4.2
Primary balance	-3.5	-2.9	-1.5	-1.6	-2.4	-2.6
Financing (net)	5.1	4.7	3.4	3.2	4.2	4.2
Domestic	3.1	2.6	1.3	2.1	2.0	2.0
External	2.0	2.1	2.1	1.1	2.2	2.2
Total central government debt (percent of GDP)	50.8	52.9	51.0	48.3	47.9	48.3
Money and credit (end of year; percent change)						
Net domestic assets	20.2	11.9	12.2	13.4	14.8	13.5
Private sector	16.3	13.9	12.6	12.0	14.7	13.2
Broad money (M2)	16.6	13.1	15.6	13.8	14.2	12.8
Balance of payments (in billions of U.S. dollars) 4/						
Exports, f.o.b.	6.4	5.9	6.5	7.5	7.8	8.0
(Annual percent change)	11.4	-7.6	9.5	15.8	4.1	2.0
Imports, f.o.b.	9.4	7.7	8.7	9.8	11.6	12.3
(Annual percent change)	11.4	-8.7	13.0	13.0	18.0	6.2
Gross official reserves (in billions of U.S. dollars)	1.3	1.6	2.5	2.7	2.7	2.7
In months of imports of goods and nonfactor services	1.7	2.1	2.9	2.8	2.4	2.2
Memorandum item						
Nominal GDP (in billions of taka)	2,535	2,732	3,005	3,345	3,731	4,171

Sources: Data provided by the Bangladesh authorities; and IMF staff estimates and projections.

1/ Fiscal year begins July 1.

2/ CPI has recently been rebased using FY96 weights.

3/ Consists of other capital, net lending, and food accounts (including check float and discrepancy).

4/ Balance of payments is presented on the basis of BPM5.

Press Release No. 05/154
FOR IMMEDIATE RELEASE
June 29, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes Third Review Under Bangladesh's PRGF Arrangement and Approves Disbursement Under the Trade Integration Mechanism

The Executive Board of the International Monetary Fund (IMF) today completed the third review of Bangladesh's economic performance under a Poverty Reduction and Growth Facility (PRGF) arrangement. The completion of the review makes immediately available to Bangladesh an amount equivalent to SDR 67.3 million (about US$ 98.5 million) under the arrangement, including the first of the three equal disbursements under the Trade Integration Mechanism (TIM) amounting to SDR 17.8 million (about US$ 26.0 million).

The IMF's Executive Board approved Bangladesh's three-year PRGF arrangement on June 20, 2003 (see Press Release No. 03/92) for an amount equivalent to SDR 347 million (about US$ 507.7 million). The Executive Board also approved on July 28, 2004 Bangladesh's request for activation of the newly created TIM with an augmentation of the PRGF amounting to SDR 53.3 (about US$ 78.0 million) (see Press Release No. 04/161). As a result, the total amount under the PRGF arrangement increased to SDR 400.3 million (about US$ 585.7 million). So far, Bangladesh has drawn SDR 148.5 million (about US$ 217.3 million) under the arrangement.

In completing the review, the Executive Board also decided today to extend the current PRGF arrangement to December 31, 2006 so that the remaining reviews and all disbursements under the arrangement could be completed. It also decided to waive the nonobservance of a structural performance criterion for end-September 2004, as the authorities have since taken corrective actions and implemented the measure.

Following the Executive Board's discussion on Bangladesh, Mr. Rodrigo de Rato, Managing Director and Chair, stated:

“Bangladesh’s reform efforts since the early 1990s have resulted in significant economic and social improvements with steady GDP growth and manageable inflation. As a result, poverty indicators have improved, malnutrition has declined, and gender equality has been enhanced. Nevertheless, Bangladesh still remains among the poorest countries in the region, requiring much faster economic growth if the Millenium Development Goals (MDGs) are to be met by 2015.

“Since the last Article IV consultation, the authorities have maintained macroeconomic stability and advanced the structural reform agenda. The thrust of the authorities’ economic policies has been broadly consistent with Fund advice. However, the pace of reforms has been slower than envisaged due to a difficult political environment.

“The authorities program for the third year of the PRGF will give priority to: further tax administration reform to increase revenue; divesting Nationalized Commercial Banks (NCBs) to improve efficiency and contain quasi-fiscal losses; liberalizing the investment regime, including trade reforms; and reforming the energy sector state-owned enterprises to secure adequate supply of power while ensuring fiscal sustainability.

“The authorities are committed to boosting revenue and reorienting expenditures to support growth and the MDGs, while protecting fiscal sustainability. They acknowledged the importance of modernizing the National Board of Revenue, and noted that a strategic plan will be developed during 2005 with World Bank assistance. The FY06 budget narrows the scope for tax exemptions while introducing some measures to broaden the tax base. On the expenditure side, pro-poor expenditures will be emphasized and the public sector wage increases will be curtailed and phased in over 3 years.

“Bangladesh should maintain a flexible exchange rate system based on market principles. It is particularly important to preserve competitiveness, and therefore interventions in the exchange market should continue to be confined to countering disorderly conditions.

“A tight monetary policy stance is important to ensure price stability and orderly exchange market conditions. The authorities have responded by increasing the Cash Reserve Requirement, raising interest rates on treasury securities, and actively using the repo and reverse-repo facilities to conduct daily monetary operations.

“Improving competitiveness and the investment climate remains a critical challenge, especially after the elimination of Multi-Fiber Agreement quotas. The authorities’ decision to ease restrictions on foreign direct investment in the ready-made garment sector, reduce the number of trade-related quantitative restrictions on imports, and to take further measures to address the infrastructural bottlenecks will help boost export competitiveness.

“The authorities have made significant efforts to strengthen the NCBs. Memoranda of Understanding have been signed with all NCBs that set explicit targets on improving operational performance and constraining lending growth. This has resulted in a reduction in non-performing loans and the rationalization of staffing and branch networks. With respect to the divestment of Rupali Bank, an information memorandum was issued in May and the authorities are hopeful that the bank will be divested by the end of the year.

“The weak performance of energy sector state-owned enterprises (SOEs) continues to impede economic growth and pose fiscal risks. The authorities’ latest decision to adjust domestic fuel prices was appropriate, and further adjustments may be necessary. The authorities should continue to work with the World Bank and Asian Development Bank to define a restructuring plan to improve the operational and financial performance of the energy sector SOEs,” Mr. de Rato said.

The PRGF is the IMF's concessional facility for low-income countries. PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent, and are repayable over 10 years with a 5 ½-year grace period on principal payments.