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Bangladesh: 2008 Article IV Consultation—Staff Report; Staff Supplement; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Bangladesh

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2008 Article IV consultation with Bangladesh, the following documents have been released and are included in this package:

- The staff report for the 2008 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on July 15, 2008, 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 August 27, 2008. 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 on the joint IMF/World Bank debt sustainability analysis.
- A staff statement of September 19, 2008 updating information on recent developments.
- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its September 19, 2008 discussion of the staff report that concluded the Article IV consultation.
- A statement by the Executive Director for Bangladesh.

The document listed below has been or will be separately released.

Selected Issues

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

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BANGLADESH

Staff Report for the 2008 Article IV Consultation

Prepared by the Staff Representatives for the 2008 Consultation with Bangladesh

Approved by Kalpana Kochhar and Anthony Boote

August 27, 2008

Mission: Discussions were held in Dhaka during July 2–15, 2008. The staff team met with Chief Advisor Fakhruddin Ahmed, Minister of Finance and Planning Mirza Md. Azizul Islam, Finance Secretary Mohammad Tareque, Bangladesh Bank Governor Salehuddin Ahmed, and other senior officials. The team also met with representatives of donors, NGOs, business, labor, the media, and academics.

Team: Mr. Rumbaugh (head), Messrs. Davies, J. Kang (all APD), Arslanalp (FAD), and Perone (PDR), assisted by the resident representative, Mr. Dunn. Mr. Ray (Advisor to the Executive Director) participated in key meetings.

Focus: Identify short-term policy priorities during the current political transition and review medium term economic prospects.

The 2007 Article IV consultation was completed on June 22, 2007: Directors pointed to low revenue collection, poor infrastructure, low skill levels, and corruption as the main impediments to sustained growth and poverty reduction (Country Report No. 07/234).
The Fund provided SDR133 million in Emergency and Natural Disaster Assistance in April 2008 (Country Report No. 08/138).

Exchange regime: The exchange rate regime is a managed float. A restriction remains in place on the convertibility and transferability of proceeds of current international transactions in nonresident taka accounts.

Statistical issues: Data are adequate for surveillance. The authorities are working to address the deficiencies identified in the 2005 ROSC.

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EXECUTIVE SUMMARY

Background

Macroeconomic performance has been remarkably resilient in a year of multiple natural disasters and elevated international food and fuel prices. Growth picked up strongly from a slow start to the year with rebounds in agriculture and garment exports playing a leading role. Strong growth of remittances and increased external assistance helped support the balance of payments in the face of rising import costs.

Nevertheless, life has become more difficult for large segments of the population. The natural disasters and subsequent rapid food price increases of early 2008 put severe pressure on incomes, reversing some of the recent reductions in poverty.

Inflation remains uncomfortably high despite delays in passing through fuel price increases. Consumer Price Index (CPI) inflation averaged 10 percent during FY08 and is expected to increase further with the 40 percent increase in administered fuel prices announced in July.

The fiscal position was supported by a significant improvement in revenue collections, which helped offset increased subsidies and outlays on safety nets.

Growth in monetary aggregates moderated early in the year but has rebounded quickly. Private sector credit growth reached 25 percent at end–June.

Key Policy Issues

The authorities have made significant efforts to maintain a stable macroeconomic situation. An impressive increase in government revenues, bringing state-owned enterprise (SOE) losses onto the budget and the recent substantial increase in administered prices were significant achievements. Staff and the authorities agreed on the policy framework required to achieve the projected increase in economic growth over the medium term.

Staff recommended adjustments in monetary policy to rein in inflationary pressures. The authorities, however, were more optimistic that inflationary pressures could be contained without monetary policy adjustments.

Staff urged the authorities to remain within the macroeconomic targets of the FY09 budget to prevent putting further pressure on inflation. The authorities were confident that expenditure reprioritization would enable them to remain within the budget framework.

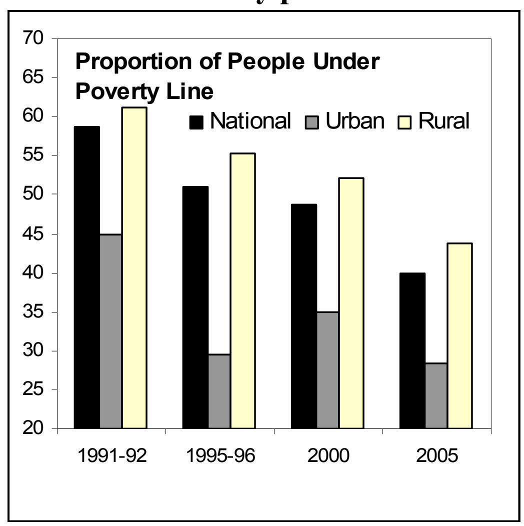
A complete modernization of the tax system is needed to underpin much-needed increases in revenue. Recent improvements in administration are welcome but need to be accompanied by accelerated efforts to modernize the legal framework.

Further financial sector development is needed to allow Bangladesh to achieve its growth potential. Key priorities include strengthening the foreign exchange and government debt markets, and improving the financial position of the state-owned banks.

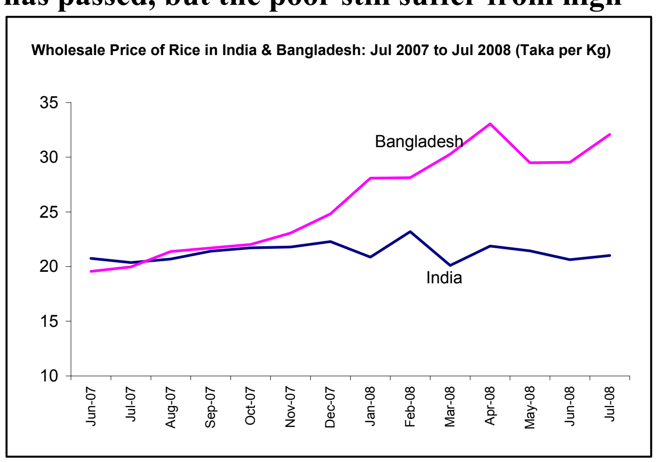
I. Background

1. **The political environment is uncertain ahead of December's national elections.** The military-backed caretaker government (CTG) that assumed control in January 2007 remains in power. Following a massive voter registration campaign, national elections have been announced for December 2008, and some elements of the state of emergency have been lifted to allow restricted political activity. The leaders of the two main political parties are both on trial for corruption with their parties threatening to boycott the elections unless they are released from jail. Although the trials continue, one leader has been freed to seek medical treatment abroad and discussions with both parties continue with the aim of ensuring participation of all major parties in the elections. The calm atmosphere surrounding the municipal elections in early August suggests there are reasons to be optimistic about the likelihood of orderly national elections.

2. **Despite impressive gains in recent years, Bangladesh remains very poor.** Sustained growth, averaging 5½ percent a year since the mid–1990s, enabled poverty rates to be reduced to 40 percent in 2005 from 50 percent in 1995. Significant progress has been made toward meeting the millennium development goals (MDGs), especially with respect to education, child mortality, and gender equality (Table 7). Per capita income, however, is still only about $550 and the country is vulnerable to natural disasters and climate change. This was demonstrated by the devastating twin floods and cyclone in late 2007 that destroyed crops and homes in rural areas, left at least 4,400 dead, and displaced millions. These disasters and the simultaneous increase in food prices have pushed some groups back over the poverty line. Preliminary estimates by the World Bank suggest that, owing to significant growth in incomes during 2006–08, poverty rates are still somewhat lower than the 2005 estimates despite these setbacks.



3. **The food supply crisis of early 2008 has passed, but the poor still suffer from high prices.** Rice shortages resulting from last year's natural disasters have dissipated as a result of a strong rice harvest in April–June. Regional export bans for rice and indications that producers and millers may be holding rice in anticipation of further price increases have, though, kept food prices relatively high (much higher than in neighboring India), particularly in urban areas. The authorities are procuring rice from domestic and international markets and recommenced open-market sales in late-August.



II. Recent Economic Developments

4. **Macroeconomic performance has been remarkably resilient in a year of multiple natural disasters and elevated food and fuel prices (Figures 1 and 2)**. Since the 2007 Article IV consultation, growth momentum has been maintained, exports and remittances continued to grow strongly, and revenue collections improved.

- ***Growth in FY08 remained strong at above 6 percent***. Early in the year, private sector activity was suppressed by political uncertainty, and fear about an outbreak of avian flu. This was compounded by the natural disasters that heavily damaged the November rice crop and also affected shrimp harvests. However, bumper harvests of wheat, potatoes and the main rice crop in late April, a rapid pickup in garments exports, and some resurgence of industrial activity compensated in the second half of the year.

- ***Inflation remains uncomfortably high despite delays in passing through fuel price increases.*** CPI inflation averaged almost 10 percent during FY08, driven mainly by high international food prices and the April 2007 fuel price increase. With the effects of that increase receding, year-on-year inflation dropped to 7½ percent in April–May 2008, but increased again to 10 percent in June 2008 and is expected to remain at double-digit levels with the increase in administered fuel prices implemented on July 1, which averaged around 40 percent.

- ***Government revenue collection improved impressively in FY08***. Improved taxpayer compliance, particularly on income tax, and collection of arrears contributed to a 27 percent increase in revenues. This allowed budget targets to be exceeded (by ½ percent of GDP) for the first time in recent history.

- ***The overall fiscal deficit for FY08 is estimated to be below the budget target***. Despite increased social spending arising from disaster relief operations and better coverage of SOE losses related to administered fuel and fertilizer prices, the deficit is expected to be less than 3½ percent of GDP (excluding a 1.4 percent of GDP debt operation to cover earlier losses of the state-owned petroleum company). The deficit was contained by the higher revenue and a reprioritization of spending, while increased external assistance allowed domestic financing to remain around 2½ percent of GDP.

- ***Growth in money aggregates moderated last year, but has started to increase.*** Money growth fell in the first half of FY08, but picked up rapidly in the last part of the period. Broad and reserve money growth stood at 17½ percent and 20½ percent respectively at end–June. Private sector credit growth accelerated even faster, in part due to the need to finance increased food imports, and reached 25 percent in June.

- ***The nominal exchange rate remained stable in dollar terms in FY08***, but depreciated by 6½ percent in effective terms as the dollar's value decreased in international markets. Intervention by Bangladesh Bank (BB) was moderate.

- ***International reserves grew moderately***. Extremely strong remittance growth, a pickup in garments exports, and external assistance, including from the Fund's ENDA, moderated the effect on reserves of increased import demand and high international commodity prices. Gross reserves increased to US$6.1 billion (2¾ months of prospective imports).

5. **Progress has been made on structural policies, including in the governance area, but the pace of reform has been constrained by the domestic political environment.**

- The CTG initially made encouraging progress, making much-needed adjustments to domestic fuel prices in April 2007, and corporatizing state-owned commercial banks (SCBs). Public financial management and revenue administration reforms were given renewed impetus and progress was made in setting up a primary dealer system for government securities. The CTG also proceeded with governance reforms, including by reconstituting the Anti-Corruption Commission and strengthening the Election Commission. A truth and accountability commission, tasked to look into past corruption, began operation in early August.
- However, the pace of reform subsequently slowed as the sensitivity of the government to public opinion grew, and addressing natural disasters and food shortages took center stage. The divestment of state-owned Rupali bank, which was a centerpiece of the financial sector reform program, failed when the buyer pulled out of the deal. Administered prices were unchanged throughout FY08 despite the rapid increase in purchase prices.
- Recent months saw the CTG belatedly responding to international price increases as losses in SOEs became untenable. In addition to the July fuel price increase of around 40 percent, retail prices for compressed natural gas for transport (a marginal portion of overall sales) and fertilizer prices were doubled. Proposed increases of around 50 percent in electricity and other natural gas prices are currently under regulatory review.

III. Economic Outlook

6. **Growth could slow while current challenges are addressed, before moving up toward its potential over the medium term.** Staff stressed that policy actions to bring inflation under control are likely to create some temporary headwinds to economic momentum. However, growth should increase to around 7 percent over the medium term. Indeed, the good FY08 performance, in the face of strong countervailing pressures, could indicate stronger underlying growth potential than assumed in staff's baseline projections. Continued improvements in agriculture and expansion in domestic services and construction as

Medium-Term Macroeconomic Framework

	FY09	FY10	FY11	FY12	FY13
			(percent)		
GDP growth	6.0	5.5	6.5	6.7	7.0
CPI inflation (average)	11.0	9.0	7.0	6.0	5.0
Broad money growth	19.8	17.1	16.8	16.4	16.3
			(percent of GDP)		
Overall fiscal balance	-4.9	-3.8	-4.0	-4.0	-4.0
External current account balance	0.8	0.4	0.5	0.4	0.0
			(months of prospective imports)		
Gross international reserves	2.6	2.7	2.9	3.0	3.1

Bangladesh capitalizes on high regional momentum will be key drivers of this growth. The external current account should remain broadly in balance, with export and remittance growth offsetting growth in imports arising from price rises and investment. External assistance and gradually increasing capital inflows would underpin a steady increase in international reserves.

7. **There are, however, significant risks.**

- The external environment is particularly uncertain at present—a sustained further increase in oil prices is not assumed in staff's baseline projections, but is certainly possible. Such an increase would put the balance of payments and fiscal position under significant stress and further reduce near-term growth prospects.
- The slowdown in early FY08 demonstrated the damaging effects that political uncertainty can have on economic growth. A further period of major upheaval leading up to the national elections could undermine short-term growth prospects, and distract the authorities from taking needed policy measures.
- The external sector depends mainly on garments and remittances for inflows.[1] Although the outlook appears optimistic, both are vulnerable to shocks: garments from external demand, domestic labor unrest, and changes in market access; and remittances from changes in labor regulations in the Middle East. A deterioration in the outlook for both could cause significant external pressure, particularly as official capital and FDI remain relatively low compared to peers in Asia.
- External debt is sustainable with low risk of distress. However, taking into account domestic debt, the risk of distress would be moderate particularly because of the vulnerability of the debt ratios to slower growth. Contingent liabilities arising from SOEs and low revenue collections are additional sources of risk.[2]
- Climate change poses a significant risk to longer-term growth. As recent events demonstrate, Bangladesh's economic base is vulnerable to potential changes in sea levels and local climactic conditions.

IV. Macroeconomic Policy Discussions

8. **The CTG is committed to leaving a sustainable macroeconomic position to the next administration.** The authorities emphasized the recent increases in administered prices as evidence of their commitment. These price rises were politically difficult, particularly in the light of the surge in food prices in early 2008, but essential to leave a workable fiscal position to the

[1] Chapter II of the Selected Issues for the 2008 Article IV consultation reviews Bangladesh's success in export diversification and briefly updates the analysis of garment sector competitiveness undertaken as part of the 2007 Article IV Consultation (IMF Country Report 07/230). Factors affecting remittances were also analyzed in the 2007 Article IV Consultation.

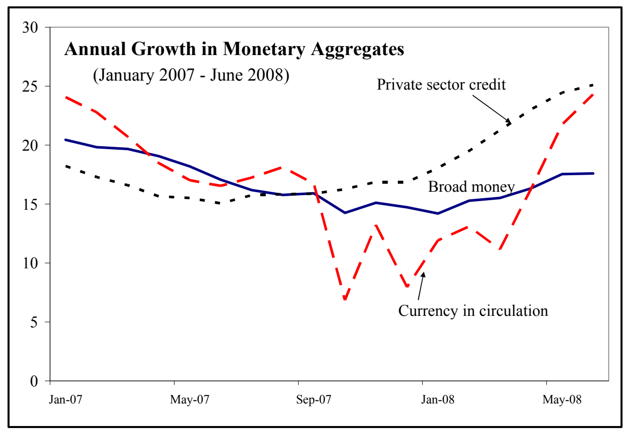
[2] See the Joint Fund-World Bank Debt Sustainability Analysis (DSA) 2008 issued as a supplement to this report.

next government. The authorities also stressed the importance of leaving adequate public food stocks at the end of their tenure.

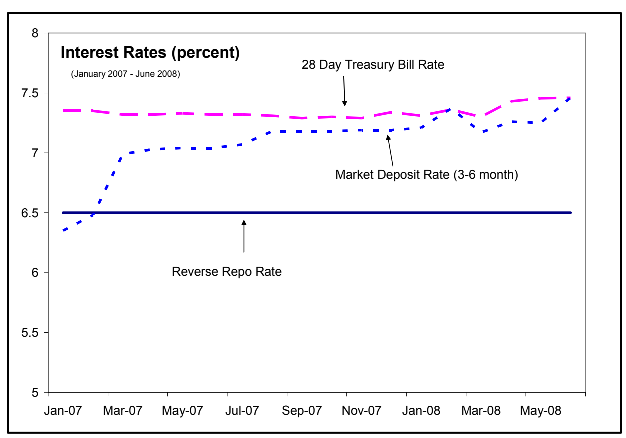
9. **Discussions focused on the policies required to maintain near-term macroeconomic stability and underpin sustained poverty reduction.** The authorities broadly agreed with staff's medium-term scenario, but were more optimistic about near-term growth prospects and the likelihood of inflation returning to single digits without significant policy adjustments as supply shocks dissipate. Staff welcomed the authorities' commitment to maintaining a sound economic position, noting in particular the improvements in fiscal management. However, staff stressed that further economic policy actions would likely be required in the coming months to deal with emerging inflationary pressures and to renew momentum on the structural reform agenda.

A. Containing Inflation

10. **Staff viewed inflation as the main near-term macroeconomic policy issue**. Recent fuel price increases will intensify underlying inflationary pressures. Staff stressed that policy making needed to take into account that, in contrast to the last fuel price increase in April 2007, demand side pressures were now evident. Growth in monetary aggregates is increasing quite rapidly. Private credit growth has reached 25 percent and currency in circulation grew by 12 percent in just the last two months of FY08. Expectations of inflation are becoming internalized in public and private wage settlements, and government current spending is set to increase significantly. With high international commodity prices and monetary policy remaining accommodative, staff believed inflation is likely to remain in double digits throughout FY09.



11. **BB's recent monetary policy statement foresees a continuation of the policy stance adopted in FY08.** Policy rates have been constant over the last 18 months with the central bank reverse repo rate remaining at 6½ percent and rates on short term government securities increasing by only a few basis points to 7½ percent. BB's six-monthly monetary policy statement was released immediately following the Article IV discussions. It did leave the door open for monetary policy actions to counter inflationary pressures, but maintained a bias toward accommodating credit demand, particularly to key growth-driving sectors. This

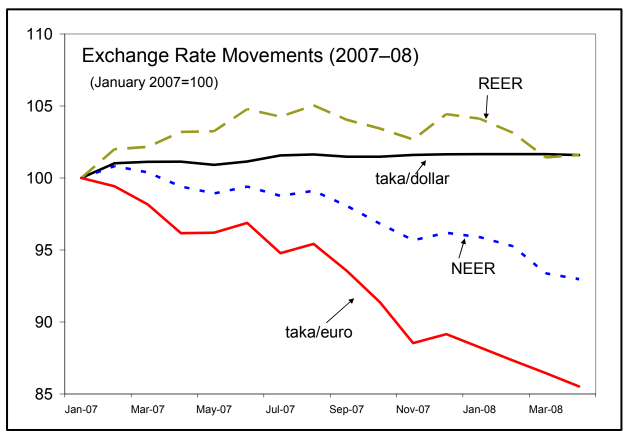


stance reflects the authorities' assessment that inflation is driven mainly by external supply-side factors, which cannot be addressed by monetary policy actions.

12. **Staff emphasized that a shift in policy is needed to prevent inflation becoming entrenched.** With a decline in economic activity in the first half of FY08 and money growth slowing, BB's neutral position (keeping interest rates and market liquidity steady) was appropriate. With circumstances now different, and policy rates well below projected inflation, staff urged BB to act quickly to send a signal of its intention to fight inflation through a small preemptive increase in interest rates. Staff acknowledged BB's concern to avoid putting the brakes on private sector growth, but stressed that the authorities' selectively accommodative monetary policy focusing on key sectors would not be effective in addressing a macroeconomic inflation problem. Staff also emphasized that inflation hits the poor hardest, and that actions in the short term to contain expectations would be less harmful to growth than more aggressive later actions to reverse entrenched inflation. The authorities indicated that they would monitor conditions closely and take monetary policy action if needed, but overall were much more sanguine about inflation risks than staff.

B. Improving Exchange Rate Management

13. **BB has kept the dollar exchange rate stable to guard against intensifying imported inflation pressures.** Staff noted that this rigidity had not yet seriously constrained external competitiveness, largely due to the depreciation of the nominal effective rate in line with the dollar.[3] Staff stressed, however, that these circumstances cannot be expected to continue, and going forward larger movements in the dollar-taka rate are likely to be needed to support policy objectives.



14. **The real exchange rate remained in line with its equilibrium level on a broad range of measures (Box 1).** The real effective rate appreciated somewhat in FY08 as a result of domestic inflation without unduly constraining external competitiveness.[4]

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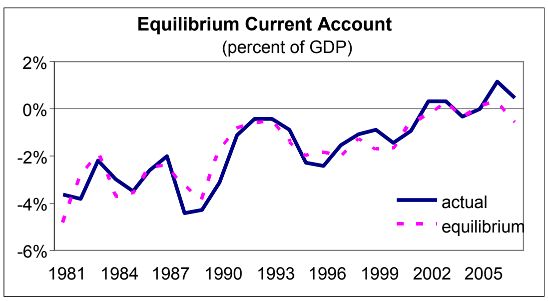
[3] Given the stability in the nominal rate during 2007/08, the de facto classification of Bangladesh's exchange rate regime in the IMF's Annual Report on Exchange Regimes and Restrictions will be changed to a conventional peg, while the de jure regime remains a managed float.

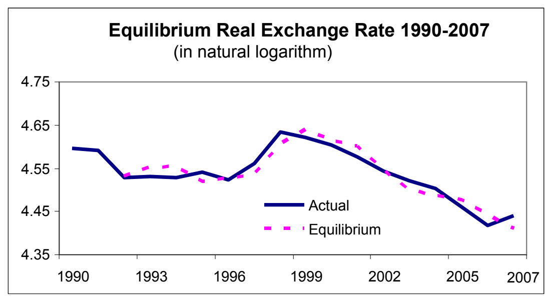
[4] Chapter II of the Selected Issues for the 2008 Article IV consultation reviews progress in export diversification and reviews indicators of external competitiveness.

Box 1. Bangladesh: Equilibrium Exchange Rate Assessment and External Stability

Staff assessed the equilibrium exchange rate using a number of single-country econometric techniques. More advanced multi-country and dynamic assessments are hampered by the lack of a long-time series of data and the lack of availability of suitable panel data. Analysis therefore focused on a relatively short sample period under three different single country approaches (Chapter I of the Selected Issues paper provides details of the analysis).

All assessment techniques found that the real exchange rate and the external current account balance were in line with their estimated equilibrium values. The macro balance approach finds that the underlying equilibrium current account balance is in line with its equilibrium value and is expected to remain so going forward. Projected current account balances are well within levels needed to maintain external sustainability. Direct estimates of the equilibrium real exchange rate also suggest that the taka is close to its equilibrium level.



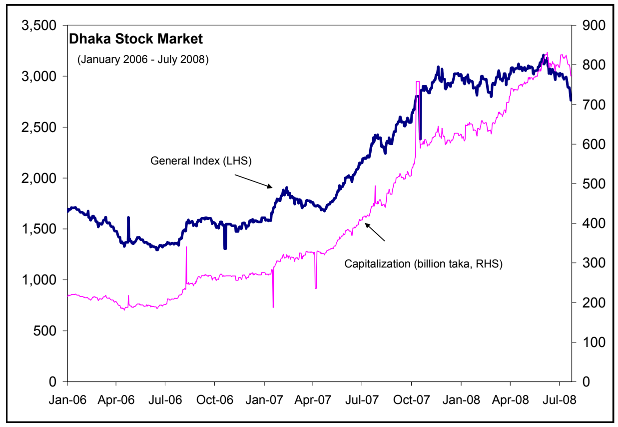


Macroeconomic policies are in line with external stability. The current account has remained broadly in balance for a number of years. Continued strong export and remittance growth are expected to underpin this into the medium term. Public external debt is sustainable with low risk of distress—although domestic contingent liabilities increase the risk of distress to public debt. Capital account flows are mainly long term and are not subject to significant liquidity risks.

15. **Greater exchange rate movement would provide more flexibility in macroeconomic policy making and would help develop the interbank market.** Staff noted that a somewhat tighter monetary stance would support BB's preference to use the exchange rate to counter imported inflation while moderating the need to sell international reserves to influence the exchange rate. The authorities agreed that more flexibility in the exchange rate would be desirable, but did not see the need for significant exchange rate movements in the near term. Staff urged the removal of the remaining exchange restriction—on the transferability of funds in nonresident taka accounts. The authorities, however, still saw a risk that removing it could precipitate capital outflows and, given the still low reserve position, were not prepared to commit to a timetable for its removal.

C. Deepening the Financial Sector

16. **Successful financial sector development is a keystone to securing future growth potential.** A deep and liquid financial sector provides resources to support private sector growth and improves the environment for monetary policy. The financial sector in Bangladesh remains dominated by banks, and private banks are growing rapidly as they expand their loan portfolios and raise capital to be Basel II compliant in 2009**.** The assets of the private banks grew by around 25 percent in FY08 and their financial soundness strengthened. The stock market is also growing in importance and now accounts for around 20 percent of financial sector assets.



17. **Staff welcomed the progress that had been made in a number of isolated areas, but cautioned that Bangladesh was still behind its comparators.** Actions taken to strengthen the regulatory and prudential framework of BB, corporatize and improve the management of the SCBs, automate stock trading, and establish a government securities market are essential foundations for financial sector development. However, the remaining agenda are large and there now needs to be a comprehensive vision for the financial sector and stronger support for market development, with BB taking a prominent leadership role. Staff stressed that as part of that effort, and to protect itself from potential vulnerabilities, BB needs to build on the reforms it has already made in its internal operations to ensure that they are in line with best international practice. The authorities concurred and stressed that they intended to reinvigorate their efforts to improve their surveillance of the financial sector, particularly as rapid increases in lending have the potential to undermine credit quality. In this regard, they requested technical assistance (TA) from the Fund to help them improve their stress testing, but did not want to request an Financial Sector Assessment Program (FSAP) update at this time pending further work on their own self-assessment.

Banking Sector Financial Soundness Indicators (percent)

	2004	2005	2006	2007
Risk-weighted capital asset ratio	6.9	7.3	5.3	7.4
Gross NPL ratio	17.6	13.5	13.1	13.2
Provisions as proportion of NPLs	19.1	24.3	26.3	42.9
Return on assets	0.7	0.6	0.8	0.9

18. **The SCBs still undermine the efficiency of the financial system.** While their market share is declining, they still account for over 30 percent of total banking sector assets and remain mainly moribund, with negative capital and high (30 percent) NPL ratios. Divestment plans appear to be at a standstill following the failure of the Rupali Bank sale. Staff stressed that accelerating progress on strengthening all the SCBs' financial positions was important to foster financial sector development and reduce the government's contingent liabilities. Formulating a renewed plan for divestment should be a high priority. The authorities planned to strengthen monitoring of the

performance indicators for the chief executives of the SCBs and pointed to the forthcoming Annual General Meetings as a chance to strengthen their Boards.

19. **Financial sector deepening requires the development of an active secondary market in government paper,** which will also assist in monetary policy implementation. However, the operation of the primary dealer system for government securities needs to be improved before an active secondary market can develop. The key constraining factor is the authorities' inflexibility on interest rates that undermines the auction process and results in substantial devolvement of securities onto the primary dealers. Staff urged the authorities to yield more to current market pressures for upward movement in rates, which would have beneficial impacts for financial sector deepening and would be consistent with shorter-term monetary policy requirements. BB stressed that it was moving gradually in this direction, but was conscious of the impacts on government debt service and on the growth of credit to the private sector. Staff welcomed BB's efforts to improve the regulatory framework, including issuing new mark-to-market and liquid reserves regulations and revising the commission system for primary dealers, and encouraged continued dialogue with the banks to iron out remaining regulatory issues.

20. **Reinvigorating the foreign exchange market would complement reforms in the government debt market.** However, a vibrant foreign exchange market will not develop in the absence of greater movements in the exchange rate. In line with its advice on exchange rate policy, staff encouraged BB to put in place measures to encourage trading, including stricter enforcement of open position limits, and allowing banks to engage in uncovered forward trades and two-way quotes on a more consistent basis.[5]

D. Building on Improvements in Fiscal Management

21. **The FY09 budget foresees a widening of the budget deficit to finance a substantial expansion of social safety net programs.** It looks to maintain FY08's gain in the share of tax revenue in GDP despite the fact that FY08 performance was boosted by some one-off collections of tax arrears (up to ½ percent of GDP). In response to the social stresses arising from the recent natural disasters and rapid escalation of food and fuel prices, the expenditure side of the budget accommodates a broadening in the scope of existing safety net programs and introduces a new cash-for-work scheme that will cover 2 million rural families during the 100 days between harvests. The total cost of these expansions is around ½ percent of GDP. Allocations for subsidies to SOEs, mainly arising from administered prices that

Fiscal Indicators FY07–09 (percent of GDP)

	FY07 Outturn	FY08 Budget	FY08 Est.	FY09 Staff Proj.
Total revenue	10.2	10.8	11.4	11.1
Tax	8.2	8.6	9.1	9.1
Non-tax	2.0	2.2	2.3	2.0
Total expenditure	13.4	15.3	14.7	16.0
Current	9.1	9.4	9.9	10.3
ADP	4.0	5.0	3.0	3.8
Other 1/	0.3	0.9	1.8	1.9
Overall balance 1/	-3.2	-4.5	-3.3	-4.9
External financing	1.3	2.3	2.2	2.2
Domestic financing 1/	1.9	2.2	1.1	2.7

1/ Excluding debt operation to cover previous BPC losses.

[5] Chapter I of the Selected Issues for the 2008 Article IV consultation provides further detail on foreign exchange market reform.

do not cover costs, were kept broadly at FY08 levels (Box 2) and the annual development program (ADP) allocation was set at a lower-than-normal level to take account of systematic under-implementation.

Box 2. Bangladesh: Subsidies and State-Owned Enterprises

SOE losses, arising mainly from administered prices that do not cover input costs, reached around 3 percent of GDP in FY08. Losses were concentrated in four main enterprises: the petroleum company (BPC), fertilizer company (BCIC), power company (PDB), and Biman Bangladesh Airlines. Budgetary transfers covered around 60 percent of these losses, a substantial improvement on recent years, with the rest covered by bank credit and arrears.

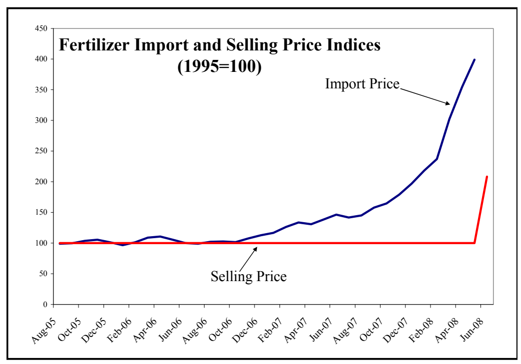
Key State-Owned Enterprises: FY08 Losses (percent of GDP)

	Total Loss	Budget Transfer
BPC	1.3	0.9
Biman	0.5	0.2
BCIC	0.8	0.7
PDB	0.4	0.1
Total	3.0	2.0

Source: Bangladesh Authorities and Fund Staff Estimates

Slow-moving fuel and fertilizer price adjustments in the face of rapidly rising input costs are a challenge to fiscal sustainability. Fertilizer prices were adjusted in June 2008 for the first time in 12 years. Fuel price increases in 2007 and 2008 were large, but still failed to keep pace with international price movements. At the beginning of FY09 both are well below the levels needed to cover import costs.

- Without further price increases and with current international oil and fertilizer prices, SOE losses could reach 3¼ percent of GDP in FY09, slightly higher than the FY08 level.
- The FY09 budget assumes transfers of around 2½ percent of GDP, leaving a gap of around ¾ percent of GDP (taka 40 billion) to be covered by expenditure prioritization.
- Each additional $10 on the international oil price would add Tk 20 billion to the overall subsidy or would require about a 10 percent increase in domestic fuel prices.



Reforms in the operations of SOEs would also improve the fiscal position. Although pricing mechanisms contribute significantly to the poor financial state of many SOEs, losses also stem from inefficiency and lack of investment. Continuing with reforms to improve operations and divesting attractive SOEs are important elements of the fiscal reform process.

22. **Staff emphasized that keeping to the macroeconomic targets of the FY09 budget will be important to prevent putting further pressure on inflation.** In normal circumstances, it would have been preferable to have a less expansionary budget. However, given the need to strengthen social safety nets while further improving coverage of SOE losses, the budget's targets are appropriate, particularly given the authorities' prudent recent record on fiscal management. The gains in tax compliance and the improvement in the base achieved in FY08 should allow the budget target for revenue to be met and perhaps even exceeded. Staff stressed that given

inflationary pressures any excess revenue should be used to reduce the overall deficit and domestic financing. Ensuring safety net programs, particularly the new 100 days employment generation program, are well targeted and minimize leakages will be important to safeguard the quality of the expenditure expansion.

23. **The substantial hike in fuel and fertilizer prices may not be sufficient to keep within the budget's subsidy provisions.** The authorities confirmed that they intend, as far as possible, to cover SOE losses arising from administered prices through budgetary transfers. Volatility in international commodity markets, however, makes it unusually difficult to forecast the fiscal burden of administered prices. Staff's baseline projection suggests potential overruns of around Tk 40 billion (Box 2). In these circumstances staff supported the authorities' plans to cover them from within the expenditure envelope.[6] Staff stressed that any additional SOE losses arising from international price rises should be met by domestic price increases so that priority spending on key social and development programs are not further compromised. The authorities agreed in principle, but noted the political difficulty in further increasing prices. In this context, the authorities stressed that staff's preference for a framework that will allow prices to automatically adjust to full cost coverage could only be considered in the medium term.

24. **Staff and the authorities agreed that in the medium-term fiscal policy should return to a path of lower deficits.** The FY09 budget is intended to be a temporary deviation from the restrained fiscal position—an overall deficit below 4 percent of GDP and domestic financing below 2 percent of GDP—that has served Bangladesh well in the recent past. In this context, staff welcomed that the draft Public Resource and Budget Management Ordinance was close to approval. The Ordinance will set fiscal policy within a clear institutional framework—that restricts domestic financing to be below 3 percent of GDP and total public debt below 60 percent of GDP—and will improve fiscal transparency and accountability, especially for future governments. Staff stressed that the Ordinance's quantitative framework should not be seen as targets and that, in normal circumstances, fiscal policy should aim to operate well below the Ordinance's ceilings. This is particularly important given the moderate risks of debt distress arising in part from the significant contingent liabilities in the SOE sector. The establishment of a macro-fiscal unit within the Ministry of Finance (MOF) that is being supported by Fund TA was particularly welcome in this regard.

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[6] Expenditure reallocations are expected to be possible from block allocations, potential overlaps between safety net allocations, and the fact that ADP continues to suffer from implementation constraints.

25. **Increased revenue remains the preeminent medium-term fiscal policy goal**. Bangladesh's revenue performance has been persistently below the levels of its regional peers. Improvements have been frustrated by a complex and inefficient policy framework, widespread evasion, and poor administration.[7] Despite some erosion in the tax base in the FY09 budget, particularly the expansion of tax holidays (albeit on a temporary basis), improvements in administration and enforcement that are already underway can underpin continued marginal increases in the revenue to GDP ratio (Box 3).[8] A complete modernization of tax legislation will, however, be required to deliver the gains in revenue needed to underpin the medium term macroeconomic framework. Staff urged that work on redrafting income tax and VAT legislation be taken forward quickly. The authorities agreed that legislation needed updating, but preferred a more gradual approach, particularly for income tax where they prefer to progressively amend the existing legislation rather than adopt a new act in its entirety. The authorities acknowledged that updating the VAT legislation is key to improving the efficiency of the tax system and plan to begin drafting a new law soon.

Tax Revenue to GDP—Selected Asian Countries

(In percent)

	2005	2006	2007	2008 Proj.
Bangladesh 1/	**8.5**	**8.5**	**8.3**	**9.1**
Cambodia	7.6	8	9.3	10.0
Indonesia 2/	11.2	11	11.4	11.4
Lao PDR 2/	8.8	9.7	9.2	9.2
Nepal	8.9	9.9	10.2	10.3
Pakistan	10.1	10.6	11.0	11.6
Philippines	13.0	14.3	14.3	...
Sri Lanka	14.2	15.3	16.3	16.8
Thailand	16.6	16.1	16.0	...
Vietnam	13.5	13.8	14.2	...
Regional average (excl. Bangladesh)	**11.5**	**12.1**	**12.4**	**...**

Source: IMF staff reports

1/ The fiscal year ends on June 30; 2/ Non-resource revenues

26. **The fiscal space provided by improved revenue needs to be used to increase the level and quality of public expenditure.**

- Generalized subsidies that primarily benefit the better off, reaching 3 percent of GDP in FY08 and FY09, represent a significant constraint on the ability to increase spending on social services and infrastructure that are necessary to sustain poverty reduction and achieve the MDGs.
- The Medium-Term Budget Framework (MTBF) provides a good basis for reorienting revenue gains and savings from reducing subsidies. The authorities intend to refine it by reviewing the success of line ministries in achieving their own MTBF performance indicators. Staff welcomed this initiative and encouraged the MOF to roll out the initiative to all spending ministries within two to three years.

[7] The 2007 Article IV consultation explored this issue in detail (IMF Country Report No. 07/234). Chapter III of this year's Selected Issues paper discusses the potential benefits of different models of tax reform.

[8] Tax holidays were renewed and extended to eight additional sectors. However, provisions to strictly limit the time period for each tax holiday and introduction of a sliding scale of tax incentives within the timeframe were included.

Box 3. Bangladesh: Revenue Administration Reforms

Revenue administration reform picked up in FY08. The institutional framework for separating tax policy from administration has been established and a new unit will begin work by the end of the year. The two Large Taxpayer Units (LTUs) have been placed under the control of a single member at the National Board of Revenue, which should further improve enforcement. Revenue gains in FY08 reflect improvements in taxpayer compliance arising in part from the authorities' new universal self-assessment scheme, efforts to increase registration, and enhance taxpayer education.

Staff and the authorities agreed on a wide-ranging agenda of actions that will further improve administration and enforcement. In the VAT area, actions focus on improving case selection and efficiency of audit and simplifying registration procedures. In customs, the authorities intend to continue reducing the number of zero-rated commodities and incorporating duty exemptions into the customs law. Further reform of the unified LTUs, which are the backbone of revenue collections, focuses on streamlining audits and expanding the coverage beyond Dhaka. Spreading the unified taxpayer identification number beyond large taxpayers is a crucial measure to improve enforcement as is improving the functioning of the disputes and appeals procedure and more rigorously applying penalties for non payment.

- Staff urged the authorities to take concrete steps to increase the implementation rate of the ADP, noting that public investment remains too low to address development needs. These include the reconstruction of infrastructure and housing destroyed in FY08's natural disasters, which have only small allocations in the FY09 ADP. The authorities agreed that increasing the ADP was a key priority. They noted, however, that the recent slowing in the pace of ADP spending reflected their efforts to stamp out corruption in implementation and have consequently led to an improvement in the quality of ADP spending. They also noted that a more comprehensive rehabilitation program in response to last November's cyclone is still under discussion with key donors. Staff welcomed any improvement in the quality of development spending and encouraged further efforts to address administrative and capacity constraints, including through better coordination with donors.

- Staff noted that maintaining control over public sector wage increases, particularly in the context of the 2009 Public Wage Commission, will also be important in maintaining fiscal space and moderating the benchmark these increases could set for the private sector. As was done after the 2005 Pay Commission, increases in pay and allowances will need to be phased in over several fiscal years to make the fiscal burden manageable.

V. Other Issues

27. **The macroeconomic framework of the draft Poverty Reduction Strategy Paper (PRSP) is broadly in line with staff's projections and the medium-term budget framework.** Staff noted the substantial work that has gone into producing the comprehensive strategy in such a

short period of time and emphasized that the transitional nature of the current administration heightens the importance of broad consultation. However, the accelerated timetable has thus far meant that consultation with civil society and the donor community has been limited.

28. **Improving the quality and timeliness of economic statistics would improve policy making.** Some improvements have been made, notably in streamlining public sector coverage in the fiscal accounts and on-going work on a new CPI consumption basket. Key priorities going forward are strengthening balance of payment statistics through improving the consistency of trade data and developing international investment statistics, improving the source data for national accounts statistics and introducing more frequent and timely dissemination practices, and moving toward GFSM2001 standards for fiscal statistics.

VI. Staff Appraisal

29. **Macroeconomic performance has been remarkably resilient in a year of multiple natural disasters and elevated food and fuel prices.** Growth picked up strongly from a slow start to the year with rebounds in agriculture and garment exports playing a leading role. Increases in remittances and external assistance helped support the balance of payments in the face of rising import costs. The fiscal position was supported by a significant improvement in revenue collections, which helped offset increasing energy and fertilizer subsidies and larger outlays on safety nets. Nevertheless, life has become more difficult for large segments of the population. The natural disasters and subsequent rapid food price increases of early 2008 put severe pressure on incomes, particularly of the urban and landless rural poor, reversing some of the recent reductions in poverty.

30. **The authorities have made significant efforts to maintain a stable macroeconomic situation.** This is particularly evident in the fiscal sector, where there has been significant strengthening of the revenue position and most SOE losses have been brought onto the budget. The recent increase in administered prices was a bold step and prevented a deterioration in SOE finances, but more still needs to be done to improve their position.

31. **Preventing an increase in inflation is the immediate policy concern.** With fiscal policy focusing on sustaining revenue collections and strengthening safety nets to address the social impact of higher commodity prices, monetary policy needs to adjust to contain inflationary pressures. A preemptive movement in interest rates would rein in increasing inflation expectations and help prevent high inflation from becoming entrenched. Higher inflation directly hurts the poor and vulnerable; delaying action could be more harmful to growth prospects as it would require larger and more aggressive policy responses in the future.

32. **Greater flexibility in the exchange rate would support monetary policy objectives without placing undue pressure on the international reserve position.** While staff judges the current level of the exchange rate to be in line with medium-term fundamentals, more day-to-day movement in the rate would provide greater flexibility in macroeconomic policy making and deepen the foreign exchange market. As there is no timetable for the removal of the one remaining

exchange restriction on the transferability of funds in nonresident taka accounts, staff does not recommend its approval.

33. **Keeping to the macroeconomic targets of the FY09 budget will prevent putting further pressure on inflation.** Despite inflationary pressures, the budget's expansionary stance is defendable given recent fiscal prudence and the need to address the social impact of natural disasters and higher food prices while further improving budget coverage of SOE losses. Given the pressures, however, any revenue collections in excess of the budget should be used to reduce domestic financing. If international oil prices rise further, additional SOE losses should be met by further administered price increases so that priority spending is not compromised.

34. **Macroeconomic policies are consistent with external stability and the medium-term outlook remains favorable.** Near-term growth may slow slightly as inflation is brought under control, but should increase to around 7 percent over the medium term as structural reforms feed through and Bangladesh capitalizes on high regional growth. Macroeconomic policies are consistent with external stability. The external current account is expected to stay broadly in balance as continued growth in exports and remittances is expected to offset higher imports. Capital flows are mainly long term and not subject to significant liquidity risk and public debt is sustainable.

35. **There are, however, significant risks**. In particular, a sustained further increase in oil prices would put the balance of payments and fiscal position under significant stress and further reduce near-term growth prospects. Poor governance and inadequate infrastructure, particularly in the power sector, remain the main constraints to investor confidence and need to be addressed to avoid a sustained slowdown in growth that could put the sustainability of debt ratios in jeopardy. There are also moderate risks of domestic debt distress stemming from large contingent liabilities in the SOE sector. Climate change is a major long-term challenge and will require careful coordination with donors in planning adaptive measures.

36. **Further financial sector development is needed to allow Bangladesh to achieve its growth potential.** Despite some recent progress, the overall development of the sector is behind comparator countries. Strengthening the SCBs' financial position with a view to eventual divestment is crucial to improve banking sector efficiency. Allowing interest rates in the primary auction for government securities to be market determined will give impetus to an active secondary market, which is vital for financial sector deepening.

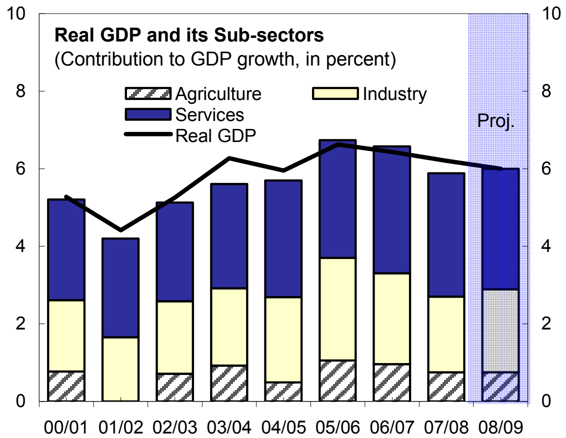
37. **In the medium term, increased revenue is crucial to allow fiscal policy to return to a lower deficit path.** The FY09 budget should be a temporary deviation from the restrained fiscal position that has served Bangladesh well in the recent past. Achieving the revenue gains needed to allow increased public expenditure will require moving quickly forward with revisions that modernize income tax and value-added tax legislation together with sustained improvements in administration and enforcement. Reducing open-ended price subsidies and replacing them with more affordable and better-targeted social safety nets will also provide fiscal space for increases in public investment and provision of social services.

38. **Continued improvement in the quality and timeliness of economic statistics would improve policy making.** Priorities in the near term include improving the compilation and dissemination of national accounts statistics, and strengthening balance of payments statistics.

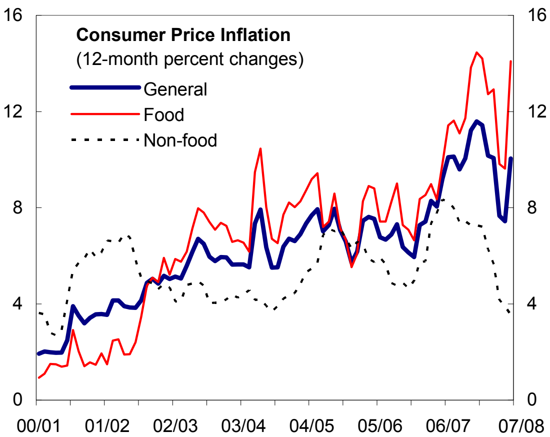
39. **It is recommended that the next Article IV consultation with Bangladesh take place within the standard 12–month cycle.**

Figure 1. Bangladesh: Real and Fiscal Sector Indicators, FY2001–09 1/

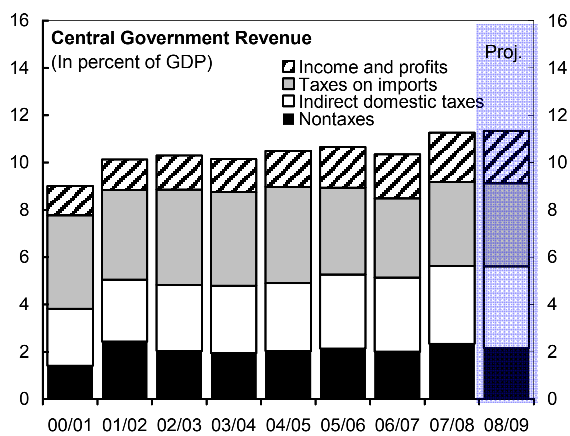
Growth has remained healthy despite problems in early FY08.



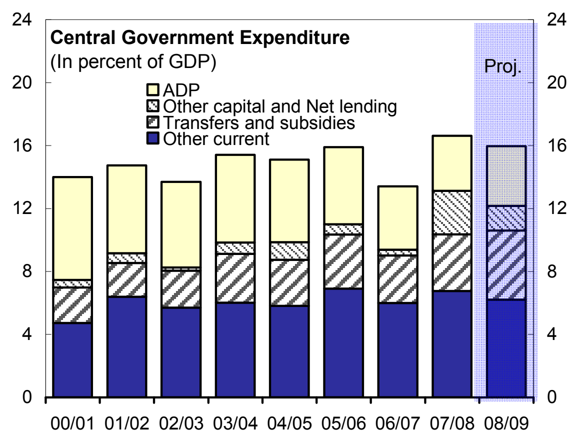
Inflation remains high, despite delays in fuel price adjustment.



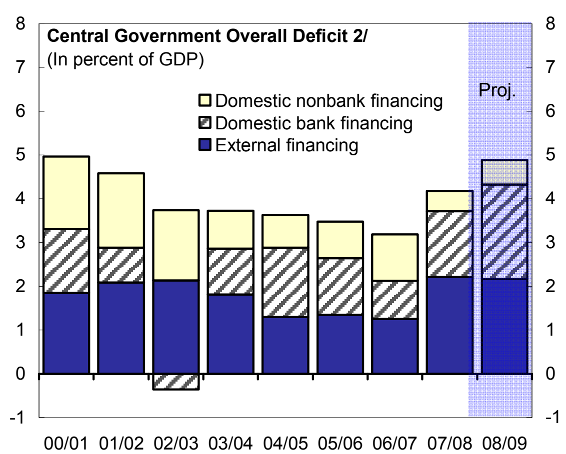
Government revenue has improved but remains low.



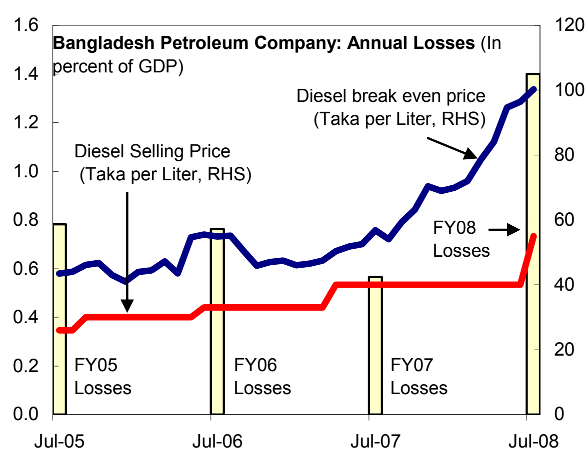
Sending has increased as a result of relief costs and increased subsidies...



...while increased external assistance has enabled domestic financing to be contained.



Administered prices, particularly for fuel, are the biggest fiscal risk.

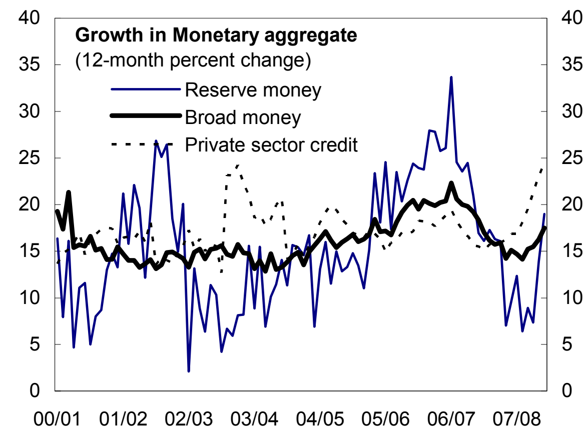


Sources: Data provided by the Bangladesh authorities; IMF, Information Notice System, *International Financial Statistics*; and Fund staff projections.

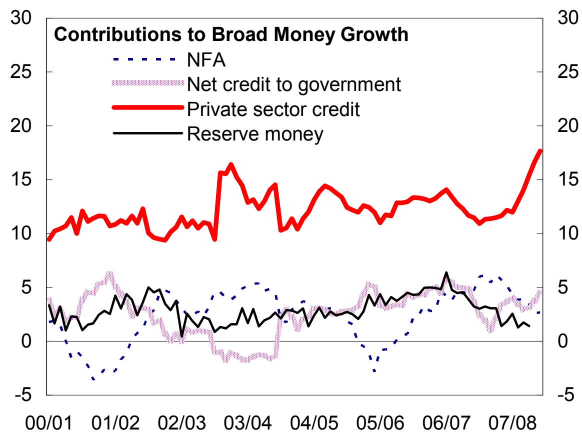
1/ Projection for 08/09.
2/ For 07/08 excludes BPC debt operation.

Figure 2. Bangladesh: Monetary and External Sector Indicators, FY2001–09

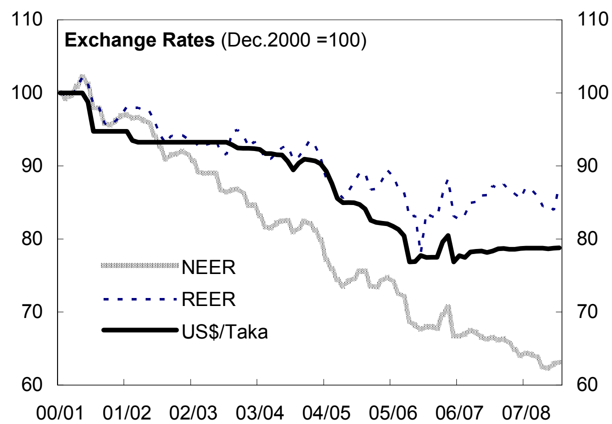
Money growth has started to increase again...



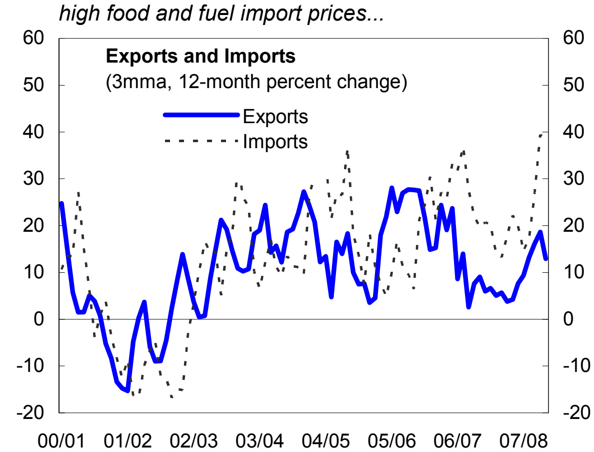
...with private sector credit driving broad money growth.



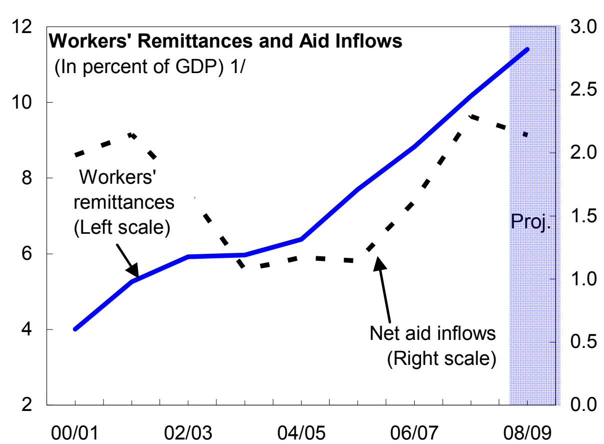
The nominal exchange rate is relatively stable.



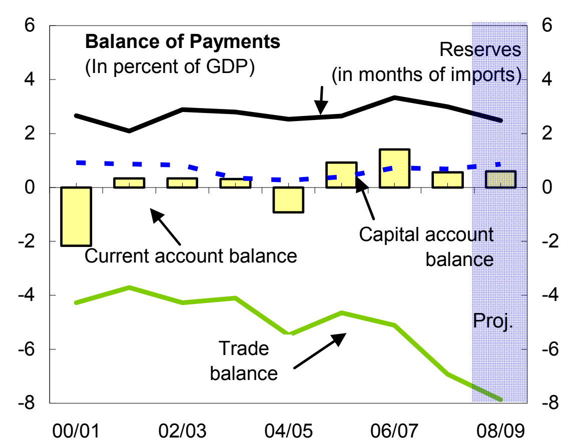
Exports have picked up, moderating the impact of high food and fuel import prices...



..whileremittances have surged and external assistance recovered ...



...offsetting the deterioration in the trade balance.



Sources: Data provided by the Bangladesh authorities; IMF, Information Notice System, *International Financial Statistics*; and Fund staff estimates and projections.
1/ Projection for 08/09.

Table 1. Bangladesh: Key Economic Indicators, FY2004–14 1/

Nominal GDP: US$79 billion
Main export (percent of total): garment (75)
Population (FY08): 142.5 million
GDP per capita (FY08): US$554
Poverty rate (FY05): 40.8 percent
FDI (percent of GDP): US$760 million (1.1)
Government debt: 43.8 percent of GDP
Foreign government debt: 62 percent of total government debt

					Est.	Projection					
	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12	FY13	FY14
National income and prices (percent change)											
Real GDP	6.3	6.0	6.6	6.4	6.2	6.0	5.5	6.5	6.7	7.0	7.0
GDP deflator	4.2	5.1	5.2	6.8	8.0	9.0	7.0	6.0	5.0	4.0	4.0
CPI inflation (annual average) 2/	5.8	6.5	7.2	7.2	9.9	11.0	9.0	7.0	6.0	5.0	4.0
CPI inflation (end of period)	5.6	7.3	7.5	9.2	10.0	11.0	8.0	6.0	5.0	5.0	4.0
Investment and savings (percent of GDP) 2/											
Gross investment	24.0	24.5	24.7	24.5	24.2	23.6	23.3	24.5	26.0	27.1	27.9
Private	17.8	18.3	18.7	19.0	19.2	18.5	18.0	18.3	18.9	19.5	20.2
Public	6.2	6.2	6.0	5.4	5.0	5.1	5.2	6.1	7.1	7.6	7.7
National savings	25.4	25.8	27.7	28.7	29.2	26.7	27.0	28.2	29.6	30.4	30.7
Private	22.1	23.3	25.0	27.3	28.3	25.3	24.8	25.0	25.5	25.9	26.1
Public	3.3	2.5	2.7	1.4	1.0	1.4	2.3	3.2	4.1	4.5	4.6
Central government operations (percent of GDP)											
Total revenue	10.2	10.5	10.7	10.2	11.4	11.1	11.6	12.1	12.6	12.7	12.7
Tax	8.2	8.5	8.5	8.2	9.1	9.1	9.6	10.1	10.6	10.7	10.7
Nontax	1.9	2.0	2.2	2.0	2.3	2.0	2.0	2.0	2.0	2.0	2.0
Total expenditure	13.3	13.8	13.9	13.4	16.1	16.0	15.4	16.1	16.6	16.7	16.7
Current expenditure	7.8	8.4	8.4	9.1	9.9	10.3	10.0	9.7	9.4	9.1	9.1
Of which: Interest payments	1.6	1.7	1.8	1.9	2.2	2.0	2.1	2.1	2.2	2.2	2.2
Of which: Subsidies and transfers	2.4	2.8	2.6	3.0	3.6	4.4	3.9	3.6	3.3	3.0	3.0
Annual Development Program	5.0	5.0	4.7	4.0	3.0	3.8	3.8	4.8	5.6	6.0	6.0
Other expenditures 3/	0.5	0.4	0.8	0.3	3.2	1.9	1.6	1.6	1.6	1.6	1.5
Overall balance (excluding grants) 4/	-3.1	-3.3	-3.2	-3.2	-4.7	-4.9	-3.8	-4.0	-4.0	-4.0	-4.0
Primary balance 4/	-1.4	-1.7	-1.4	-1.3	-2.5	-2.9	-1.7	-1.9	-1.8	-1.8	-1.8
Financing (net)	3.1	3.3	3.2	3.2	4.7	4.9	3.8	4.0	4.0	4.0	4.0
Domestic 4/	1.8	1.7	2.1	1.9	2.5	2.7	2.0	2.1	2.1	2.0	2.0
External	1.3	1.6	1.2	1.3	2.2	2.2	1.8	1.9	1.9	2.0	2.0
Total central government debt (percent of GDP)	51.0	50.1	48.3	46.0	43.8	42.5	42.0	41.2	40.6	40.0	39.3
Money and credit (end of fiscal year; percent change)											
Net domestic assets	13.5	17.1	19.6	12.6	18.0	16.9	14.6	13.2	13.2	14.5	15.6
Credit to private sector	17.5	17.0	18.3	15.1	25.1	21.4	18.2	18.9	18.8	19.0	19.4
Broad money (M2)	13.8	16.7	19.3	17.1	17.6	19.8	17.1	16.8	16.4	16.3	16.1
Balance of payments (in billions of U.S. dollars)											
Exports, f.o.b.	7.5	8.6	10.4	12.1	14.2	16.6	19.2	21.9	25.1	28.4	32.1
(Annual percent change)	15.9	14.0	21.6	15.6	18.1	16.3	15.7	14.4	14.4	13.3	12.9
Imports, f.o.b.	-9.8	-11.9	-13.3	-15.5	-19.5	-23.3	-27.3	-31.2	-35.9	-41.3	-47.6
(Annual percent change)	13.0	20.6	12.1	16.6	25.8	19.3	17.2	14.4	14.9	15.1	15.4
Current account	0.2	-0.6	0.6	1.0	0.6	0.7	0.4	0.5	0.4	0.0	-1.1
(Percent of GDP)	0.3	-0.9	0.9	1.4	0.8	0.8	0.4	0.5	0.4	0.0	-0.8
Gross official reserves (in billions of U.S. dollars)	2.7	2.9	3.5	5.1	6.1	7.8	9.4	11.7	14.2	16.7	18.9
In months of imports of goods and nonfactor services	2.3	2.2	2.3	2.7	2.7	2.6	2.7	2.9	3.0	3.1	3.1
Exchange rate (taka per US$; period average)	59.5	64.3	68.1	68.8	68.6	…	…	…	…	…	…
Nominal effective rate (2000=100)	82.8	77.0	71.2	66.9	...	…	…	…	…	…	…
Real effective rate (2000=100)	91.4	88.1	84.7	83.8	...	…	…	…	…	…	…
Terms of trade (percent change)	-2.4	-4.1	-4.1	-2.6	...	…	…	…	…	…	…
Memorandum item:											
Nominal GDP (in billions of taka)	3,330	3,707	4,157	4,725	5,419	6,261	7,068	7,979	8,939	9,948	11,070

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

1/ Fiscal year begins July 1.
2/ CPI uses FY96 weights.
3/ Consists of other capital, net lending, food account balances, check float and discrepancy.
4/ Includes assumption of BPC liabilities of 1.4 percent of GDP in FY08.

Table 2. Bangladesh: Balance of Payments, FY2005–09 1/

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

	FY05	FY06	FY07	Est. FY08	Proj. FY09
Trade balance	-3,297	-2,879	-3,459	-5,269	-6,716
Exports (f.o.b.)	8,573	10,422	12,053	14,240	16,567
Of which: RMG sector	6,432	7,903	9,211	10,869	12,826
Imports (f.o.b)	-11,870	-13,301	-15,511	-19,509	-23,283
Of which: Crude petroleum and petroleum products	-1,602	-2,004	-2,233	-3,006	-3,617
Services	-870	-1,110	-1,261	-1,714	-2,230
Income	-680	-786	-883	-1,096	-1,224
Transfers	4,290	5,347	6,554	8,687	10,900
Official current transfers 2/	37	34	97	149	228
Private transfers	4,253	5,313	6,457	8,538	10,672
Of which: Workers' remittances	3,848	4,802	5,979	7,940	9,925
Current account balance	-557	572	952	608	730
Capital and financial account balance	624	-207	360	-128	983
Capital account	163	242	490	530	750
Financial account	461	-449	-130	-658	234
Foreign direct investment	800	675	760	701	825
Portfolio investment	0	32	106	72	110
Medium and long term loans	491	432	508	1,108	889
Disbursements	940	921	1,037	1,633	1,425
Amortization	-449	-489	-529	-525	-536
Other capital 3/	-830	-1,588	-1,504	-2,539	-1,590
Overall balance	67	365	1,312	480	1,713
Financing items	-67	-365	-1,312	-480	-1,713
Bangladesh Bank	-67	-365	-1,312	-480	-1,713
Assets (- increase)	-225	-554	-1,602	-1,039	-1,697
Liabilities	158	189	290	559	-16
Memorandum items:					
Current account balance (percent of GDP)	-0.9	0.9	1.4	0.8	0.8
Export growth rate (percent)	14.0	21.6	15.6	18.1	16.3
Import growth rate (percent)	20.6	12.1	16.6	25.8	19.3
Gross official reserves (in millions of U.S. dollars)	2,930	3,471	5,077	6,116	7,814
(In months of prospective imports of goods and nonfactor services)	2.2	2.3	2.7	2.7	2.6
Net international reserves (in millions of U.S. dollars) 4/	2,046	2,221	3,533	4,013	5,726
Medium and long-term external public debt (in millions of U.S. dollars)	19,286	18,603	19,111	20,219	21,107
(In percent of GDP)	32.0	30.0	27.9	25.6	24.0
Net aid flows/GDP (in percent)	1.1	1.1	1.6	2.3	2.1
Nominal GDP (in millions of U.S. dollars)	60,299	61,952	78,992	78,992	87,883

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

1/ Fiscal year begins July 1.
2/ Excludes official capital grants.
3/ Includes trade credits, long-term borrowing, short-term financing for Bangladesh Petroleum Company (BPC), commercial bank net borrowing, and errors and omissions.
4/ Gross official reserves less foreign liabilities of Bangaldesh Bank and balances in commercial bank foreign currency clearing accounts.

Table 3. Bangladesh: Central Government Operations, FY2006–09 1/

	FY06	FY07	FY08		FY09	
			Budget	Est.	Budget	Proj. Staff
			(In billions of taka)			
Total revenue	444	483	573	618	694	694
Tax revenue	354	390	458	492	568	568
NBR taxes	339	371	439	472	545	545
VAT, supplementary duties, excises	183	200	233	256	300	300
Customs duties	78	82	94	96	109	104
Taxes on income and profits	71	87	108	116	131	136
Other NBR taxes	6	3	4	5	6	6
Non-NBR taxes	15	19	20	20	23	23
Nontax revenue	89	94	115	125	126	126
Total expenditure	578	634	885	873	1,000	1,000
Current expenditure	350	430	499	536	619	646
Pay and allowances	100	129	135	136	155	155
Goods and services	61	62	75	80	83	83
Interest payments	75	90	108	120	126	126
Subsidies and transfers	109	143	167	195	245	275
Block allocations	6	6	15	5	11	8
Annual Development Program	195	191	265	161	256	237
Non-ADP capital spending	38	28	50	52	88	80
Net lending	3 3/	-11	51	98 4/	20	20
Other expenditures 2/	-1	-4	20	26	17	17
Overall balance (excluding grants)	-134	-151	-312	-255	-306	-306
Primary balance (excluding grants)	-59	-60	-205	-136	-180	-180
Overall balance (excl. grants and BPC debt operation)			-237	-180		
Net financing	134	151	312	255	306	306
External	48	59	120	120	136	136
Domestic	86	91	193	135	170	170
Banks	59 3/	41	148	110 4/	135	135
Nonbanks	28	50	45	25	35	35
Privatization receipts	0	0	0	0	0	0
		(In percent of GDP, unless otherwise specified)				
Total revenue	10.7	10.2	10.8	11.4	11.3	11.1
Tax revenue	8.5	8.2	8.6	9.1	9.3	9.1
Nontax revenue	2.2	2.0	2.2	2.3	2.1	2.0
Total expenditure	13.9	13.4	16.7	16.1	16.3	16.0
Current expenditure	8.4	9.1	9.4	9.9	10.1	10.3
Pay and allowances	2.4	2.7	2.5	2.5	2.5	2.5
Goods and services	1.5	1.3	1.4	1.5	1.4	1.3
Interest payments	1.8	1.9	2.0	2.2	2.0	2.0
Subsidies and transfers	2.6	3.0	3.1	3.6	4.0	4.4
Subsidies	0.4	0.7	0.8	1.1	1.1	1.7
Transfers	2.2	2.3	2.4	2.5	2.9	2.7
Block allocations	0.1	0.1	0.3	0.1	0.2	0.1
Annual Development Program	4.7	4.0	5.0	3.0	4.2	3.8
Non-ADP capital spending	0.9	0.6	0.9	1.0	1.4	1.3
Net lending	0.1 3/	-0.2	1.0	1.8 4/	0.3	0.3
Other expenditures 2/	0.0	-0.1	0.4	0.5	0.3	0.3
Overall balance (excluding grants)	-3.2	-3.2	-5.9	-4.7	-5.0	-4.9
Primary balance (excluding grants)	-1.4	-1.3	-3.9	-2.5	-2.9	-2.9
Overall balance (excl. grants and BPC debt operation)			-4.5	-3.3		
Net financing	3.2	3.2	5.9	4.7	5.0	4.9
External	1.2	1.3	2.3	2.2	2.2	2.2
Domestic	2.1	1.9	3.6	2.5	2.8	2.7
Banks	1.4 3/	0.9	2.8	2.0 4/	2.2	2.2
Nonbanks	0.7	1.1	0.8	0.5	0.6	0.6
Privatization receipts	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:						
Nominal GDP (in billions of taka)	4,157	4,725	5,303	5,419	6,131	6,261
BPC and BCIC losses (in billions of taka)	34	29	60	114	92	132
Poverty reducing spending	6.8	8.4	8.6	9.2	9.5	9.3
Total central government debt	46.9	46.5	...	44.4	...	43.8

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

1/ Fiscal year begins July 1. Cash basis unless otherwise specified.
2/ Include food account surplus(-)/deficit(+) and extraordinary expenditures.
3/ Includes bonds (Tk 10 billion) issued to a nationalized commercial bank to assume BPC's liabilities.
4/ Includes bonds (Tk 75 billion) issued to three nationalized commercial banks to assume BPC's liabilities.

Table 4. Bangladesh: Central Bank Balance Sheet, June 2006–June 2009

	Actual						Proj.
	Jun-06	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Jun-09
	(End of period; in billions of taka)						
Net international reserves 1/	155	243	265	255	258	275	420
Net domestic assets 1/	185	151	150	213	161	201	143
Net credit to central government	237	243	220	233	171	245	203
Credit to other nonfinancial public sector	0	0	1	1	1	1	0
Credit to deposit money banks	60	57	58	77	84	67	77
Other items, net 1/	-111	-149	-128	-97	-95	-112	-137
Reserve money	340	394	416	468	420	476	564
Currency	249	288	306	355	319	356	412
Reserves 2/	90	106	108	113	99	118	152
	(Change since start of fiscal year; in billions of taka)						
Net international reserves 1/	24	88	22	11	15	32	145
Net domestic assets 1/	41	-34	-1	62	10	49	-57
Net credit to central government	92	6	-22	-10	-71	3	-43
Credit to other nonfinancial public sector	0	0	1	1	1	1	-1
Credit to deposit money banks	2	-2	0	20	27	9	10
Other items, net 1/	-52	-37	21	52	54	37	-24
Reserve money	66	55	21	74	25	81	88
Currency	46	39	18	67	32	69	55
Reserves 2/	20	16	3	7	-6	12	34
	(Year-on-year percent change)						
Net international reserves 1/	19	57	75.0	48.7	29.5	13.1	52.8
Net domestic assets 1/	29	-18	-27.2	-13.0	-15.8	32.8	-28.5
Net credit to central government	63	3	-1.0	-9.7	-23.8	1.2	-17.4
Credit to other nonfinancial public sector	0	0	3.0	3.0	3.0	3.0	3.0
Credit to deposit money banks	4	-4	-4.4	29.1	40.2	16.5	15.5
Other items, net 1/	89	34	68.1	34.7	1.4	-24.6	21.8
Reserve money	24	16	16.1	12.3	7.3	20.6	18.5
Currency	22	16	17.9	11.3	12.9	23.8	15.5
Reserves 2/	28	17	10.5	15.3	-7.3	11.7	28.7
Memorandum items:							
Net international reserves (in millions of U.S. dollars) 1/	2,221	3,533	3,862	3,711	3,769	4,013	5,726
Flow since start of fiscal year (in millions of U.S. dollars) 1/	175	1,311	329	179	236	480	1,713
Required domestic cash reserves (in billions of taka)	86	101	102	109	111	109	145
Excess domestic cash reserves (in billions of taka)	4	5	6	4	-11	9	7

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates and projections.
1/ Calculated from monetary data using end-of-period exchange rates.
2/ Liabilites from banks' foreign currency clearing accounts and non-bank deposits are not included in reserves.

Table 5. Bangladesh: Monetary Survey, June 2006–June 2009

	Actual						Proj.
	Jun-06	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Jun-09
	(End of period; in billions of taka)						
Net foreign assets	218	326	339	338	340	376	512
Bangladesh Bank	155	243	265	255	258	275	420
Commercial banks	63	83	74	83	80	98	92
Net domestic assets	1,588	1,789	1,821	1,969	1,982	2,111	2,467
Domestic credit	1,732	1,982	2,039	2,176	2,257	2,419	2,959
Net credit to central government	296	338	405	419	390	448	583
Credit to other nonfinancial public sector	127	139	73	94	106	87	88
Credit to private sector	1,309	1,506	1,561	1,663	1,762	1,884	2,287
Other items, net	-144	-194	-219	-207	-275	-308	-492
Broad money (M2)	1,806	2,114	2,160	2,306	2,322	2,487	2,979
	(Change since start of fiscal year; in billions of taka)						
Net foreign assets	32	108	13	12	14	51	136
Net domestic assets	260	200	32	180	193	322	356
Domestic credit	301	250	57	194	275	436	540
Net credit to central government	59	41	67	81	52	110	135
Credit to other nonfinancial public sector	40	12	-65	-45	-33	-52	1
Credit to private sector	202	197	55	157	256	378	403
Other items, net	-41	-50	-25	-14	-82	-114	-184
Broad money (M2)	292	308	45	192	208	372	492
	(Year-on-year percent change)						
Net foreign assets	17.2	49.6	52.0	34.8	25.9	15.5	36.1
Net domestic assets	19.6	12.6	11.0	11.9	13.9	18.0	16.9
Domestic credit	21.1	14.5	13.5	14.4	18.7	22.0	22.3
Net credit to central government	24.8	14.0	26.5	20.6	19.6	32.6	30.1
Credit to other nonfinancial public sector	46.7	9.3	-43.5	-28.1	-16.5	-37.3	1.7
Credit to private sector	18.3	15.1	15.9	16.9	21.3	25.1	21.4
Other items, net	40.2	34.9	15.9	46.5	61.3	59.1	59.7
Broad money (M2)	19.3	17.1	15.9	14.7	15.5	17.6	19.8
	(In billions of taka, unless otherwise noted)						
Memorandum items:							
Broad money multiplier	5.3	5.4	5.2	4.9	5.5	5.2	5.3
Broad money velocity	2.3	2.2	2.3	2.2	2.3	2.2	2.1
Net domestic financing (since beginning of FY)	86	91	70	91	64	135	170
Bank	59	41	67	81	52	110	135
Nonbanks	28	50	3	10	12	25	35

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

Table 6. Bangladesh: Financial Soundness Indicators

	2003	2004	2005	2006	2007
Risk-weighted capital asset ratio	8.6	6.9	7.3	5.3	7.4
State-owned commercial banks	4.5	-1.1	-0.4	-10.4	-7.1
Specialized development banks	8.3	9.1	9.2	9.6	10.4
Private commercial banks	10.6	10.2	9.1	9.7	10.6
Foreign commercial banks	22.6	24.4	26.0	23.0	22.7
Gross NPL ratios	28.6	17.6	13.5	13.1	13.2
State-owned commercial banks	35.0	25.3	21.4	22.9	29.9
Specialized development banks	55.6	42.9	34.8	33.7	28.6
Private commercial banks	17.4	8.5	5.6	5.5	5.0
Foreign commercial banks	2.0	1.5	1.3	0.8	1.4
Provisions as proportion of NPLs	24.9	19.1	24.3	26.3	42.9
State-owned commercial banks	14.8	3.4	13.2	15.8	41.0
Specialized development banks	28.5	27.8	24.2	21.9	23.0
Private commercial banks	40.8	44.1	50.2	51.7	57.2
Foreign commercial banks	129.6	144.4	215.0	363.1	198.1
Return on assets	0.5	0.7	0.6	0.8	0.9
State-owned commercial banks	0.1	-0.1	-0.1	0.0	0.0
Specialized development banks	0.0	-0.1	-0.1	-0.2	-0.3
Private commercial banks	0.7	1.2	1.1	1.1	1.3
Foreign commercial banks	2.6	3.2	3.1	3.3	3.1
Interest rate spread	6.1	5.3	5.4	5.6	6.0
State-owned commercial banks	5.8	4.9	5.4	5.6	6.0
Specialized development banks	4.8	3.7	3.7	5.5	3.0
Private commercial banks	6.6	5.5	5.1	8.1	5.7
Foreign commercial banks	7.3	7.5	7.9	3.2	8.8
Composition of credit					
Agriculture	10.7	10.2	9.6	8.5	7.5
Industry	20.0	19.0	18.8	20.1	21.1
Working capital	16.3	17.7	18.3	18.1	17.4
Construction	6.8	6.9	7.0	7.3	6.8
Trade	34.0	34.5	34.4	33.6	34.3
Other	12.2	11.6	11.8	12.5	12.9

Sources: Bangladesh Bank; and Fund staff estimates.

Table 7. Bangladesh: Millennium Development Goals, 1990–2007 1/

	Base 1990-95	2000-02	Current 2005–07	Target 2015	Status
Goal 1: Eradicate extreme poverty and hunger	**Goal will probably be met**				
Target 1: Halve by 2015 the proportion of people living below the poverty line					
Poverty headcount ratio	59	50	40	29	On Track
Poverty gap ratio	17	13	9	8	On Track
Share of income or consumption held by poorest 20 percent (percent)	7	...	5	...	
Target 2: Halve by 2015 the proportion of people who suffer from hunger					
Prevalence of child malnutrition (percent of children under 5)	67	51	40	33	On Track
Population below minimum level of dietary energy consumption (percent)	28	...	20	14	On Track
Goal 2: Achieve universal primary education	**Goal will probably be met**				
Target 3: Ensure that all boys and girls complete a full course of primary schooling					
Net enrollment ratio in primary education	61	83	87	100	On Track
Percentage of cohort reaching grade 5 (percent)	43	...	67	100	Needs attention
Adult literacy rate	37	39	54	100	Needs attention
Goal 3: Promote gender equality and empower women	**Goal will probably be met**				
Target 4: Eliminate gender disparity in primary and secondary education preferably by 2005 and at all levels by 2015					
Ratio of girls to boys in primary and secondary education (percent)	77	104	106	100	Achieved
Ratio of girls to boys in tertiary education (percent)	33	56	56	100	Needs attention
Ratio of literate females to males (percent of ages 20–24)	65	77	71	100	Needs attention
Share of women employed in the nonagricultural sector (percent)	41	...	59	50	On track
Proportion of seats held by women in national parliament (percent)	10	...	15	...	
Goal 4: Reduce child mortality	**Goal will probably be met**				
Target 5: Reduce by two thirds by 2015 the under 5 mortality rate					
Under 5 mortality rate (per 1,000)	151	82	62	50	On track
Infant mortality rate (per 1,000 live births)	94	56	45	31	On track
Immunization, measles (percent of children under 12 months)	54	69	87	100	On track
Goal 5: Improve maternal health	**Goal will probably be met**				
Target 6: reduce by three quarters, by 2015, the maternal mortality ratio					
Maternal mortality ratio (modeled estimate, per 100,000 live births)	574	320-400	290	147	On track
Births attended by skilled health staff (percent of total)	5	12	20	50	Needs attention
Goal 6: Combat HIV/AIDS, malaria, and other diseases	**Goal will potentially be met**				
Target 7: Have halted by 2015 and begin to reverse the spread of HIV/AIDS					
Contraceptive prevalence rate (percent of women ages 15–49)	40	…	58	...	
Target 8: Have halted by 2015 and begin to reverse the incidence of malaria and other major diseases					
Notified cases of malaria per 100,00 population	42	...	34		
Incidence of tuberculosis (per 100,000 people)	...	233	406	...	
Tuberculosis cases detected under DOTS (percent)	34	34	71	100	On track
Goal 7: Ensure environmental sustainability	**Goal will potentially be met**				
Target 9: Integrate the principles of sustainable development into country polcies and reverse the loss of environmental resources					
Forest area (percent of total land area)	9.0	10.2	13.0	20	Needs attention
Nationally protected areas (percent of total land area)	…	0.0	2.0	...	Insufficient data
GDP per unit of energy use (PPP $ per kg oil equivalent)	10.1	10.9	10.5	...	
CO2 emissions (metric tons per capita)	0.1	0.2	0.3	...	
Target 10: Halve, by 015, the proportion of people without sustainable access to safe drinking water and sanitation					
Proportion of urban population with access to safe drinking water	98.8	82.0	99.9	100	On track
Proportion of rural population with access to safe drinking water	93.1	72.0	79	96.5	Needs attention
Proportion of urban population with access to sanitary latrines	56.2	56.0	88.0	85.5	On track
Proportion of rural population with access to sanitary latrines	15.3	29.0	85.0	55.5	On track
Target 11: By 2020 have achieved a signficicant improvement in the lives of at least 100 million slum dwellers					
Proportion of households with access to secure tenure	...	...	36.4	...	Insufficient data
Goal 8: Develop a global partnership for development	**Goal will potentially be met**				
Target 12: Develop and implement strategies for decent and productive work for youth					
Youth unemployment rate (percent of total labor force ages 15–24)	2.9	8.0	13.4	...	
Target 13: Make available the benefits of new technoligies, specially information and communication					
Fixed line and mobile telephones (per 100 people)	0.2	1.3	13.6	...	
Personal computers (per 100 people)	…	0.2	0.2	...	
General indicators					
Population (in millions)	104.0	131.5	140.6	...	
Gross national income (in billions of U.S. dollars)	31.0	49.6	68.0	...	
GNI per capita (in U.S. dollars)	300.0	380.0	487.0	...	

Sources: Bangladesh Planning Commission and United Nations Development Program

INTERNATIONAL MONETARY FUND

BANGLADESH

Staff Report for the 2008 Article IV Consultation—Informational Annex

Prepared by Asia and Pacific Department
(In consultation with other departments)

August 27, 2008

Contents Page

ANNEX I. BANGLADESH: FUND RELATIONS

(As of June 30, 2008)

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	666.36	124.95
Reserve position in Fund	0.28	0.05

III. **SDR Department:**

	SDR million	Percent Allocation
Net cumulative allocation	47.12	100.00
Holdings	0.45	0.96

IV. **Outstanding Purchases and Loans:**

	SDR million	Percent Quota
Emergency Assistance	133.33	25.00
PRGF arrangements	316.73	59.39

V. **Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount approved (SDR million)	Amount drawn (SDR million)
PRGF	6/20/03	6/19/07	400.33	316.73
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):

	2008	2009	2010	2011	2012
Principal	4.95	14.85	29.70	83.22	130.01
Charges/Interest	4.23	8.40	8.27	7.79	5.18
Total	9.18	23.25	37.97	91.01	135.19

VII. Safeguards Assessment

Under the Fund's safeguards assessment policy, Bangladesh Bank (BB) is subject to an assessment with respect to the PRGF arrangement, which was approved on June 20, 2003. A safeguards assessment of the BB was completed on January 24, 2005. The assessment concluded that substantial risks exist in the legal structure, financial reporting, internal audit, and internal control systems. Implementation of the measures by the BB is monitored by staff.

VIII. Exchange Arrangement

Exchange regime. The exchange rate regime is a managed float. The de facto classification will be changed to a conventional peg given recent stability in the dollar rate. Until end–May 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 end–May 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 end–May 2003, BB no longer announced a trading band for its foreign exchange transactions.

At the last Article IV consultation (June 2007), the Executive Board urged the authorities to remove the restriction on the convertibility and transferability of proceeds of current international transactions in nonresident taka accounts.

IX. Article IV Consultation

The previous Article IV consultation was concluded on June 22, 2007 (IMF Country Report No. 07/234).

X. Resident Representative

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

ANNEX II. Bangladesh: Fund and World Bank Work Priorities

Issues affecting economic growth

The following issues have been found to foster or constraint economic growth in Bangladesh according to the PRSP and a number of analytical studies. *Macroeconomic stability* correlates with growth in Bangladesh and is a centerpiece of the PRSP. Given the country's exceptionally low tax receipts, *revenue mobilization* and *expenditure rationalization* are key to this stability. Outward orientation and *trade liberalization* hold great promise, given low wage costs, the success of the export-oriented RMG sector, and a still relatively closed economy. However, *poor governance*, a weak *banking sector*, and unreliable *power supply* are major drags on growth. Notwithstanding the recent progress, Bangladesh ranks near the bottom of Transparency International's corruption perceptions index; interest rate spreads exceed regional averages; and the World Bank estimates that power outages significantly reduce total factor productivity growth in manufacturing. *Sectoral policies* are the main vehicle for ensuring equitable and pro-poor growth according to the PRSP.

The Bank and Fund staffs (and other relevant donors) continue to work closely together to support this agenda of enhancing economic growth, as defined in the following matrix.

Issue	Fund	Bank	Other Donors
Macroeconomic policy framework	Takes the lead on foreign exchange market, monetary policy, and macroeconomic aspects of fiscal policy.	Takes the lead role on medium-term growth prospects, as well as structural and supply-side policies to support growth.	Other donors, especially AsDB and Japan, play key roles in supporting the growth strategy as reflected in the PRSP and the Bank's CAS.
Revenue Mobilization	Fund provides the overall resource mobilization objectives, takes the lead on tax policy, and works together with the Bank on tax administration.	Cooperates with the Fund on tax administration and policy.	DfID provides TA support to the National Bureau of Revenue.
Public Financial Management	Advises on total government spending that is consistent with the macroeconomic framework. Works jointly with the Bank on public debt management and takes the lead on structural reforms in the government debt market.	Takes the lead on expenditure composition and management. Prepares the Public Expenditure Review. Works jointly with the Fund on public debt management	The AsDB participates in the preparation of the Public Expenditure Review. DfID provides TA support to the Finance Division on the MTBF and budget accounting system.
Banking Sector Reform	Takes the lead on bank regulation and supervision, and central bank accounting and internal audit. Works jointly with the Bank on divestment of state banks.	Takes the lead on restructuring of the state banks. Works jointly with the Fund on divestment of the banks. Takes the lead on strengthening IT and human resources management at the central bank.	
Energy Sector Reform	Monitors the implications of quasi-fiscal losses for debt sustainability, monetary management, and transparency.	Takes the lead in energy sector reform. The goal is a financially viable and efficient energy sector without power disruptions.	One-third of AsDB's lending to Bangladesh is directed toward the energy sector.
Other Sectoral Policies	Limited involvement unless quasi-fiscal risks threaten macro-stability.	Bank takes the lead in agriculture, health, education, rural development and other sectoral policies.	Many donors involved with various aspects of sectoral reforms, with significant donor assistance provided through NGOs.
Governance	Improving the transparency and efficiency of macroeconomic institutions and policies.	Takes the lead on procurement and anti-corruption efforts. Prepared several analytical reports on the subject and is providing technical assistance.	Good governance is a cornerstone of AsDB's new Country Strategy Program 2006–10 (approved October 2005).
Trade Liberalization	Cooperates with the Bank on trade liberalization and facilitation. Concerned with the implications of trade liberalization for revenue, competitiveness, and growth.	Takes the lead in lowering trade protection. Provides analytical and technical support on export diversification, WTO-related negotiations, and trade facilitation.	

Work Programs

Title	Products	Provisional Timing of Missions (if relevant)	Expected Delivery Date
	A. Information on Relevant Work Programs		
Bank work program for FY09	Public Expenditure Review Transitional Support Credit Energy Sector DPL PFM Improvement Program (jointly with other donors) Revenue Admin. Project Investment Climate Assessment Poverty Assessment	Various over 2007/08 April–May 2008 May 2008 June 2008, September 2008 August 2008	June 2008 June 2008 June 2008 December 2008–January 2009 Bank FY09 June 2008 June 2008
IMF work program for FY09	2008 Article IV Consultation Possible staff visit to review macro policy TA on VAT TA on Revenue Admin. TA on central bank accounting/internal audit, and the government debt market TA on macro/fiscal forecasting TA on debt management/strategy TA on CPI and rational accounts	July 2008 November. 2008 August 2008 October 2008 June, October 2008; February 2009 Several visits commencing June 2008 August 2008 January 2009	Sept. 2008 November 2008 September 2008 October 2008 July, November 2008; March 2009 FY09 October 2008 March 2009
	Requests for Work Program Inputs (as needed)		
Fund requests to Bank	Public Expenditure Review		June 2008
Bank request to Fund	Assessment letters		June 2008
	Expected joint products		
Joint products in next 12 months	DSA FSAP update (if requested) PRS Feedback	July 2008 TBA	September 2008 TBA July 2008

ANNEX III. BANGLADESH: RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

Lending and technical assistance operations

Bangladesh joined the Asian Development Bank (AsDB) in 1973 and, as of 31 December 2007, cumulative public sector lending amounted to about $9.27 billion for 186 loans, with $178.6 million for technical assistance (TA) grants for 324 projects. The country is one of the largest borrowers of concessionary Asian Development Fund resources. The loans and TAs have supported all key sectors including energy, transport, social infrastructure, agriculture, and natural resources. AsDB has also supported eight private sector projects worth $242.18 million, including the Meghnaghat Power Project—the first build-own-operate power project in the country—and GrameenPhone, which substantially expanded rural access to mobile phone services.

In 2007, AsDB approved a total amount of $965.7 million in loans covering the Railway Sector Investment Program, Sustainable Power Sector Development Program, the Good Governance Program, the Padma Multipurpose Bridge Design Project (TA Loan), the Dhaka Water Supply Sector Development Program (Project Loan), and the South Asia Subregional Economic Cooperation Information Highway Project. The projects focused on helping remove critical constraints to growth by improving power generation and transmission; transport and communication network; management and operations of urban water supply and sewerage; anticorruption and judicial reforms; governance in the energy, transport, education, and integrated urban infrastructure sectors. Energy reforms aimed to help the Government restructure the power sector to ensure adequate and reliable power supply at competitive prices through increased private sector participation and more effective management and operations. In the railways, the focus was on improving sector efficiency by restructuring Bangladesh Railway to make it a market-oriented business organization with better financial governance, human resources, and operational systems. Successful implementation of the Second Primary Education Development Program, which will improve the quality of primary education and its accessibility to children from poor households, is currently underway with AsDB as the lead agency, together with 10 other development partners.

Country Partnership Strategy

The current results-based country partnership strategy (CPS), covering the period 2006–10, is part of a joint strategy prepared with the UK's Department for International Development, Government of Japan, and World Bank. Under this CPS, AsDB is playing a major role in the energy, transport, education, urban health, and urban water supply and sanitation sectors. In other areas, such as agriculture (i.e., agribusiness), water resources management, the

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[1] Based on material provided by AsDB staff.

financial sector and small- and medium-sized enterprise development, AsDB is supporting initiatives led by other development partners. Disaster mitigation, regional cooperation, gender, and environment continue to be addressed as key crosscutting issues. The CPS emphasizes designing projects that are better prepared for implementation. This means projects that are simpler; take into consideration capacity constraints; and include covenants that are realistic, focused, and properly sequenced.

AsDB's 2008 public sector lending program comprises five firm projects totaling about $592 million (including two Emergency Assistance Projects - Emergency Disaster Damage Rehabilitation Project of $120 million and Emergency Assistance for Food Security of $170 million. The first project was included in the pipeline considering the devastating cyclone and flood that affected Bangladesh in 2007 and the second project, to address the adverse impact of rising international commodity prices on domestic food security). The TA program for 2008 consists of 9 projects with an allocation of $5,740 in grant funding (including two piggy-backed loan for the two Emergency Assistance Projects).

The proposed (to be approved in August 2008) country operations business plan (COBP) for Bangladesh for 2009–11 consists of 25 firm projects totaling about $2.9 billion (including an amount of $350 million for Padma Multipurpose Bridge in 2010). The TA program for 2009-11 comprises 25 projects with an annual allocation of about $6.4 million in grant funding.

Cofinancing operations enable AsDB's financing partners—government or their agencies, multilateral financing institutions, and commercial organizations—to participate in financing of AsDB projects. The additional funds are provided in the form of grants, official loans, or credit enhancement products. As of year–end 2007, cumulative direct value-added cofinancing for Bangladesh amounted to $1.1 billion for 24 investment projects and $58. million for 68 TA projects.

The CPS is aligned with the vision and priorities of the Bangladesh's national poverty reduction strategy, which aims to achieve the MDGs, including halving the number of poor people in the country by 2015 and delivering substantial improvement in almost all aspects of human development. The four partners' joint strategy is built on: (i) improving the investment climate for private sector-led growth and employment; (ii) advancing the social development agenda to empower the poor so that all benefit from growth; and (iii) addressing key governance issues to enable growth and social development.

Economic and sector work program

AsDB publishes its *Asian Development Outlook* and its update every year, in which it assesses macroeconomic performance. AsDB's Bangladesh Resident Mission also publishes the *Bangladesh Quarterly Economic Update*. A new bimonthly *Economic Indicators Update* has been launched. In support of AsDB's Country Partnership Strategy exercise, several new thematic assessments and sector studies have been completed. 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, Dhaka-Chittagong economic corridor development, and public sector borrowing capacity study. Several new studies were completed in 2007–08, including Trade Integration of Bangladesh in South Asia: Prospects and Challenges; Improving Institutional Arrangements for Enhancing Manpower Export and Remittance Inflow; Improving the Monitoring System of State-Owned Enterprises; Macroeconomic Framework for Finance Division; Macroeconomic Assessment of the 2007 Flood and Cyclone; and Food Security Assessment. Several new studies will be undertaken in 2008–09 on trade and export competitiveness, regional cooperation, foreign investments and private sector development, and other sectoral issues.

ANNEX IV. BANGLADESH: STATISTICAL ISSUES

Macroeconomic data provided to the Fund have some shortcomings, but are broadly adequate for surveillance. Bangladesh participates in the General Data Dissemination System (GDDS). A multi-sector technical assistance mission covering national accounts, balance of payments, government finance , and monetary and financial statistics, took place during January 21–February 4, 2008. It found that the authorities have implemented a number of the recommendations of the 2005 data ROSC mission. The ROSC report is available on the IMF website and includes the following recommendations that cut across sectors:

- Legislation should be enacted to define the role of the Bangladesh Bureau of Statistics (BBS) and to provide it with sufficient powers to fulfill its mandate.
- Inter-agency cooperation should be improved, particularly for generating consistent data on bank financing of the government and debt.
- Advance calendars for the release of data should be established, disseminated, and observed.
- The BBS should also use its website to disseminate data and metadata to ensure simultaneous data release to all users.

Some improvements have been made recently, notably in streamlining public sector coverage in the fiscal accounts and on-going work on a new CPI consumption basket. Key priorities going forward are strengthening BoP statistics through improving the consistency of trade data and developing international investment statistics, improving the source data for national accounts statistics and introducing more frequent and timely dissemination practices, and moving toward adoption of the *Government Finance Statistics Manual 2001 (GFSM2001)* for fiscal statistics.

National accounts

The paucity of source data remains the principal impediment to improving national accounts statistics and adversely affects the ability of the BBS to absorb technical assistance aimed at improving compilation techniques. 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 2005 data ROSC recommended that the BBS establish and maintain a business register for all economic units as a basis for surveys, which should be conducted annually. Taking into account cost implications of an annual survey program, the BBS could start with a limited program covering key formal sector activities.

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. In addition, the use of inappropriate deflators and 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, but 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 2005 ROSC mission reiterated that the CPI should be compiled using updated weights. A household income and expenditure survey (HIES) was carried out in 2005, and it would be appropriate to derive weights from this survey to update the CPI.

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

Government finance and debt

The Ministry of Finance has, in the past two years, achieved significant progress in improving the coverage, accuracy, and timeliness of fiscal statistics in line with the recommendations of the 2005 ROSC. Suspense accounts were cleared, data on government-guaranteed external debt compiled, and the timeliness of dissemination fiscal and debt data improved. The 2008 multi-sector mission recommended additional actions to strengthen the analytical usefulness of fiscal data, including to: improve the integration of debt stocks and related financial flows; sensitize donors to the need to promptly provide complete data on Direct Project Assistance; and establish an inter-agency committee to prepare a migration plan to the *GFSM2001*.

Central government consolidated data according to the classification of the *GFSM 2001* has been published in the IMF's *Government Finance Statistics Yearbook* for FY2004 and the authorities plan to resume shortly submission of the data for FY2005–FY2007 to the IMF's Statistics Department.

Monetary accounts

Monthly accounts of the Bangladesh Bank (BB) and other depository corporations are available with a lag of six weeks. In addition, the 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

ROSC recommendations, the BB embarked on a project to improve monetary and financial statistics (MFS). The concepts, definitions, institutional coverage, classification of financial instruments, and sectorization of institutional units broadly conform to the methodology of the *Monetary and Financial Statistics Manual* (*MFSM*). The BB compiles monetary data using the standardized report forms (SRFs) framework, and the SRFs are reported electronically to the IMF on a regular basis, with the result that a consistent time series based on SRF data is available from December 2001. These data are being published in the *IFS Supplement on Monetary and Financial Statistics*.

Balance of payments

Balance of payments data are broadly on the basis of the *Balance of Payments Manual*, fifth edition (*BPM5*). The foreign exchange settlements-based system provides broad coverage of transactions, but there are emerging problems related to the activities of firms in Export Processing Zones (EPZs). They are considered nonresidents under foreign exchange regulations, and problems arise because only partial data are being collected on EPZ activities. The 2008 multi-sector mission urged treating EPZs as residents, in conformity with international statistical guidelines, and to integrate them fully into regular collections.

In the area of goods transactions, the data are collected from two completely different data sources—exports are based on information from customs declarations processed by the National Board of Revenue (NBR) and imports are based on foreign exchange settlements. This recording also gives rise to an inconsistency with the national accounts, where customs trade data are used in compiling net exports of goods and services.

Within the financial account, the 2008 multi-sector mission identified a range of issues relating to the coverage, classification, and sectorization of financial flows and their consistency with the stocks recorded in the international investment position, and made recommendations for improvement to the flows and stocks. Among these issues, the recording of trade credit assets appears to create the most distortion, contributing to an overestimation in the accumulation of foreign assets.

An IIP statement is reported each year to the IMF's Statistics Department for publication purposes. However, these data have not yet been disseminated by BB. There is an important initiative underway in BB to develop a database on private sector external debt, which will help improve the coverage of external debt in the IIP. There is a need for additional staff resources to advance the work on this project and related work on foreign direct investment.

Bangladesh: Table of Common Indicators Required for Surveillance
August 1, 2008

	Date of latest observation	Date received	Frequency of data[7]	Frequency of reporting[7]	Frequency of publication[7]	Memo Items: Data Quality-Methodological soundness [8]	Memo Items: Data Quality-Accuracy and reliability[9]
Exchange Rates	Jun. 2008	7/8/08	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	5/10/07	5/10/07	D	D	D		
Reserve/Base Money	May 2008	6/24/08	D	D	M	O, O, LO, LO	O, LO, O, O, O
Broad Money	May 2008	8/1/08	M	M	M		
Central Bank Balance Sheet	May 2008	6/24/08	W/M	W/M	M		
Consolidated Balance Sheet of the Banking System	May 2008	8/1/08	M	M	M		
Interest Rates[2]	Jun. 2008	8/1/08	W	W	D		
Consumer Price Index	Apr. 2008	6/24/08	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	n/a	n/a	n/a	n/a	n/a	O, LO, LNO, LO	LO, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	Feb. 2007	4/15/07	M/Q	Q	Q		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Mar. 2007	5/20/07	M	M	M		
International Investment Position[6]	2007	6/4/08	A	A	A		
External Current Account Balance	Q1 2008	6/4/08	M	M	M	O, LO, O, LO	LO, LO, LO, O, O
Exports and Imports of Goods and Services	Q1 2008	6/4/08	M	M	M		
GDP/GNP	2007	7/23/08	A	A	A	O, LNO, LO, LO	LNO, LO, LNO, LNO, O
Gross External Debt	Jun. 2005	9/15/05	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] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[8] Reflects the assessment provided in the data ROSC published on December 8, 2005, and based on the findings of the mission that took place during March 2–16, 2005 for the dataset corresponding to the variables in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[9] Same as footnote 8, except referring to international standards concerning source data, assessment and validation of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

BANGLADESH

Joint Fund-World Bank Debt Sustainability Analysis (DSA) 2008[1]

Prepared by the Staffs of the International Monetary Fund and
the International Development Association

Approved by Kalpana Kochhar and Anthony Boote (IMF)
and Carlos Braga and Ernesto May (IDA)

September 2, 2008

Bangladesh's risk of debt distress is low based on external debt indicators. *Bangladesh's external debt burden indicators do not breach the relevant policy-dependent indicative thresholds under the baseline scenario and exhibit only a marginal breach under the stress tests.*[2] *Debt burden indicators are significantly worse when domestic debt is included. Accordingly, this analysis reveals a more elevated risk of debt distress on public debt compared to results based solely on external debt. Staffs will monitor closely the evolution of domestic debt and the government's ability to mobilize domestic resources.*

1. **The results of this DSA are similar to those of the previous DSA.**[3] The primary difference between the two is that in the current DSA, one of the thresholds is marginally breached in the most extreme stress test, namely the combination of one-half standard-

[1] This DSA has been prepared jointly by World Bank and IMF staffs and in consultation with the Asian Development Bank using the debt sustainability framework for low-income countries approved by the Boards of both institutions. The DSA is based on macroeconomic data gathered in the context of IMF missions to Dhaka in 2008. Estimated debt outstanding and disbursed as of end–FY2007 provides the basis for debt figures.

[2] The low-income country debt sustainability framework (LIC DSF) recognizes that better policies and institutions allow countries to manage higher levels of debt, and thus the threshold levels are policy-dependent. Bangladesh's policies and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA), place it as a "medium performer." The relevant indicative thresholds for this category are: 40 percent for the NPV of debt-to-GDP ratio, 150 percent for the NPV of debt-to-exports ratio, 250 percent for the NPV of debt-to-revenue ratio, 20 percent for the debt service-to-exports ratio, and 30 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed external debt.

[3] IMF Country Report No. 06/406 (Annex I).

deviation shocks to net transfers, export growth, GDP growth, and the GDP deflator. This breach emerges largely because the relative magnitude of the shock is substantially higher compared to the previous DSA. As a result of the significant volatility displayed in some of Bangladesh's historical macroeconomic series, the standard deviation of exports and net transfers has increased; meanwhile, baseline projections for those variables were revised upwards. Since the values of the key parameters under the shock are simulated to be the historical average subtracted of half a standard deviation, this is now much lower vis-à-vis the baseline compared to the analysis done in the previous DSA.[4] The projections of debt to GDP in the previous DSA were, by and large, accurate as the actual outturn deviated from the projection by less than 1 percentage point. Moreover, the longer-term debt dynamics under the baseline are similar, but slightly more favorable.

2. **Box 1 summarizes the medium-term macroeconomic framework underlying the DSA**. Most notably, it is based on projections for growth that are in line with but slightly lower than those in the country's own medium-term framework, and estimates of external assistance that reflect both expected scaling up in the context of the millennium development goals (MDGs), as well as the country's ability to absorb additional external financing. Export growth rates are slightly higher in the medium term than historical averages, but taper off to the historical average in the out years. Export performance for 2006 and 2007[5] was substantially better than projected in the previous DSA, and accordingly projections in the current DSA were revised upward. On the other hand, import growth is also projected to be significantly higher than the historical average throughout the projection period but particularly in the medium term. Finally, due to a strong growth in remittances from Bangladeshis in the United States, United Kingdom, and Gulf states, private net current transfers are expected to continue their increasing trend.

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[4] For example, in the case of net transfers, the shock simulated in this year's DSA is equivalent to a decline (vs. the baseline scenario) of 6–7 percentage points of GDP, compared to a decline of 4 percentage points simulated in the previous DSA.

[5] All references are to the Bangladeshi fiscal year which runs from July 1 through June 30.

Box 1. Bangladesh: Macroeconomic Assumptions Underlying the DSA

The macroeconomic assumptions are as follows:

Real GDP growth in the medium term is, at 6.4 percent, above the recent historical average of 5.6 percent, and it picks up in the outer years to 7 percent. This is close to (but slightly lower than) Bangladesh's own medium-term projections, and assumes continued progress in broad-based structural reforms and increased openness of the economy that should allow Bangladesh to benefit from dynamic growth elsewhere in the Asian region.

Inflation, as measured by the GDP deflator, increases in 2008 due to higher food and energy prices, but then declines and stabilizes at around 4 percent.

The growth of **exports** and **imports** is strong in the medium term (14 percent and 17 percent respectively); as the economy opens both will increase in terms of GDP with imports gaining the most as increasing investment and intermediate goods are imported.

The **current account** (including grants) moves from a small surplus to a deficit, which peaks in the outer years at about 2 percent of GDP, as a result primarily of continued strong growth of capital and intermediate goods imports related to increasing investment projects. These effects are offset to some extent by strong growth of remittances, which are projected to grow at an annual average of about 13 percent over the medium and long term.

Net aid inflows reach 2 percent of GDP and stabilize in that range (consistent with Bangladesh's medium-term framework). The projections assume that the grant element of new borrowing decreases over the 20-year period from 48 percent to 39 percent in the out years.

The **overall fiscal deficit** (excluding grants) is assumed to remain close to the historical average (around 4 percent of GDP), while the primary deficit declines slightly over time. A modest rise is assumed in the **revenue-to-GDP ratio** (excluding grants) in the initial years (from 11½ percent in FY08 to 13 percent in FY13), supported by efforts to mobilize domestic revenues.

Real interest rates on domestic currency debt are assumed to stay more or less constant at about 3.5 percent.

I. External Debt Sustainability Analysis

3. **All external debt indicators remain well below the policy-dependent debt burden thresholds under the baseline scenario, but one threshold is breached under the most extreme standard stress test.** The main results of the external DSA are as follows:

- **All debt indicators in the baseline scenario are expected to decline over the 20-year projection period** (Table 1 and Figure 1)**.** The NPV of debt-to-GDP ratio decreases from about 17 percent in 2007 to 9 percent (compared to an indicative threshold of 40 percent) during the projection period, while the NPV debt-to-exports ratio decreases from 84 percent to 30 percent (compared to an indicative threshold of 150 percent), and the debt service ratio decreases from 5 percent to 3 percent (compared to an indicative threshold of 20 percent).

- **The standard stress tests do not reveal any serious vulnerability** although the NPV of debt to revenues threshold is breached in the most extreme test, in which GDP growth, exports, net current transfers, and FDI suffer a one-half standard deviation shock (Table 2 and Figure 1). The breach is temporary, lasting for two years. The dynamics lead to a sharp secular decline in the ratio thereafter. As explained earlier, the debt dynamics are similar to the previous DSA, and the increased magnitude of the shocks (which causes the breach of the threshold) reflects the volatility in some of Bangladesh's macroeconomic variables rather than newly identified risks.

- **The Table below summarizes Bangladesh's indicative thresholds, actual 2007 ratios, and average debt ratios under the baseline scenario.**

Policy-Based External Debt Burden Thresholds for Bangladesh

	Threshold	Bangladesh's Ratios	
		2007	2008-28 1/
PV of debt in percent of			
GDP	40	17	11
Exports	150	84	44
Revenues	250	166	92
Debt Service in percent of			
Exports	20	5	3
Revenues	30	10	6

1/ Average for the period under the baseline scenario.

II. Public Debt[6] Sustainability Analysis

4. **Domestic debt has been relatively stable over the past five years.** Gross debt has remained around 18–19 percent of GDP from end–June 2002 to end–June 2007 (Table 3). The majority of the domestic debt is in the form of treasury bills and savings certificates held by nonbanks, and just over a quarter is held by the central bank.

5. **The baseline scenario entails a gradual decline in the NPV of public debt-to-GDP ratio, with both external and domestic debt declining relative to nominal GDP** (Table 3). The NPV of public debt-to-revenue ratio is also projected to decline while the debt service-to-revenue ratio remains relatively low reflecting highly concessional terms on external loans.

6. **Despite the manageable outlook in the baseline scenario, the alternative scenarios and bound tests indicate that the projected paths of debt indicators are sensitive to alternative assumptions and point to considerable risks** (Table 4).

[6] Public debt includes domestic central government debt and external public and publicly guaranteed debt.

- **The public debt position is vulnerable to a growth slowdown**. The NPV of public debt-to-GDP ratio ceases to decline under a low growth scenario, in which growth slows down to baseline minus one half the standard deviation of the historical growth rate, (about 6.6 percent per year—see scenario A3). In fact because the low growth scenario also assumes that revenues adjust downward to lower growth whereas expenditures do not, the debt-to-GDP ratio starts to rise modestly in the outer years (2015 onwards). This highlights the need to manage expenditures prudently, while protecting priority spending, in the event of a growth slowdown.

- **Public debt indicators are also vulnerable to one-off debt creating flows** (scenario B5). Underpricing of energy products by BPC and BPDB, and of fertilizer prices by BCIC are creating contingent liabilities that may need to be borne by the government. These contingent liabilities are presently growing by almost 1 percent of GDP per annum, and in the absence of an effective strategy to address this problem, the risks of large debt-creating flows in the future are elevated. Under the assumption of a one-off debt creating flow of 10 percent of GDP—which could be conservative given that contingent liabilities will increase further unless policies are changed—the debt-service to revenue ratio reaches 36 percent in 2010, compared with the baseline ratio of 23 percent.

III. Debt Management

7. **In response to a request from the authorities, a joint Bank/Fund mission visited Bangladesh in January 2008 to provide technical assistance to help improve Bangladesh's medium-term debt strategy formulation.** The mission focused on assisting the authorities to create the capacity to formulate debt management strategies through comprehensive sharing and analysis of external and domestic debt data and the identification, measurement, and management of cost and risk in the context of DSA.

8. **The authorities have made significant progress in moving forward with the recommendations of the mission.** Among other actions: (i) a committee was created under the chairmanship of the Resource and Debt Management Wing of the Finance Division of the Ministry of Finance with members from all the divisions and departments that currently deal with debt information; (ii) UNCTAD's debt management system (DMFAS) was installed to help to monitor and analyze existing debt; and (iii) Finance Division staff are working with Fund and Bank staff to familiarize themselves with the preparation of DSAs.

IV. Conclusion

9. **It is the staffs' view that Bangladesh should be considered at low risk of debt distress based on external indicators, but the analysis reveals a more elevated risk of debt distress on public debt.** The baseline projections and the associated standard stress tests show little risk related to external debt given that none of the indicators breaches or is

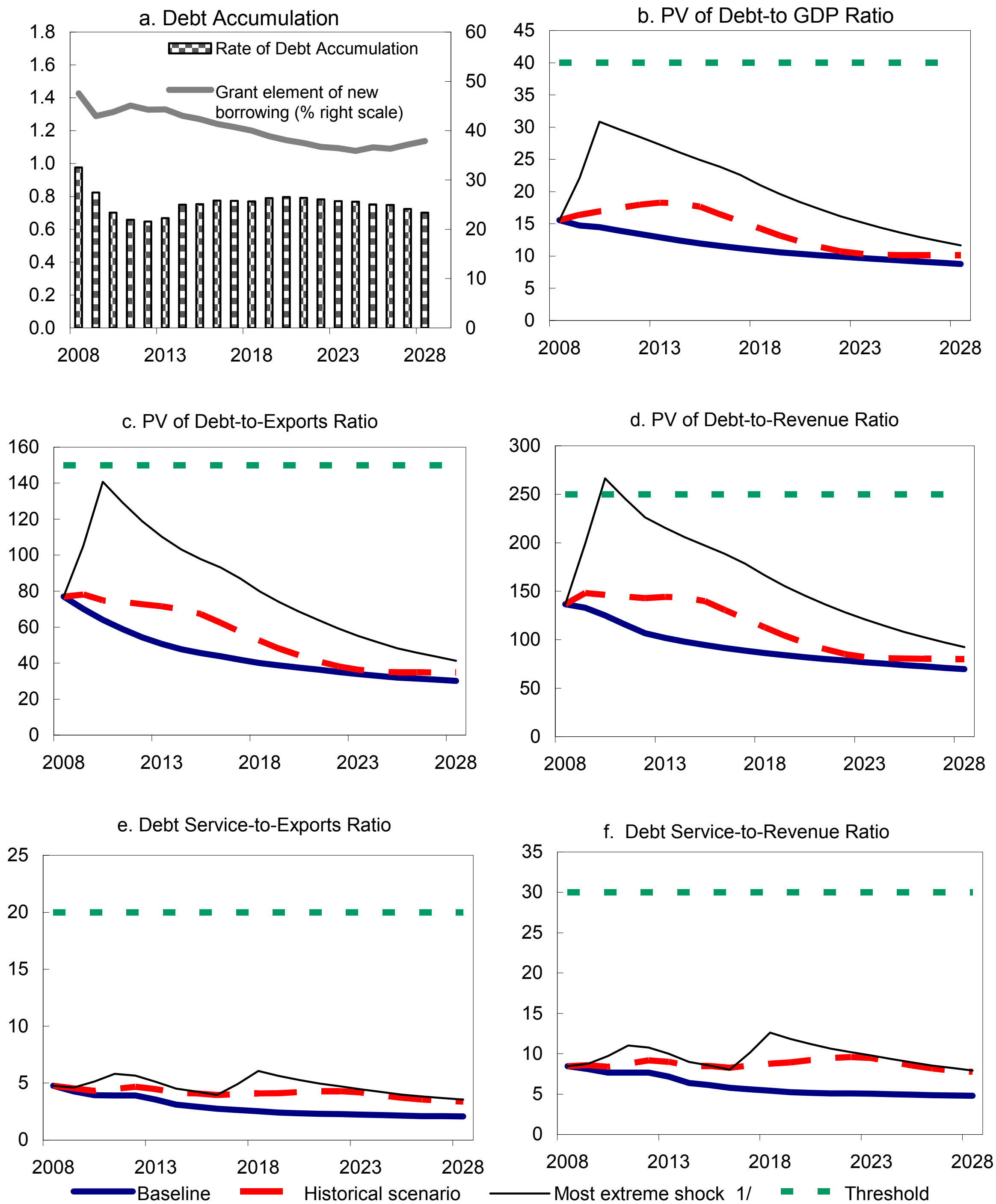
close to the indicative debt burden thresholds. A temporary and minor breach of one threshold under a particularly severe stress test does not change this conclusion. Risks to domestic debt accumulation, however, especially coming from the possible recognition of contingent liabilities, raise concerns.

10. The substantial increase in debt ratios when domestic debt is included, allied to concerns about contingent liabilities, calls for careful management of the public debt. While the NPV of public debt-to-revenue ratio would decline over the 20-year horizon (albeit from a relatively high level) under baseline assumptions, the ratio would remain high in some of the bound tests. The substantial jump in the key liquidity ratio (debt service to revenues) under the shock that simulates the recognition of contingent liabilities is a particular cause for concern, and highlights the risks that can materialize if economic policies are not managed carefully and public enterprise losses are not contained.

11. Efforts to mobilize domestic revenues, especially in the initial years, as well as the appropriate management of contingent liabilities, and managing expenditures prudently while protecting priority spending are the keys to ensure improvement in the debt indicators. This exercise also underscores the importance of effective management of the existing debt and new debt accumulation.

12. The staff encourages the authorities to build on recent steps and move forward as quickly as possible to strengthen debt management capacity. In this regard, it will be important to develop a comprehensive external debt data base and to centralize the reporting of all external aid flows.

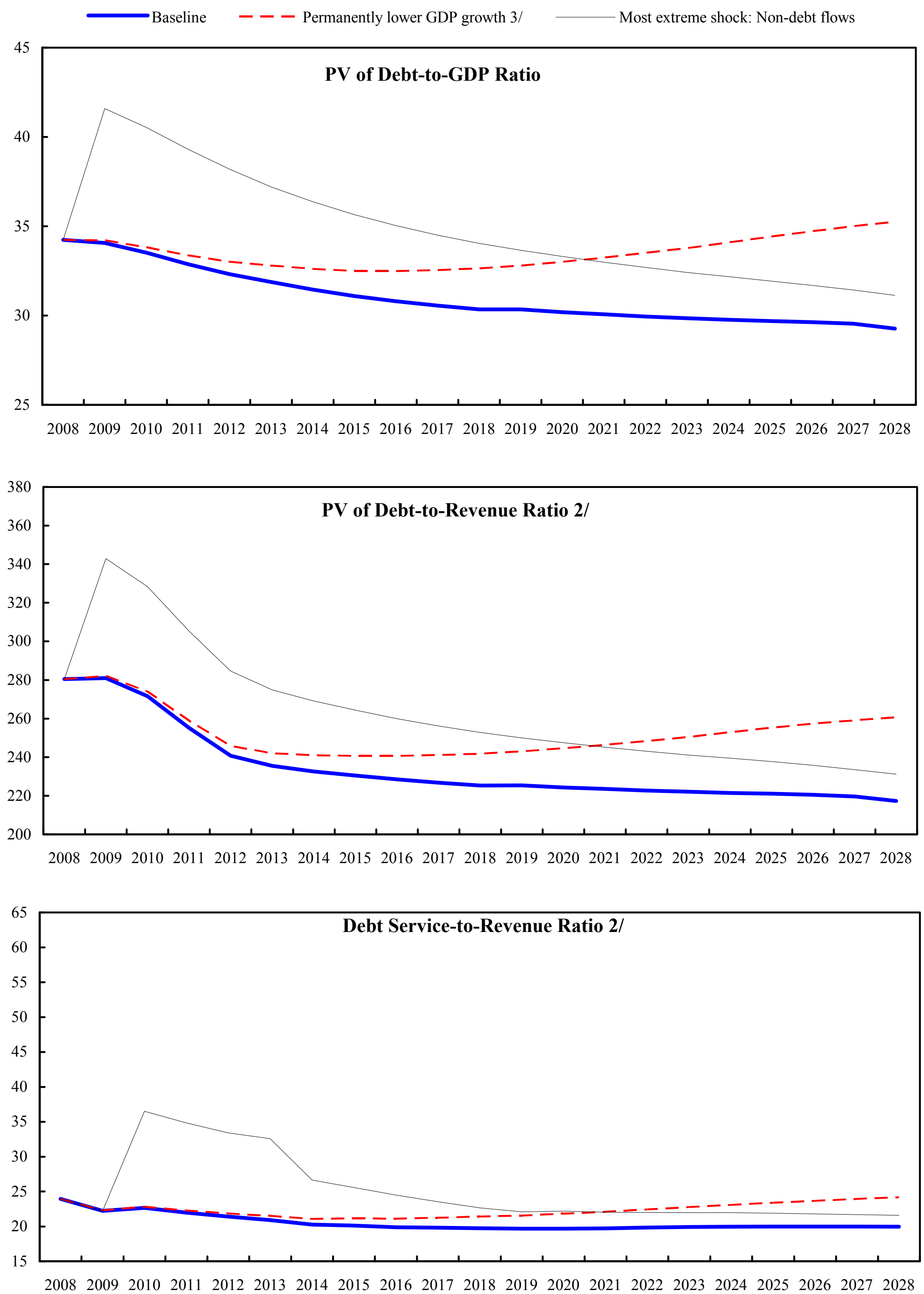
Figure 1. Bangladesh: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2008–28 1/



Source: Staff projections and simulations.

1/ The most extreme stress test is the test that yields the highest ratio in 2018. In figure b. it corresponds to a Combination shock; in c. to a Combination shock; in d. to a Combination shock; in e. to a Combination shock and in picture f. to a Combination shock.

Figure 2. Bangladesh: Indicators of Public Debt Under Alternative Scenarios, 2008–28 1/



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

1/ The most extreme stress test is the test that yields the highest average ratio during the projection period.

2/ Revenues are defined inclusive of grants.

3/ Assumes a growth rate equal to the baseline less 1/2 standard deviation of the historical growth rate.

Table 1. Bangladesh: External Debt Sustainability Framework, Baseline Scenario, 2005–28 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 2/	Standard Deviation	**Projections**									
	2005	2006	2007			2008	2009	2010	2011	2012	2013	2008–2013 Average	2018	2028	2014–2028 Average
External debt (nominal) 1/	**29.6**	**28.9**	**28.7**			**25.9**	**24.4**	**23.8**	**22.9**	**22.0**	**21.1**		**17.3**	**13.1**	
Of which: public and publicly guaranteed (PPG)	29.3	28.6	28.4			25.7	24.2	23.6	22.6	21.7	20.9		16.9	12.6	
Change in external debt	-1.4	-0.7	-0.1			-2.8	-1.6	-0.6	-0.9	-0.9	-0.9		-0.6	-0.3	
Identified net debt-creating flows	-2.3	-2.8	-4.3			-3.2	-3.2	-2.7	-3.0	-2.9	-2.6		0.1	-0.9	
Noninterest current account deficit	**0.6**	**-1.2**	**-1.0**	**-0.1**	**1.0**	**-1.1**	**-1.1**	**-0.7**	**-0.8**	**-0.6**	**-0.3**		**2.4**	**1.7**	1.8
Deficit in balance of goods and services	6.9	6.4	7.2			8.8	10.2	11.7	12.5	13.5	14.8		19.9	19.4	
Exports	16.2	18.9	20.5			20.2	21.0	22.6	23.7	24.7	25.5		27.2	29.1	
Imports	23.1	25.4	27.7			29.1	31.2	34.3	36.2	38.2	40.3		47.1	48.4	
Net current transfers (negative = inflow)	-7.1	-8.6	-9.4	-6.3	1.7	-11.0	-12.4	-13.5	-14.5	-15.3	-16.2		-18.7	-19.1	-18.8
Of which: official	-0.1	-0.1	-0.1			-0.2	-0.3	-0.1	-0.1	-0.1	-0.1		-0.1	0.0	
Other current account flows (negative = net inflow)	0.8	1.0	1.1			1.1	1.1	1.1	1.2	1.2	1.2		1.3	1.4	
Net FDI (negative = inflow)	**-1.3**	**-1.1**	**-1.0**	**-0.7**	**0.3**	**-0.9**	**-0.9**	**-1.0**	**-1.1**	**-1.1**	**-1.2**		**-1.4**	**-1.9**	-1.6
Endogenous debt dynamics 3/	**-1.6**	**-0.5**	**-2.2**			**-1.2**	**-1.1**	**-1.0**	**-1.2**	**-1.2**	**-1.2**		**-0.9**	**-0.7**	
Denominator: 1+g+r+gr	1.1	1.0	1.1			1.2	1.1	1.1	1.1	1.1	1.1		1.1	1.1	
Contribution from nominal interest rate	0.4	0.3	0.3			0.3	0.3	0.3	0.3	0.3	0.2		0.2	0.2	
Contribution from real GDP growth	-1.7	-1.9	-1.7			-1.5	-1.4	-1.3	-1.4	-1.4	-1.4		-1.1	-0.8	
Contribution from price and exchange rate changes	-0.2	1.1	-0.8			…	…	…	…	…	…		…	…	
Residual (3-4) 4/	**0.9**	**2.1**	**4.1**			**0.4**	**1.6**	**2.1**	**2.0**	**2.0**	**1.7**		**-0.8**	**0.6**	
Of which: exceptional financing	-1.3	-1.1	-1.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 5/	...	...	17.5			15.8	14.9	14.7	14.2	13.7	13.2		11.2	9.2	
In percent of exports	...	...	85.3			78.0	71.1	65.0	59.9	55.3	51.6		41.4	31.7	
PV of PPG external debt	**...**	**...**	**17.2**			**15.6**	**14.7**	**14.5**	**14.0**	**13.4**	**12.9**		**10.9**	**8.8**	
In percent of exports	**...**	**...**	**83.9**			**76.9**	**70.1**	**64.1**	**59.0**	**54.3**	**50.6**		**40.1**	**30.2**	
In percent of government revenues	**...**	**...**	**166.1**			**136.5**	**132.9**	**125.1**	**115.5**	**106.7**	**101.9**		**86.1**	**69.5**	
Debt service-to-exports ratio (in percent)	**7.8**	**5.8**	**5.1**			**5.1**	**4.5**	**4.2**	**4.2**	**4.2**	**3.8**		**2.9**	**2.5**	
PPG debt service-to-exports ratio (in percent)	**7.6**	**5.6**	**4.9**			**4.8**	**4.3**	**3.9**	**3.9**	**3.9**	**3.6**		**2.5**	**2.1**	
PPG debt service-to-revenue ratio (in percent)	**11.7**	**10.0**	**9.8**			**8.5**	**8.1**	**7.7**	**7.7**	**7.7**	**7.2**		**5.4**	**4.8**	
Total gross financing need (billions of U.S. dollars)	0.3	-0.7	-0.7			-0.7	-1.0	-0.7	-0.8	-0.8	-0.5		3.6	2.7	
Noninterest current account deficit that stabilizes debt ratio	1.9	-0.5	-0.9			1.7	0.4	-0.1	0.2	0.3	0.6		3.1	2.0	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.0	6.6	6.4	5.6	0.7	6.2	6.0	5.5	6.5	6.7	7.0	6.3	7.0	7.0	7.0
GDP deflator in U.S. dollar terms (change in percent)	0.6	-3.6	2.7	-0.7	3.0	9.9	5.0	0.9	2.0	1.9	1.9	3.6	2.9	2.9	2.9
Effective interest rate (percent) 6/	1.3	1.0	1.0	1.1	0.1	1.3	1.3	1.3	1.2	1.2	1.2	1.2	1.2	1.5	1.3
Growth of exports of G&S (U.S. dollar terms, in percent)	15.5	20.2	18.3	11.0	7.7	15.2	15.5	14.6	13.6	13.7	12.7	14.2	11.7	10.1	11.0
Growth of imports of G&S (U.S. dollar terms, in percent)	19.6	12.9	19.5	9.7	8.7	22.4	19.3	17.2	14.4	14.9	15.1	17.2	11.7	10.1	11.5
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	47.6	43.0	43.8	45.1	44.3	44.3	44.7	40.0	37.9	38.6
Government revenues (excluding grants, in percent of GDP)	10.5	10.7	10.3			11.4	11.1	11.6	12.1	12.6	12.7		12.6	12.6	12.6
Aid flows (in billions of US dollars) 7/	0.7	0.6	0.5			2.0	2.2	2.0	2.3	2.6	2.8		4.2	10.2	
Of which: Grants	0.2	0.3	0.2			0.6	0.9	0.7	0.8	0.9	1.0		1.6	4.3	
Of which: Concessional loans	0.5	0.4	0.4			1.4	1.3	1.3	1.5	1.6	1.8		2.5	6.0	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			1.8	1.8	1.4	1.5	1.6	1.6		1.4	1.3	1.4
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			62.6	65.2	62.6	63.6	63.1	63.4		61.8	61.7	61.0
Memorandum items:															
Nominal GDP (billions of US dollars)	60.3	62.0	67.7			79.0	87.9	93.6	101.6	110.5	120.5		194.9	509.6	
Nominal dollar GDP growth	6.6	2.7	9.3			16.7	11.3	6.5	8.6	8.7	9.0	**10.1**	10.1	10.1	10.1
PV of PPG external debt (in billions of US dollars)			11.6			12.3	12.9	13.6	14.2	14.8	15.6		21.2	44.7	
(PVt-PVt-1)/GDPt-1 (in percent)						1.0	0.8	0.7	0.7	0.6	0.7	0.7	0.8	0.7	0.8

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
3/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.
4/ 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.
5/ Assumes that PV of private sector debt is equivalent to its face value.
6/ Current-year interest payments divided by previous period debt stock.
7/ Defined as grants, concessional loans, and debt relief.
8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Bangladesh: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2008–28

(In percent)

	Projections							
	2008	2009	2010	2011	2012	2013	**2018**	2028
PV of debt-to GDP ratio								
Baseline	16	15	14	14	13	13	**11**	9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008–2028 1/	16	16	17	17	18	18	**14**	10
A2. New public sector loans on less favorable terms in 2008–2028 2/	16	15	15	14	14	13	**11**	9
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2009–2010	16	15	15	14	14	13	**11**	9
B2. Export value growth at historical average minus one standard deviation in 2009–2010 3/	16	16	19	18	17	16	**13**	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009–2010	16	16	17	16	15	15	**12**	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009–2010 4/	16	20	25	24	23	23	**17**	10
B5. Combination of B1-B4 using one-half standard deviation shocks	16	22	31	30	28	27	**21**	12
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	16	21	20	20	19	18	**15**	12
PV of debt-to-exports ratio								
Baseline	77	70	64	59	54	51	**40**	30
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008–2028 1/	77	78	75	74	73	72	**52**	35
A2. New public sector loans on less favorable terms in 2008–2028 2/	77	70	64	60	55	51	**40**	31
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2009–2010	77	70	64	59	54	51	**40**	30
B2. Export value growth at historical average minus one standard deviation in 2009–2010 3/	77	86	102	94	86	80	**61**	40
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009–2010	77	70	64	59	54	51	**40**	30
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009–2010 4/	77	95	112	103	95	88	**64**	35
B5. Combination of B1-B4 using one-half standard deviation shocks	77	105	141	129	119	110	**80**	41
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	77	70	64	59	54	51	**40**	30
PV of debt-to-revenue ratio								
Baseline	137	133	125	115	107	102	**86**	69
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008–2028 1/	137	148	146	145	143	144	**113**	80
A2. New public sector loans on less favorable terms in 2008–2028 2/	137	133	126	117	108	103	**87**	71
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2009–2010	137	134	127	117	108	104	**88**	71
B2. Export value growth at historical average minus one standard deviation in 2009–2010 3/	137	145	160	148	136	130	**106**	74
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009–2010	137	145	143	132	122	116	**98**	79
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009–2010 4/	137	179	219	202	186	177	**138**	80
B5. Combination of B1-B4 using one-half standard deviation shocks	137	199	266	245	226	215	**166**	92
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	137	186	175	162	149	143	**121**	97

Table 2. Bangladesh: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2008–2028 (concluded)

(In percent)

	Projections							
	2008	2009	2010	2011	2012	2013	**2018**	2028
Debt service-to-exports ratio								
Baseline	5	4	4	4	4	4	**3**	2
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008–2028 1/	5	5	4	4	5	4	**4**	3
A2. New public sector loans on less favorable terms in 2008–2028 2/	5	4	4	4	4	4	**3**	2
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2009–2010	5	4	4	4	4	4	**3**	2
B2. Export value growth at historical average minus one standard deviation in 2009–2010 3/	5	5	5	5	5	5	**4**	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009–2010	5	4	4	4	4	4	**3**	2
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009–2010 4/	5	4	4	5	5	4	**5**	3
B5. Combination of B1-B4 using one-half standard deviation shocks	5	5	5	6	6	5	**6**	4
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	5	4	4	4	4	4	**3**	2
Debt service-to-revenue ratio								
Baseline	8	8	8	8	8	7	**5**	5
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008–2028 1/	8	9	8	9	9	9	**9**	8
A2. New public sector loans on less favorable terms in 2008–2028 2/	8	8	8	8	8	8	**6**	4
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2009–2010	8	8	8	8	8	7	**6**	5
B2. Export value growth at historical average minus one standard deviation in 2009–2010 3/	8	8	8	8	8	8	**7**	6
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009–2010	8	9	9	9	9	8	**6**	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009–2010 4/	8	8	9	9	9	9	**10**	7
B5. Combination of B1-B4 using one-half standard deviation shocks	8	9	10	11	11	10	**13**	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	8	11	11	11	11	10	**8**	7
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	39	39	39	39	39	39	**39**	39

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ 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 (implicitl an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 3. Public Sector Debt Sustainability Framework, Baseline Scenario, 2005–28

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections							
	2005	2006	2007	Average 1/	Standard Deviation	2008	2009	2010	2011	2012	2013	2008-13 Average	2018	2028
Public sector debt 2/	47.5	46.9	46.5			44.4	43.8	42.8	41.7	40.7	39.9		36.4	33.1
Of which: foreign currency denominated	29.3	28.7	28.3			25.7	24.9	24.1	23.0	22.0	21.0		17.0	12.7
Change in public sector debt	-1.6	-0.5	-0.4			-2.1	-0.6	-1.0	-1.1	-1.0	-0.9		-0.5	-0.3
Identified debt-creating flows	-0.8	0.2	-1.7			-2.1	-0.6	-0.8	-0.9	-0.8	-0.7		-0.4	-0.1
Primary deficit	1.4	1.0	1.1	1.3	0.8	2.2	1.7	0.9	1.0	1.0	1.0	1.3	1.0	0.9
Revenue and grants	10.9	11.1	10.6			12.2	12.1	12.3	12.9	13.4	13.5		13.5	13.5
Of which: grants	0.4	0.4	0.2			0.8	1.0	0.8	0.8	0.8	0.8		0.8	0.8
Primary (noninterest) expenditure	12.2	12.1	11.7			14.4	13.9	13.2	13.9	14.4	14.5		14.5	14.4
Automatic debt dynamics	-2.2	-0.9	-2.8			-4.2	-2.3	-1.7	-2.0	-1.8	-1.7		-1.4	-1.0
Contribution from interest rate/growth differential	-3.2	-3.5	-3.4			-4.1	-3.9	-2.8	-2.7	-2.3	-2.0		-1.6	-1.2
Of which: contribution from average real interest rate	-0.5	-0.5	-0.5			-1.4	-1.4	-0.5	-0.1	0.3	0.7		0.8	1.0
Of which: contribution from real GDP growth	-2.8	-3.0	-2.8			-2.7	-2.5	-2.3	-2.6	-2.6	-2.7		-2.4	-2.2
Contribution from real exchange rate depreciation	1.0	2.6	0.6			-0.2	1.6	1.1	0.8	0.5	0.3		...	...
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	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	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	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	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	0.0
Residual, including asset changes	-0.8	-0.7	1.3			0.0	-0.1	-0.2	-0.2	-0.2	-0.2		-0.1	-0.2
Other Sustainability Indicators														
PV of public sector debt	18.1	18.2	35.3			34.2	34.1	33.5	32.9	32.3	31.9		30.3	29.3
Of which: foreign-currency denominated	0.0	0.0	17.1			15.5	15.2	14.8	14.2	13.6	13.0		10.9	8.8
Of which: external	...	...	17.1			15.5	15.2	14.8	14.2	13.6	13.0		10.9	8.8
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...
Gross financing need 3/	3.4	3.9	3.6			3.8	5.1	4.3	3.6	3.8	3.8		3.7	3.6
PV of public sector debt-to-revenue and grants ratio (in percent)	167.1	164.6	333.7			280.5	280.9	271.5	255.2	240.7	235.5		225.3	217.3
PV of public sector debt-to-revenue ratio (in percent)	172.8	171.0	341.4			300.5	307.5	289.4	272.2	256.9	251.3		240.1	231.7
Of which: external 4/	…	…	165.6			136.4	136.9	127.6	117.2	107.8	102.4		86.6	69.9
Debt service-to-revenue and grants ratio (in percent) 5/	23.2	23.2	25.3			24.0	22.2	22.6	22.0	21.4	20.9		19.7	19.9
Debt service-to-revenue ratio (in percent) 5/	15.5	16.6	18.3			19.8	18.8	18.8	17.8	17.0	16.8		17.0	17.6
Primary deficit that stabilizes the debt-to-GDP ratio	3.0	1.6	1.5			4.3	2.4	1.9	2.2	2.0	1.9		1.6	1.2
Key macroeconomic and fiscal assumptions														
Real GDP growth (in percent)	6.0	6.6	6.4	5.6	0.7	6.2	6.0	5.5	6.5	6.7	7.0	6.3	7.0	7.0
Average nominal interest rate on forex debt (in percent)	1.2	0.9	0.9	1.1	0.1	1.2	1.2	1.2	1.2	1.1	1.1	1.2	1.1	1.2
Average real interest rate on forex debt (in percent)	7.2	13.4	7.4	10.0	3.6	2.4	5.9	10.4	9.3	9.3	9.3	7.8	8.3	8.2
Real exchange rate depreciation (in percent, + indicates depreciation)	8.2	19.9	5.2	9.7	6.4	-1.3	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	0.6	-3.6	2.7	-0.7	3.0	9.9	5.0	0.9	2.0	1.9	1.9	3.6	2.9	2.9
Growth of real primary spending (deflated by GDP deflator, in percent)	0.1	0.1	0.0	0.1	0.1	0.3	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	47.6	43.0	43.8	45.1	44.3	44.3	44.7	40.0	37.9

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

1/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
2/ Central government gross debt.
3/ 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.
4/ Revenues excluding grants.
5/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

Table 4. Bangladesh: Sensitivity Analysis for Key Indicators of Public Debt 2008–28

		Projections						
	2008	2009	2010	2011	2012	2013	2018	2028
PV of Debt-to-GDP Ratio								
Baseline	34	34	34	33	32	32	30	29
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	34	33	33	33	33	33	35	40
A2. Primary balance is unchanged from 2008	34	33	33	33	33	33	33	35
A3. Permanently lower GDP growth 1/	34	34	33	33	33	32	32	35
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	34	34	34	33	33	33	32	31
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	34	34	34	33	33	32	31	30
B3. Combination of B1-B2 using one half standard deviation shocks	34	34	34	33	33	32	31	30
B4. One-time 30 percent real depreciation in 2009	34	40	39	38	37	36	33	30
B5. 10 percent of GDP increase in other debt-creating flows in 2009	34	41	40	39	38	37	34	31
PV of Debt-to-Revenue Ratio 2/								
Baseline	280	281	271	255	241	236	225	217
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	276	275	268	256	245	245	257	292
A2. Primary balance is unchanged from 2008	276	276	271	258	247	244	247	258
A3. Permanently lower GDP growth 1/	276	278	270	255	243	240	241	261
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	276	280	273	258	245	241	235	233
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	276	278	276	259	244	239	229	221
B3. Combination of B1-B2 using one half standard deviation shocks	276	278	274	258	244	239	229	218
B4. One-time 30 percent real depreciation in 2009	276	333	318	295	275	265	241	223
B5. 10 percent of GDP increase in other debt-creating flows in 2009	276	339	325	302	282	273	252	232
Debt Service-to-Revenue Ratio 2/								
Baseline	24	22	22	22	22	21	21	22
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	24	22	23	22	22	22	23	26
A2. Primary balance is unchanged from 2008	24	22	23	23	23	23	22	23
A3. Permanently lower GDP growth 1/	24	22	23	23	22	22	22	24
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009-2010	24	22	23	23	22	22	21	21
B2. Primary balance is at historical average minus one standard deviations in 2009-2010	24	22	23	23	23	22	20	20
B3. Combination of B1-B2 using one half standard deviation shocks	24	22	23	23	22	22	20	20
B4. One-time 30 percent real depreciation in 2009	24	24	26	26	26	25	24	23
B5. 10 percent of GDP increase in other debt-creating flows in 2009	24	22	37	35	34	33	23	21

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

1/ Assumes that real GDP growth is at baseline minus 1/2 standard deviation.
2/ Revenues are defined inclusive of grants.

Statement by the IMF Staff Representative on Bangladesh
September 19, 2008

1. This statement summarizes economic developments since the issuance of the staff report to the Executive Board. These developments do not alter the thrust of the staff appraisal.

2. Money growth continued to be rapid with reserve and broad money growing at 19 percent in July and credit growth approaching 26 percent. Bangladesh Bank responded on September 16 by raising their repo rate by 25 basis points to 8¾ percent. The CPI for July still has not been released by the authorities.

3. The taka remains stable against the dollar and net international reserves have declined by around US$170 million thus far during FY09 mainly reflecting valuation changes.

4. Government revenue performance in early FY09 was strong with collections through August 19 percent higher than in FY08. Recent declines in international oil prices make it more likely that budget provisions will be able to cover the losses of the state-owned petroleum company but, unless prices decline further, losses will continue to accrue.

5. Recent weeks have seen significant floods in the southern and central regions, but water levels have begun to recede and, at present, there are no indications that the calamitous flooding of 2007 will be repeated.

6. The political situation has evolved since the staff report was issued. The leaders of both main political parties have now been released on bail and are planning to participate in their respective party's preparations for national elections. The Election Commission is expected to announce very soon a late December date for national elections and to clarify its position on holding additional local government elections prior to the national elections.

INTERNATIONAL MONETARY FUND
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IMF Executive Board Concludes 2008 Article IV Consultation with Bangladesh

On September 19, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bangladesh.[1]

Background

Bangladesh's macroeconomic performance has been remarkably resilient in a year of multiple natural disasters. Real GDP growth in FY08 (July–June) remained strong at above 6 percent, supported by a strong pickup in domestic economic activity in the second half of the year and rapid growth in garments exports and remittances. However, inflation has picked up to average 10 percent over the year, mainly driven by escalating international food and fuel prices and inflationary pressures are expected to remain high with the increase in administered fuel prices implemented on July 1 and signs of emerging demand pressures.

The nominal exchange rate remained stable in dollar terms in FY08, but depreciated by 6½ percent in effective terms as the dollar's value decreased in international markets. Strong remittance growth, a pickup in garment exports and external assistance kept the current account in surplus despite an increase in the trade deficit and allowed international reserves to grow moderately (2¾ months of prospective imports) in a year of increased import demand and high international commodity prices.

[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.

The overall fiscal balance for FY08 is estimated to have been below the budget target. Government revenue collection improved impressively and exceeded the budget target for the first time in recent history. Revenue was mainly driven by improved taxpayer compliance and collection of tax arrears. This allowed the overall fiscal deficit to be 3.3 percent of GDP compared with the budget target of 4.5 percent of GDP (excluding historical losses of the petroleum company), despite increased social spending arising from disaster relief operations and better coverage of state-owned enterprise losses related to administered fuel and fertilizer prices. Increased external assistance allowed domestic financing to remain below 2 percent of GDP.

Revenue administration improved markedly in FY08. The institutional framework for separating tax policy from administration has been established and a new unit will begin work by the end of the year. The two Large Taxpayer Units have been placed under the control of a single member at the National Board of Revenue, which should further improve enforcement. Revenue gains in FY08 reflected improvement in taxpayer compliance arising in part from the authorities' new universal self-assessment.

Growth in monetary aggregates moderated in the first half of FY08 but picked up rapidly in the last part of the year. Broad money growth stood at 17½ percent at end-June. Reflecting the need to finance increased food imports and Bangladesh Bank's (BB's) selectively accommodative monetary policy focusing on growth-driving sectors, private sector credit growth picked up during the year and reached 25 percent in June.

Several actions have been taken to further develop the financial sector such as strengthening the regulatory and prudential framework of BB, corporatizing and improving the management of the state-owned commercial banks (SCBs), automating stock trading, and establishing a government securities market. However, SCBs, which still account for over 30 percent of total banking sector assets, remain moribund and undermine the efficiency of the financial system. Inflexibility with regard to interest rates in the auction process of government securities has limited the operation of the primary dealer system and the development of an active secondary market.

Bangladesh's medium-term economic outlook is favorable. Though growth could slow in the near term while inflationary pressures and other current challenges are addressed, it is projected to increase to around 7 percent over the medium term, mainly driven by improvements in agriculture and expansion in domestic services and construction, supported by strong regional growth momentum. The external current account is projected to remain broadly in balance, with export and remittance growth offsetting growth in imports arising from higher investment. External assistance and gradually increasing capital inflows are expected to underpin a steady increase in international reserve coverage.

Executive Board Assessment

Executive Directors commended the authorities for their efforts to maintain macroeconomic stability in a year of multiple natural disasters and elevated food and fuel prices, which have put severe pressure on incomes, particularly of the urban and landless rural poor. Despite the long-term challenge of climate change, the medium-term outlook is favorable. Economic growth is expected to increase as key structural reforms take root and the country capitalizes on accelerating growth across the region.

Directors considered that preventing an increase in inflation is the immediate priority, as the poor and vulnerable are hit hardest by inflation. With fiscal policy focusing on addressing the social impact of higher commodity prices, most Directors saw the need to tighten monetary policy to keep inflation expectations in check, and welcomed the recent action by the central bank in this regard.

Directors agreed that macroeconomic policies are consistent with external stability. The external current account is expected to stay broadly in balance as continued growth in exports and remittances offset growth in imports. The current exchange rate policy has allowed the real exchange rate of the taka to remain in line with medium-term fundamentals. Directors broadly agreed, however, that more flexibility in the rate would support monetary policy objectives and encourage deepening of the foreign exchange market. They urged the authorities to adopt a timetable to remove the remaining exchange restriction.

Directors congratulated the authorities on the recent progress in fiscal stability. A significant improvement in revenue collections has helped offset increasing energy and fertilizer subsidies and larger outlays on social safety nets. The July increase in administered prices was a bold step, which has prevented a deterioration in state-owned enterprise finances. However, more remains to be done to place state-owned enterprises on a secure footing and to increase poverty-reducing spending.

Directors stressed that keeping to the macroeconomic targets of the FY09 budget will be important in controlling inflation. Directors supported the budget’s mildly expansionary stance, particularly in the light of recent fiscal prudence and the need to address the social impact of higher food prices. Given current inflationary pressures, Directors encouraged the authorities to use any excess revenue collections to reduce domestic financing.

Directors stressed that increasing revenue will be crucial to allow fiscal policy to return to a lower deficit path in the medium term, while at the same time increasing essential public expenditures. They encouraged the authorities to move forward to revise income tax and value-added tax legislation, and to maintain recent progress in strengthening revenue administration and enforcement. Replacing open-ended price subsidies with more affordable and better-targeted social safety nets will help provide fiscal space for increases in public investment and the provision of social services. Directors urged the authorities to address constraints in implementing the Annual Development Program so that priority spending increases in line with development needs.

Directors noted that further deepening of the financial sector will help Bangladesh to achieve its growth potential. They encouraged the authorities to give priority to strengthening the financial positions of the SCBs and to developing a secondary market for government securities.

Directors called on the authorities to accelerate the implementation of structural reforms and to strengthen institutions, in order to attract investment and prevent a slowdown in growth that could jeopardize debt sustainability. In the same vein, it will also be important to improve infrastructure, particularly in the electric power sector.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Bangladesh: Selected Economic Indicators, FY2004–08 1/

	FY04	FY05	FY06	FY07	FY08 Est.
National income and prices (percent change)					
Real GDP	6.3	6.0	6.6	6.4	6.2
GDP deflator	4.2	5.1	5.2	6.8	8.0
CPI inflation (annual average)	5.8	6.5	7.2	7.2	9.9
Central government operations (percent of GDP)					
Total revenue	10.2	10.5	10.7	10.2	11.4
Tax	8.2	8.5	8.5	8.2	9.1
Nontax	1.9	2.0	2.2	2.0	2.3
Total expenditure	13.3	13.8	13.9	13.4	16.1
Current expenditure	7.8	8.4	8.4	9.1	9.9
Of which: Interest payments	1.6	1.7	1.8	1.9	2.2
Of which: Subsidies	2.4	2.8	2.6	3.0	3.6
Annual Development Program	5.0	5.0	4.7	4.0	3.0
Other expenditures 2/	0.5	0.4	0.8	0.3	3.2
Overall balance (excluding grants) 3/	-3.1	-3.3	-3.2	-3.2	-4.7
Primary balance 3/	-1.4	-1.7	-1.4	-1.3	-2.5
Financing (net)	3.1	3.3	3.2	3.2	4.7
Domestic 3/	1.8	1.7	2.1	1.9	2.5
External	1.3	1.6	1.2	1.3	2.2
Total central government debt (percent of GDP)	51.0	50.1	48.3	46.0	43.8
Money and credit (end of fiscal year; percent change)					
Net domestic assets	13.5	17.1	19.6	12.6	18.0
Credit to private sector	17.5	17.0	18.3	15.1	25.1
Broad money (M2)	13.8	16.7	19.3	17.1	17.6
Balance of payments (in billions of U.S. dollars)					
Exports, f.o.b.	7.5	8.6	10.4	12.1	14.2
(Annual percent change)	15.9	14.0	21.6	15.6	18.1
Imports, f.o.b.	-9.8	-11.9	-13.3	-15.5	-19.5
(Annual percent change)	13.0	20.6	12.1	16.6	25.8
Current account	0.2	-0.6	0.6	1.0	0.6
(Percent of GDP)	0.3	-0.9	0.9	1.4	0.8
Gross official reserves (in billions of U.S. dollars)	2.7	2.9	3.5	5.1	6.1
In months of imports of goods and nonfactor services	2.3	2.2	2.3	2.7	2.7
Memorandum item:					
Nominal GDP (in billions of taka)	3,330	3,707	4,157	4,725	5,419

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

1/ Fiscal year begins July 1.
2/ Consists of other capital, net lending, food account balances, check float, and discrepancy.
3/ Includes assumption of BPC liabilities of 1.4 percent of GDP in FY08.

Statement by Adarsh Kishore, Executive Director for Bangladesh and Partha Ray, Advisor to Executive Director September 19, 2008

1. The Bangladesh Authorities would like to take this opportunity to put on record their appreciation of the IMF staff for an effective and fruitful Article IV Consultation. The staff report on Article IV Consultation has presented a balanced view of the economy, broadly reflecting the discussions held between the staff and the authorities. The authorities are in broad consonance with the assessment and policy messages of the Report.

Growth

2. Despite natural disasters and high global food and fuel prices, Bangladesh economy has shown remarkable signs of resilience. The real GDP growth rate for the financial year 2007-08 (i.e., July 2007 to June 2008) is estimated at 6.2 percent, which is slightly lower than the 6.4 percent achieved in 2006-07. Growth has picked up during the latter half of 2007-08, supported by a bumper agricultural harvest, escalating garment exports and very strong remittances. Agricultural production rebounded with a record 19 percent increase in Boro crop harvest. Industrial growth, however, slowed down from 8.4 percent in 2006-07 to 6.9 percent in 2007-08 due to slower growth in construction and manufacturing. It is expected that the effects of the natural calamities prove transient and should not pose any serious threat to disrupt the macroeconomic fundamentals of the economy.
3. The growth target of 6.5 percent for the financial year 2008-09 appears feasible, especially due to brighter prospects of increasing agricultural and manufacturing outputs, but would require concerted efforts to supplement the existing growth supportive policies with additional policies to realize the potential. In fact, given the growth trend in recent years and also considering the current macroeconomic scenario and near-term projections, the authorities view the staff projection of growth for 2008-09 at 6 percent as somewhat conservative.

Millennium Development Goals (MDGs)

4. Despite low per capita income there was a significant progress in Bangladesh in terms of achieving MDGs particularly in human development areas, especially with respect to education, child mortality and gender equality. Illustratively, adult literacy rate went up from 37 percent in during 1990-95 to 54 percent during 2005-07, and under-five mortality rate (per 1,000) registered a significant fall from 151 during 1990-95 to 62 during 2005-07.

Inflation

5. Consequent on the elevated global food and energy prices as well as internal shocks, Bangladesh witnessed a high inflationary trajectory in recent times. The 12-month average CPI inflation, which was 7.2 percent in the financial years 2006-07, rose to a high of 10.0 percent in March 2008 and then marginally declined to 9.9 percent in June 2008. The current inflationary pressure in Bangladesh is driven mainly by external supply side factors triggered by international price hike of food, fuel and

fertilizer. It is expected that with the easing of their price level in international market and domestic food prices, the inflationary pressure would reduce and stay within a single digit during the fiscal year.

6. The government raised administered price of compressed natural gas (CNG) in June 2008 and prices of fuel oil and urea fertilizer in July 2008. These adjustments pushed up the point to point inflation to 10.0 percent in June 2008 from 7.4 percent in May 2008. However, with the expected positive supply response of the real sector to policy measures of the Government and the Bangladesh Bank (BB, the Central Bank) the impact of the rise may be avoided in due course. The authorities keep a constant watch on the current inflationary trend and affirmative actions, if and when required, would be taken if the inflationary scenario poses a threat to existing macroeconomic stability.

Monetary Policy

7. The expansion in broad money (M2) at 17.6 percent during the financial year 2007-08 was marginally higher than that of 17.0 percent experienced during the financial year 2006-07. Domestic credit increased by 21.1 percent during the financial year 2007-08 compared with 14.9 percent in the previous year. Reserve money (RM) recorded an increase of 19.6 percent during 2007-08 as compared with 17.7 percent during 2006-07.

8. The stance of the monetary policy in Bangladesh could be seen as not adequately contractionary. However, it was felt that while monetary tightening can bring down inflation, it has unacceptably high cost in terms of foregone output and employment which an economy like Bangladesh can ill afford at present in view of its growth and poverty reduction imperatives. This, however, does not negate the importance of avoiding excessive monetary laxity which would harm macroeconomic stability and hence growth and poverty reduction efforts. The monetary policy stance during the first half of the financial year 2008-09 aims at ensuring reasonable price stability and providing support to sustainable and high output growth as adopted in the macro framework of the current fiscal year. For supporting growth promoting policies, the policy stance would give priority to unhindered flow of private sector credit to the economy's productive sectors, with agriculture, SMEs, and the rural economy being the prime targets. While the policy stance would be to lessen the pressure on inflation through increasing supply of outputs and keeping demand pressure within control, the target rate of average inflation has been taken at around 9.0 percent for the financial year 2008-09.

Public Finance

9. The total revenue for the Budget for the financial year 2008-09 has been estimated at 11.3 percent of GDP. Out of this, the revenue from the National Board of Revenue (NBR, the central authority for tax administration in Bangladesh) has been targeted at 8.9 percent of GDP. Non-tax and Non-NBR revenues have been estimated at 2.1 percent of GDP and 0.4 percent of GDP, respectively. In the face of escalating social spending following cyclone and floods, and after absorbing huge losses of state-owned enterprises (SOEs) through budget transfer, the budget deficit of 2007-08 remained below 4 percent of GDP. Yet more, domestic financing (excluding

Bangladesh Petroleum Corporation's non-cash assumption of debt) was less than 1 percent of GDP.

10. The fiscal position was supported by a significant improvement in revenue collections, which helped offset increased subsidies and outlays on safety nets. High revenue collection of the financial year 2007-08 was not a one-off shot. Instead, an overall improvement in governance led to greater compliance in taxation resulting in a historic 27 percent growth exceeding the budget estimate by 1½ percentage points and even the scaled up revised revenue estimates by ½ percentage point. The increased flow of revenue to the coffers helped in maintaining fiscal and macro economic stability despite the domestic shocks and external shocks. Nevertheless, the losses of the state-owned enterprises (SOEs) remains an area that has attracted the interventions of the authorities; admittedly, reforms in the operations of the SOEs, such as corporatization of the Bangladesh Airlines, cost-containments measures in the Bangladesh Petroleum Corporation, private-public partnership in operating the Bangladesh Jute Mills units would improve fiscal position.
11. In the wake of rapid rise of food prices and consequent erosion of purchasing power of the poor, the Government have launched its largest ever cash-for-work safety net programme titled 100 Days' Employment Generation Programme to protect the poor from sliding back to poverty. This programme would guarantee employment to any person who would slip through other safety net programs in place and would guarantee 100 days work for 2 million poor at a cost of Tk 20 billion. The 100 Days' Employment Generation Programme is being implemented under policy guidelines designed to be well targeted. This and other safety-net programmes would involve 3 percent of GDP.
12. The debt sustainability analysis of Bangladesh, based on external indicators, seems to indicate that the economy's risk of debt distress is low. Illustratively, the net present value of debt-GDP ratio decreases from about 17 percent in 2007 to 9 percent during the projection period of 2008-28. The standard stress tests too do not reveal any serious vulnerability.

External Sector

13. As per recent trends in external trade, a robust growth in import during 2007-08 by 26.1 percent exceeded the exports growth of 15.9 percent and resulted in a widening trade deficit of US $ 5,541 million. Despite the surge in trade deficit, higher external aid flow and healthy growth in workers' remittances provided a cushion to the external balance, resulting in a surplus of US $ 672 million in current account balance during 2007-08 . Overall, the balance of payments showed a surplus of US$ 604 million during 2007-08 against a surplus of US $ 1,493 million in the previous year.
14. The foreign exchange market remained mostly stable in 2007-08 although the high inflow of remittances coupled with rising exports enabled Taka to appreciate slightly against USD. The Bangladesh Bank, as a part of its pro-active monetary policy, remained active in the foreign exchange market and made necessary interventions in the interbank market to help dampen inflationary pressure partly by cutting import costs of food items. The policy stance also enabled BB to maintain a comfortable foreign exchange reserve throughout FY08.

15. Both nominal effective exchange rate (NEER) and real effective exchange rate (REER) depreciated while nominal exchange rate appreciated slightly in May 2008 over June 2007. The real exchange rate remained in line with its equilibrium level on a broad range of measures and macroeconomic policies and was in line with external stability.
16. Our authorities concur with the broad thrust of the Staff report and are prepared to go forward in implementing various facets of reform programme that would generate further growth and have positive spillovers on poverty eradication. Bangladesh in recent years has shown considerable resilience to the effects of natural calamities and external shocks. Furthermore, it is the considered view of the authorities that the upcoming political transition process in December 2008 is not likely to have any negative impact on growth, as the thrust of growth in Bangladesh continues to be private sector-led. Nevertheless, uncertainties in the external front as well as those related to climate changes could have some ramification for medium-term growth prospects.