Bangladesh

The economy grew robustly in fiscal year 2019 (FY2019, ended 30 June 2019) on strong expansion in industry. Inflation moderated with a good harvest. The current account deficit was narrower than forecast in ADO 2019 as import growth slowed and exports accelerated beyond expectations, and as remittances rose to a new record. For FY2020, this Update anticipates sustained high GDP growth despite some deterioration in global growth and trade conditions, slightly higher inflation, and a continued moderate current account deficit.

Updated assessment

GDP growth was 8.1% in FY2019, according to preliminary official estimates, slightly higher than projected in ADO 2019 as growth in industry accelerated from 12.1% in FY2018 to 13.0%, exceeding expectations thanks to robust growth in manufacturing and electricity, water, and gas utilities (Figure 3.3.4). Output from large and medium-sized industrial enterprises grew briskly by 15.6% as exports picked up, especially to the US and some newly penetrated markets. Small manufacturers also excelled. Service growth rose slightly from 6.4% to 6.5%, mainly on better performance in wholesale and retail trade and transport services. Growth in agriculture moderated from a high base of 4.2% in FY2018 to 3.5%.

On the demand side, growth was lifted by a 1.3 percentage point contribution by net exports as exports outpaced imports. Record remittances at $16.4 billion underpinned 5.4% expansion in private consumption, which allowed total consumption to contribute 4.0 percentage points to growth. Although investment growth eased from a year earlier, gross domestic investment rose from the equivalent of 31.2% of GDP to 31.6% as public investment expanded from 8.0% to 8.2% and private investment edged up from 23.3% to 23.4%. Total investment contributed 2.8 percentage points to growth.

Inflation slowed from an average of 5.8% in FY2018 to 5.5% thanks to a good crop harvest and lower global food prices. Food inflation slowed to 5.5% year on year in June 2019 from 7.1% a year earlier, while nonfood inflation picked up from 3.7% to 5.4%, largely in line with rising domestic gas prices and currency depreciation (Figure 3.3.5).

Broad money growth accelerated in FY2019 from 9.2% a year earlier to 9.9% but ended up short of the FY2019 monetary program target of 12.0% (Figure 3.3.6). Private credit growth slowed from 16.9% a year earlier to 11.3%, also falling short of its 16.5% program target. Net credit to the public sector increased by 19.1% as the government borrowed more from banks for its domestic financing of the FY2019 budget deficit, thereby easing its reliance on nonbank financing, mainly through high-interest national savings certificates, from 85%...
in FY2018 to about 60%. With a decline in reserve liabilities, growth in net foreign assets continued to improve. Bangladesh Bank, the central bank, kept its policy interest rates unchanged as liquidity pressures moderated (Figure 3.3.7).

The official revised budget for FY2019 raised the revenue collection target from the equivalent of 9.6% of GDP in FY2018 to 12.5%. However, more recent data from the National Board of Revenue indicates that revenue underperformed the revised target by about 20% with shortfalls in the collection of income and value-added taxes. Total revised spending was targeted to jump from 14.3% of GDP in FY2018 to 17.4% on augmented annual development program spending and on higher current spending mostly for subsidies and pay and allowances. When budget accounts are next revised, the revenue shortfall is expected to be offset by lower spending than under the current revised budget to hold the budget deficit under a ceiling equal to 5.0% of GDP, which should keep the ratio of public debt to GDP broadly stable. Domestic sources financed 63% of the deficit.

Export growth accelerated from 6.7% in FY2018 to 10.1% (Figure 3.3.8). Growth in garment exports rose from 8.8% to 11.5%, reflecting strong demand from the US and newer markets for Bangladesh like Australia, Canada, India, Japan, the People’s Republic of China (PRC), and the Republic of Korea. Garments accounted for 84.2% of exports. Other exports increased by 5.8% on higher demand for agricultural, petroleum, and chemical products.

Imports grew modestly by 1.8% in FY2019 from a high base set in the previous year. Petroleum products, raw materials for garments, and construction materials rose markedly, reflecting strong growth in industry. Imports of capital goods rose little as investment fell short of expectations, while bountiful crop production drove down food imports substantially.

The trade deficit narrowed from $18.2 billion to $15.5 billion. Remittances grew strongly by 9.6% to reach a record $16.4 billion (Figure 3.3.9). This occurred as the Bangladesh taka depreciated and measures were taken to enhance money transfers through official channels. With the markedly improved trade deficit and larger remittances, the current account deficit narrowed sharply to $5.3 billion, equal to 1.7% of GDP. This was only half of the FY2018 deficit of $9.6 billion, or 3.5% of GDP, and much less than the ADO 2019 forecast in April (Figure 3.3.10).

The surplus in the combined capital and financial account, adjusted for errors and omissions, shrank from $8.7 billion in FY2018 to $5.3 billion mainly because of larger repayments of trade credit and less use of commercial bank credit and short-term loans. Notably, net foreign direct investment increased by over 40% to $2.5 billion. With net financing about equal to the current account deficit, the overall balance of payments
improved from a deficit of $857.0 million to a small surplus of $12.0 million in FY2019. Gross foreign exchange reserves in the central bank, including valuation adjustments, fell marginally to $32.8 billion, or cover for 6.0 months of imports (Figure 3.3.11).

The taka depreciated by 0.9% against the US dollar in FY2019 as Bangladesh Bank, the central bank, sold $2.3 billion to commercial banks to meet demand for foreign exchange and to tamp down excessive market volatility (Figure 3.3.12). Taking into account inflation differentials, the taka appreciated by 5.1% in real effective terms, indicating eroded competitiveness.

Prospects

GDP growth is expected at a strong 8.0% in FY2020 (Figure 3.3.13), as projected in ADO 2019, on continued buoyant exports underpinned by trade redirection in response to tensions between the US and the PRC, robust private consumption expenditure with higher remittances, accommodative policy on private sector credit, ongoing reform to improve the cost of doing business including the establishment of a one-stop service for private investment, and stepped up budget spending, especially to develop infrastructure.

Agriculture is expected to edge up to 3.8% growth in FY2020 as government policy improves farm prices. Industry growth is expected to stay high at 12.5% with domestic demand continuing to be powered by remittances and the central bank promoting investment in productive pursuits. Services are expected to grow by 6.4%, supported by sustained growth in agriculture and industry.

Inflation is forecast to accelerate to 5.8% in FY2020, as forecast in ADO 2019, on upward adjustments to domestic natural gas rates, higher prices for goods and services as value-added tax (VAT) coverage expands, and taka depreciation as demand rises for foreign exchange.

Central bank monetary policy will continue to be accommodative in FY2020 to support the government’s target for growth but without breaching the 5.5% cap on inflation. The central bank will adjust its sector-specific financing support policies and programs as needed. With money and foreign exchange markets poised to improve liquidity conditions, and with the economy running at full steam, the central bank made no changes in its monetary policy statement for FY2020 to its main policy interest rates, cash reserve requirement, or statutory liquidity ratio. It will handle liquidity stress at weak banks case by case. To make monetary policy transmission more efficient, the central bank is continuing preparations for adopting a monetary policy regime based on a policy interest rate.
The FY2020 budget sustains an expansionary approach. To finance a bigger annual development program, the government aims to raise revenue collection to the equivalent of 13.1% of GDP and increase spending to 18.1% (Figure 3.3.14). Current spending is expected to grow by 12.2%, mostly for higher pay and allowances, interest payments, and subsidies. Development expenditure is envisaged to grow by 22.0% to expedite the implementation of high-priority projects to enhance growth. The budget deficit is targeted equal to 5.0% of GDP, with 53.0% financed domestically. To further reduce reliance on national saving certificates as begun in FY2019, 61% of domestic financing is anticipated from banks and only 39% from certificates.

The Value-Added Tax and Supplementary Duty Act, 2012 came into effect on 1 July 2019 with provision for four rates: 5.0%, 7.5%, 10.0%, and 15.0%. The new VAT law is expected to generate additional revenue with more comprehensive coverage, better auditing, and market price accounting. Online services are provided for VAT registration, submitting returns, making payments, and requesting refunds. Other revenue-enhancing measures are expected to help improve revenue mobilization, but various VAT exemptions and tax holidays will likely offset some of these efforts.

Despite global economic slowing, export growth is expected to be strong at 10.0% in FY2020 as Bangladesh benefits from trade redirection caused by US–PRC trade tensions. Exports to newly penetrated markets are expected to rise further. Exports should benefit as well from government efforts to improve the investment climate by reducing the cost of doing business.

Imports are expected to grow by 9.0% in FY2020, though less than forecasted in ADO 2019 as expansion in public investment moderates more than expected in April 2019. Still, import growth will be substantially higher than in FY2019 as the implementation of large infrastructure projects picks up and boosts imports of capital equipment and raw materials. Liquified natural gas will become a sizeable new import with the installation of two floating storage and regasification units. Food imports will continue to be subdued, assuming a good crop harvest and with the revival of an import duty on rice.

Growth in remittance inflows is likely to slow to 9.0% in FY2020 as fewer people take jobs overseas. While import growth picks up, continued strong expansion in exports will broadly stabilize the trade deficit. As remittances will still be sizable, the current account deficit is projected to edge up slightly in FY2020 to equal 1.8% of GDP. With import payments exceeding export receipts, some pressure on foreign exchange reserves will continue, causing them to fall moderately.