INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/158

BANGLADESH

June 2018

2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; 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 2018 Article IV consultation with Bangladesh, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its May 30, 2018 consideration of the staff report that concluded the Article IV consultation with Bangladesh.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 30, 2018, following discussions that ended on March 9, 2018, 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 May 10, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staff of the IMF and the International Development Association (IDA).
- A **Statement by the Executive Director** for Bangladesh.

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

Selected Issues

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June 8, 2018

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IMF Executive Board Concludes 2018 Article IV Consultation with Bangladesh

On May 30, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the 2017 Article IV Consultation with Bangladesh.[1]

The Bangladesh economy continues to perform well with robust and stable growth. The strong growth comes with stable inflation, moderate public debt, and greater resilience to external shocks. The country continues to make steady progress in reducing poverty and improving social indicators.

Real GDP growth in FY17 (ending September 30) further accelerated to 7.3 percent from 7.1 percent in the previous fiscal year, led by strong private consumption and investment. Headline inflation slightly picked up towards the end of the fiscal year with higher food prices caused by flood-related disruption in agricultural harvest. The current account turned into a deficit with slower export growth, higher imports, and decline in remittances, while the balance of payments remained in small surplus. The debt-to-GDP ratio has remained stable at around 30 percent with the fiscal deficit well below the 5 percent of GDP budget target.

The macroeconomic situation is expected to remain robust in FY18. Growth is projected at around 7 percent with strong domestic demand. Inflation is expected to remain below 6 percent, close to Bangladesh Bank’s target as flood-related pressure on food prices eases with the rice harvest recovery. The current account deficit is projected to widen to close to 2 percent of GDP with stronger import demand for food, industrial raw materials, and capital machinery, while remittances and exports start to recover. Slow progress in resolving the Rohingya refugee crisis could add to economic, political, and social pressures.

[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.

Executive Board Assessment[2]

Executive Directors commended the authorities for their sound macroeconomic policies which have contributed to robust growth, a significant reduction in poverty, and improvement in social indicators. Directors agreed that continued implementation of prudent policies and structural reforms, including enhancing productive investment, will be key to further strengthening strong and inclusive growth over the medium term. Directors commended the authorities for their efforts to host the large number of Rohingya refugees and highlighted the importance of continued financial support from the international community.

Directors welcomed the authorities' efforts to contain the fiscal deficit and keep the public debt-to-GDP ratio broadly stable. Noting the urgent need to increase tax revenues, they encouraged the authorities to undertake tax reforms, especially implementation of the VAT reform and improvements in tax administration. Directors underscored the importance of raising revenues to finance the needed infrastructure investment and social safety nets. They welcomed the progress in implementing the public financial management reform strategy and encouraged sustained efforts in this area.

Directors highlighted the need to remain vigilant to inflation dynamics and tighten monetary policy as needed. They recommended that addressing liquidity problems in individual banks should be done through targeted conditional liquidity support, and considered that a gradual increase in exchange rate flexibility would help buffer the economy against external shocks.

Directors emphasized that stronger banking regulation and supervision is necessary to address banking sector weaknesses. Noting the high non-performing loans (NPLs), particularly in state-owned commercial banks (SOCBs), they called for an accelerated resolution of the NPLs, a shift towards risk-based supervision, and strengthened banks' internal controls and risk management systems. Directors encouraged the authorities to avoid regulatory forbearance and put in place a robust resolution framework for troubled banks. For the SOCBs, it would be important to enforce the monitoring mechanism and clearly formulate their public policy role with transparent budgetary support. Directors called for steps to further strengthen the AML/CFT framework.

Directors supported continued efforts to develop the capital market to mobilize long-term financing for investment, which remains limited. In this context, they called for review

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[2] 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. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

and reform of the scheme for the national savings certificates by tightening its eligibility and revising the pricing mechanism.

Directors noted that further progress in diversifying exports, increasing female labor participation, and enhancing financial inclusion, especially for women, are critical to sustain strong and inclusive growth. They highlighted the need to increase expenditure on health, better align vocational training to market demands, improve rural infrastructure, and strengthen labor laws. Directors emphasized that climate change poses significant risk to Bangladesh’s economy and this issue requires continued attention and efforts.

Table 1. Bangladesh: Selected Economic Indicators, FY2014–18 1/

I. Social and Demographic Indicators

Population (FY16, millions; estimate)	161	Infant mortality (2015, per thousand live births)	31
GDP per capita (FY16, U.S. dollars)	1378	Life expectancy at birth (2014, years)	72
Labor force participation rate (FY10, percent; national measure)	59	Adult literacy (2015, percent of people)	62
Poverty headcount ratio (2010, national measure, percent)	32	Population dependency ratio (2015, percent)	52
Gini index (World Bank estimate)	32	Population growth (FY16, y/y, percent; estimate)	1.3

II. Macroeconomic Indicators

	FY14	FY15	FY16	FY17	FY18
				Prelim.	Staff proj.
National income and prices (annual percent change)					
Real GDP	6.1	6.6	7.1	7.3	7.0
GDP deflator	5.7	5.9	6.7	6.3	6.0
CPI inflation (annual average)	7.3	6.4	5.9	5.4	5.9
CPI inflation (end of period)	7.0	6.3	5.5	5.9	5.9
Nonfood CPI inflation (end of period)	5.4	6.2	7.5	3.7	3.9
Central government operations (percent of GDP)					
Total revenue and grants	10.9	9.8	10.1	10.2	10.7
Total revenue	10.4	9.6	10.0	10.2	10.5
Tax	8.6	8.5	8.8	9.0	9.4
Nontax	1.8	1.1	1.2	1.2	1.1
Grants	0.5	0.2	0.1	0.1	0.2
Total expenditure	14.0	13.8	13.4	13.6	14.9
Current expenditure	8.2	7.9	8.3	8.3	8.4
Annual Development Program (ADP)	4.1	4.3	4.4	4.1	5.0
Other expenditures 2/	1.7	1.6	0.8	1.1	1.4
Overall balance (including grants)	-3.1	-4.0	-3.4	-3.3	-4.2
(Excluding grants)	-3.5	-4.1	-3.5	-3.4	-4.3
Primary balance (excluding grants)	-1.5	-2.1	-1.6	-1.7	-2.6
Total central government debt (percent of GDP)	35.3	33.7	33.3	33.2	33.4
Money and credit (end of fiscal year; percent change)					
Credit to private sector by the banking system	12.3	13.2	16.8	15.7	14.6
Reserve money 3/	15.4	14.3	30.1	16.3	12.0
Broad money (M2)	16.1	12.4	16.3	10.9	12.9
Balance of payments (billions of U.S. dollars)					
Exports, f.o.b.	29.8	30.7	33.4	34.0	35.9
(Annual percent change)	12.1	3.1	8.9	1.7	5.5
Imports, f.o.b.	-36.6	-37.7	-39.9	-43.5	-49.5
(Annual percent change)	8.9	3.0	5.9	9.0	13.9
Current account balance 4/	1.4	3.5	4.3	-1.5	-4.8
(Percent of GDP)	0.8	1.8	1.9	-0.6	-1.8
Capital and financial account balance	3.5	2.4	1.4	4.8	4.2
Of which: Foreign direct investment	1.5	1.8	1.3	1.7	2.0
Overall balance	5.5	5.0	5.0	2.8	-0.7
Gross official reserves (billions of U.S. dollars) 5/	21.4	24.9	30.2	33.5	32.8
In months of prospective imports of goods and services	5.8	6.5	7.2	7.0	6.4
Exchange rate (taka per U.S. dollar; period average)	77.7	77.7	78.3	79.1	…
Exchange rate (taka per U.S. dollar; end-period)	77.6	77.8	78.4	80.6	…
Nominal effective rate (2010=100; period average)	89.7	95.4	100.4	101.2	…
Real effective rate (2010=100; period average)	107.9	120.7	133.1	139.3	…
Memorandum item:					
Nominal GDP (billions of taka)	13,437	15,158	17,329	19,758	22,414

Sources: Bangladesh authorities; World Bank, *World Development Indicators*; and IMF staff estimates and projections.

1/ Fiscal year begins July 1.

2/ Includes non-ADP capital spending, net lending, food account surplus (-)/deficit (+), and extraordinary expenditures.

3/ Reserve money excludes liabilities arising from banks' foreign currency clearing accounts at Bangladesh Bank (BB) and nonbank deposits at BB.

4/ Imports are based on customs data.

5/ Excludes deposits held in offshore accounts of resident financial institutions, noninvestment grade sovereign bonds, and foreign exchange overdrafts provided by BB to domestic banks.

INTERNATIONAL MONETARY FUND

BANGLADESH

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

May 10, 2018

KEY ISSUES

Context. The Bangladesh economy continues to perform well with robust and stable growth. Led by the ready-made garment sector, the economy has diversified away from an agrarian to a more manufacturing based economy with abundant low-cost labor. Poverty has declined steadily and other social indicators have improved. To sustain the strong economic performance, the country needs to promote productive investments, while preserving economic and financial stability.

Near-term outlook. The macroeconomy is expected to remain robust in FY18. GDP growth is projected at around 7 percent, with inflation remaining below 6 percent. The current account deficit is expected to increase due to higher import needs. Risks to the outlook are broadly balanced.

Main policy recommendations:

- On monetary policy, Bangladesh Bank should closely monitor the impact of the recent accommodation and stand ready to tighten in case inflation increases again. Gradually increasing exchange rate flexibility will help buffer the economy against external shocks.
- Fiscal policy should continue to ensure public debt is broadly stable over the medium-term. Raising tax revenues would require tax reforms, including implementation of the delayed VAT reform, and improvements in tax administration.
- Banking sector weaknesses need to be addressed by strengthening banking regulation and supervision, ending regulatory forbearance, adopting risk-based supervision, and improving banks' internal control and risk management systems, particularly in state-owned commercial banks. Non-performing loan resolution needs to accelerate. Reforming National Savings Certificates remain a priority for the development of the capital market.
- The authorities need to continue their efforts to promote female labor force participation and financial inclusion to ensure inclusive growth.

Approved By
Kenneth Kang and Kevin Fletcher

Discussions took place in Dhaka during February 25-March 8, 2018. The staff team comprised Daisaku Kihara (head), Jiri Jonas, Jayendu De, Ragnar Gudmundsson (Resident Representative) and Muhammad Imam Hussain (Resident Representative office) (all APD). Subir Gokarn and Mohua Roy (OED) participated in the discussions. Cormac Sullivan and Stephen Chukwumah (APD) assisted in preparing this report.

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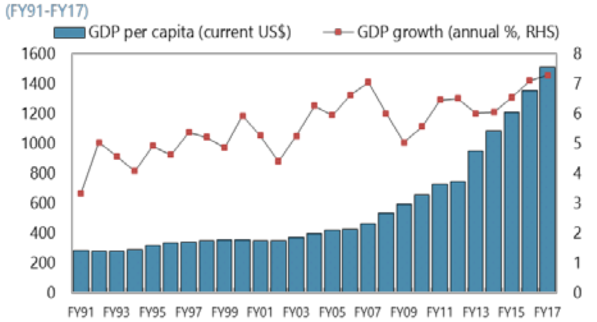
CONTEXT

1. The Bangladesh economy continues to perform well with robust and stable growth. GDP growth has averaged more than 6.0 percent over the last decade, significantly lifting GDP per capita. Thanks to the ready-made garment (RMG) sector, the economy has diversified away from an agrarian to a more manufacturing-based economy, supported by abundant low-cost labor. Poverty has declined steadily and other social indicators have improved. As a result, Bangladesh is now emerging from a low-income to lower-middle income country status.[1] More recently, broadly sound macroeconomic policies have contributed to robust growth, stable inflation, moderate public debt, and greater resilience to external shocks.

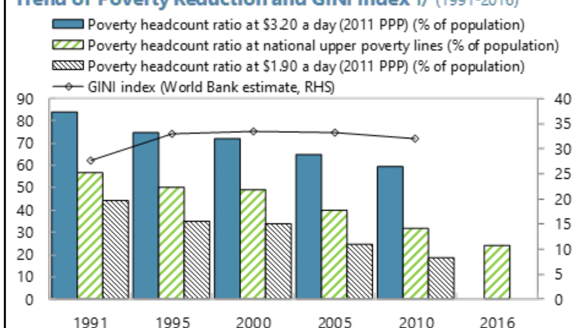
2. Political tensions are expected to increase in the run up to the general elections in December 2018. There have been sporadic demonstrations in early 2018, but unlike the last election, wide-spread and violent protests have not been observed thus far. However, underlying tensions remain and the risks from political unrest could increase. The potential threat of terrorism continues to be a source of concern.

Trend of Real GDP Growth and GDP per capita 1/ (FY91-FY17)



Sources: Bangladesh Bureau of Statistics (BBS), WDI, and IMF staff calculations
1/ In calculatying GDP per capita, population data is taken from the WDI. To calculate FY17 WDI population data, FY17 national population growth rate is used.

Trend of Poverty Reduction and GINI Index 1/ (1991-2016)



Sources: Bangladesh Bureau of Statistics (BBS) and WDI
1/ For 1991 a person having intake of less than 2,122 kilo-calories daily was considered below upper povety lines. Since 1995, the 'Cost of Basic Needs (CBN)' method has been used.

RECENT DEVELOPMENTS

3. Output growth further accelerated to 7.3 percent in FY17 from 7.1 percent in FY16.[2] The strong growth was led by robust domestic demand. Private consumption contributed about 2/3rd of the growth. Contribution from net exports turned negative with higher imports and slower export growth. On the supply side, growth was mainly driven by manufacturing and services with the sectoral composition of the economy's output continuing to shift away from agriculture.

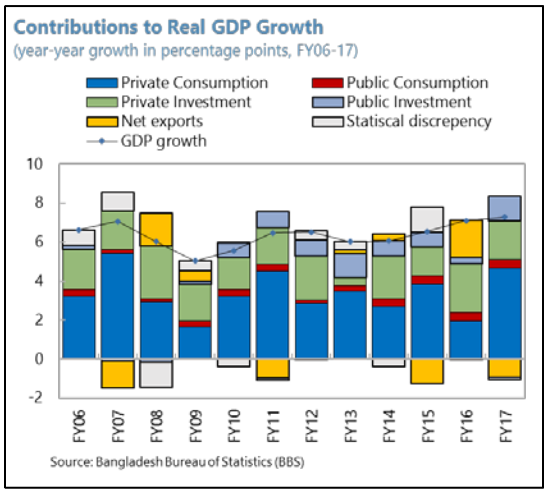
4. Following a temporary increase in 2017, headline CPI inflation has gradually eased. Higher food prices caused by flood-related disruption in agricultural harvests pushed inflation to

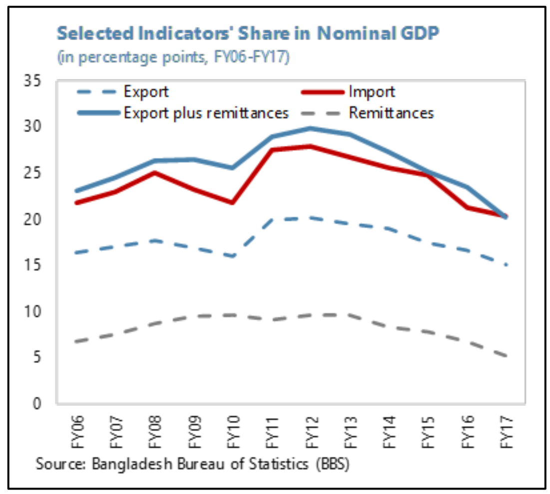
[1] Bangladesh continues to be PRGT-eligible in the IMF and is IDA eligible in the World Bank. The country is considered a lower middle-income country by the World Bank. Bangladesh fulfilled the eligibility criteria to graduate from the Least Developing Country category (UN classification) for the first time in 2018.

[2] The fiscal year ends in June.

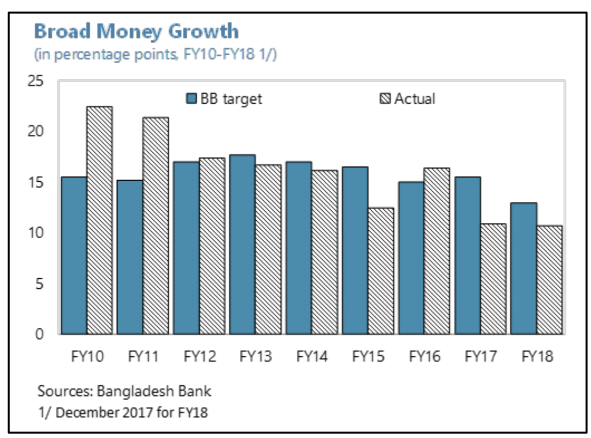
about 6 percent in the second half of 2017, while non-food inflation has remained broadly stable. With food price inflation gradually falling due to government efforts to increase food imports, overall inflation in March 2018 fell to 5.7 percent (y/y).

5. The current account (CA) turned into deficit in FY17. The CA deficit reached 0.6 percent of GDP due to slower exports, higher imports, and a decline in remittances. The increase in import values was mainly led by increased demand for raw materials, while RMG exports stagnated primarily reflecting slower growth in the global RMG market and domestic security concerns. Remittances declined by 14.0 percent in FY17 after growing 12.5 percent, on average, for the past decade, mostly due to the slowdown in the Gulf Cooperation Council (GCC) countries and a shift towards informal channels (Annex IV). With sustained capital inflows, the balance of payments remained in a small surplus and foreign exchange reserves increased slightly to US$34.0 billion (seven months of imports).



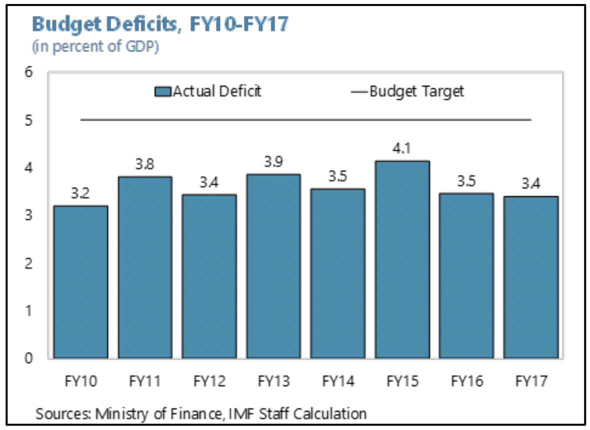


6. During FY18, both reserve and broad money growth slowed, falling below the Bangladesh Bank (BB) target. The slowdown mainly reflects a weaker balance of payments that led to a deceleration of growth in net foreign assets. Total domestic credit growth has been broadly in line with the BB target. However, credit to the public sector has been falling significantly, offset by strong credit growth in the private sector (over 18.0 percent). In response, BB has reduced the maximum advances-to-deposit ratio (ADR) from 85.0 percent to 83.5 percent in January 2018.[3] With liquidity tightening, deposit and lending rates have begun to increase recently.



[3] The ADR limit for the Shariah-based Islamic banks was reduced from 90 percent to 89 percent.

7. The FY17 fiscal deficit was below the budget target. The authorities have maintained a prudent fiscal stance, and the FY17 fiscal deficit was 3.4 percent of GDP, close to the level in previous years, and below the 5.0 percent of GDP budget target. Spending control and slower implementation of development projects more than compensated for revenue underperformance. In the first half of FY18, fiscal performance followed a similar trend: revenue and expenditure growth was less than budgeted, with the H1 deficit below 1.0 percent of GDP, as in FY17.



NEAR-TERM OUTLOOK AND RISKS

8. The macroeconomic situation is likely to remain robust in FY18. Growth is expected to remain strong at around 7.0 percent, led by private consumption and investment. Net exports will continue to contribute negatively due to higher infrastructure-related imports and the temporary need for food imports. Inflation is expected to remain below 6.0 percent, close to BB's 5½ percent average inflation target, with the expected rice harvest recovery. Despite a rebound in remittances and exports, the CA deficit is projected to widen to close to 2.0 percent of GDP due to stronger food, industrial raw materials, and capital machinery imports.

9. Risks to the outlook are broadly balanced (Annex II). In the near-term, the main upside risks stem from robust global demand for exports and stronger recovery of remittances. Downside risks include a resumption of political unrest in the run up to the elections in December, which could affect confidence and investment. Inflation could be higher due to stronger second round effects from high food prices. Sustained increases in non-performing loans (NPL) and weak governance in banking sector could impair its ability to extend credit and support growth, in particular if the economy slows down. In addition, a further deterioration in the financial health of state-owned commercial banks (SOCBs) could undermine fiscal balance. The impact from global trade conflicts will depend on further developments. If higher tariffs are not globally applied and the RMG sector is excluded, then the direct impact could be relatively small given Bangladesh's limited integration in the global supply chain.

10. Slow progress in resolving the Rohingya refugee crisis could add to economic, political, and social pressures (Box 1). Despite the high influx of refugees starting in August 2017, the Bangladeshi government continues to keep its borders open and provide assistance to incoming refugees in coordination with humanitarian agencies. The government has so far managed the additional spending with support from the international community. However, given the uncertainties surrounding the repatriation process, the crisis impact on host communities and the rest of the country could intensify. In the near-term, refugee camps face significant risks from floods and landslides during the monsoons, highlighting the urgent need to upgrade infrastructure. Donor support continues to be essential in meeting spending needs.

Authorities' Views

11. The authorities view that the macroeconomic performance in FY18 will remain stable and robust. They pointed to the growth in industrial production and industrial raw material imports as signs of strong domestic demand and project FY18 growth to be 7.65 percent. They expect that inflationary pressures will continue to ease in the second half of FY18 with an expected recovery in crop harvests. The authorities project a somewhat stronger balance of payment than staff and expect it to remain slightly positive, reflecting the strong growth of exports and remittances. The authorities broadly shared staff's assessment on risks, including potential second round effects from higher food prices and the impact from the Rohingya refugee crisis. However, they expect that risks from political unrest in the run up to the elections will be minimal.

NEAR-TERM MACROECONOMIC MANAGEMENT

A. Monetary and Macroprudential Policies

12. In April 2018, BB eased its monetary policy stance. BB reduced banks' cash reserve ratio (CRR) from 6.5 percent to 5.5 percent and the repo rate from 6.75 percent to 6.0 percent.[4] It also extended the deadline again (to March 2019), which had been already moved earlier (from June 2018 to December 2018), for banks to meet the recently reduced ADR. In addition, the authorities increased the share of state-owned agencies' deposits in the private banks from 20 to 50 percent. The monetary easing was motivated by tightening liquidity conditions from a weaker balance of payments, limited redistribution of liquidity within the banking system, and the increase in bank's deposit and lending rates. Concerns over the bailout of a weak private bank also appears to have contributed to tighter liquidity.

13. The authorities should closely monitor the impact of monetary easing and stand ready to tighten should inflation begin to increase again. With growth projected to remain strong and inflation close to 6.0 percent, the upper limit of the authorities projected range, the authorities need to remain vigilant against second round price effects from elevated food prices and a pick-up in inflation expectations. Monetary easing could also add to inflationary pressures, reignite private credit growth, which has exceeded the BB's target for several months, and further weaken the CA balance. Enhanced supervision of weak banks and targeted conditional liquidity support rather than a broad easing of monetary policy is better suited to shoring up confidence and addressing liquidity problems in individual banks.

14. Macroprudential policies should be utilized to mitigate the financial stability risk from accelerating credit growth. Strong investment demand has contributed to private sector credit

[4] The repo rate has been previously cut by 50 basis points in January 2016, and the CRR was reduced from 7.0 percent to 6.5 percent in June 2014.

growth. However, high NPLs and weak bank governance point to potential financial stability risks from rapid credit growth and call for macroprudential measures to mitigate these risks. The recent tightening of the ADR was appropriate, and the new limits should be strictly enforced. The authorities should avoid relaxing the existing caps on credit growth in the SOCBs.

15. The authorities are planning to upgrade the monetary policy framework. Currently, BB operates a quantity-based policy regime, aiming to keep broad money growth in line with its inflation objective. Over the medium-term, it plans to move towards interest rate targeting which will strengthen the monetary policy transmission mechanism. This move should emphasize (i) the importance of price stability as BB's primary objective; (ii) the need for greater exchange rate flexibility to enhance monetary policy autonomy; (iii) further development of financial markets; and (iv) the need to strengthen forecasting of banking and government sector liquidity.

16. BB has introduced various measures to mitigate risks from breaches in cyber security. Of the US$81.0 million stolen in the 2016 reserve heist, approximately US$15.0 million has been recovered, and the authorities are in discussions to recover the remaining amount. The authorities have enhanced the security measures of their internal IT systems, updated the ICT Security Policy, and provided training to its employees. Nevertheless, continuous efforts in upgrading cyber security are still required.

Authorities' Views

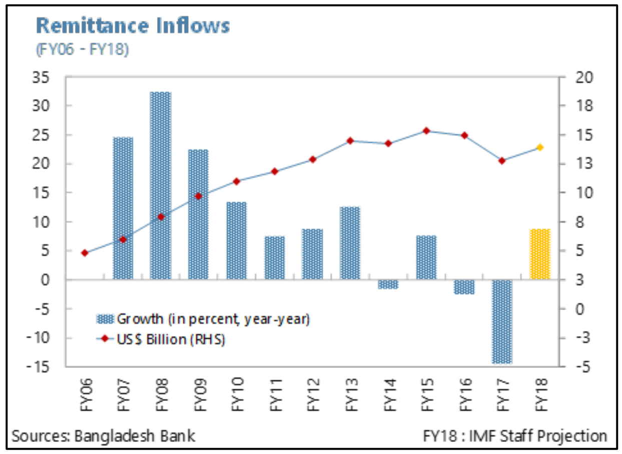
17. The authorities agreed with staff's recommendation that the impact of recent policy easing should be monitored closely to guard against a potential rise in inflation. They explained that the decision to ease monetary policy was motivated by the recent tightening of liquidity conditions with broad money growth in single digits, below the nominal GDP growth, and the risk that banks may have to sharply cut financing to businesses. The authorities noted that the risk to inflation should be contained if the expected bumper rice harvest materializes. They also noted that broad money growth remains close to nominal GDP growth and do not expect inflationary pressures arising from monetary developments. In addition, wage growth remains stable and well anchored. The authorities observed that the acceleration in private credit growth mainly reflects large imports related to megaprojects and is expected to moderate. Nevertheless, they were concerned that, in some banks, credit growth has exceeded prudent levels and decided to reduce the ADR to promote financial stability by ensuring that the pace of credit is in line with deposit growth.

B. External Development and Exchange Rate Policy

18. The overall external position in FY17 is assessed to be broadly in line with fundamentals and desired policies (Annex III). The CA deficit in FY17 mainly reflected higher investments, instead of lower savings. After a long period of appreciation, the Taka real exchange rate has recently started to depreciate vis a vis trading partners. While reserve growth in FY17 has been modest, reserve coverage remains adequate at seven months of imports. Given the high share of concessional borrowing, the risk of external debt distress continues to be low. The authorities should continue to rely on concessional financing to the extent possible for externally-financed infrastructure spending.

19. The authorities should continue to gradually increase exchange rate flexibility. The de jure exchange rate arrangement is floating, and the central bank intervenes in the foreign exchange market to keep the exchange rate relatively stable against the US dollar. Enhanced flexibility would help buffer the economy against external shocks, preserve the level of reserves, and increase monetary policy autonomy.

20. Remittances are recovering due to an uptick in non-oil growth in the GCC and stronger global growth (Annex IV). Remittances inflows have more than doubled over the past decade, reaching around US$15 billion in FY16, supported by the trend of workers migrating abroad. However, inflows declined sharply in FY17 despite higher outflows of migrant workers. External conditions in the GCC countries coupled with an increase in informal channels of remitting are some factors behind this sharp decline. The economies in the GCC have since recovered, and the authorities have taken various measures to increase the use of formal financial channels. Official flows have rebounded thus far in FY18.

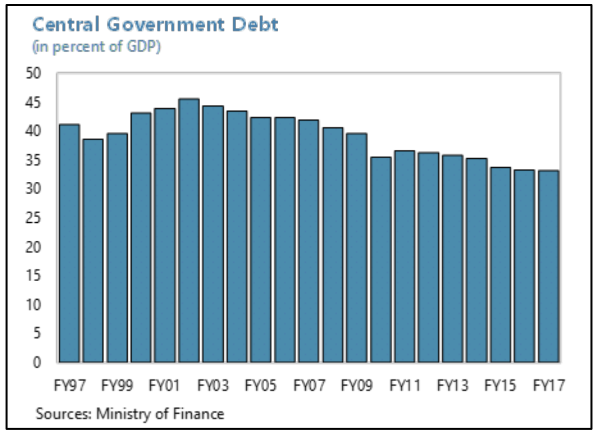


Authorities' Views

21. The authorities' views on the external position were broadly in line with staff's. They agreed that the CA deficit was driven mainly by large capital imports related to mega-projects and food grain imports due to crop loss and that this deficit is likely to continue over the short to medium-term. They agreed that the reserve coverage is adequate and that reserves are expected to benefit from the strong growth in export earnings and a rebound in remittances. They noted that the recent depreciation of the Taka reflects an increased demand for foreign currency from higher imports. The authorities continue to view excessive exchange rate fluctuations as undesirable and thus intervene in the market as needed to avoid large movements. Looking ahead, they do not expect the balance of payments pressures to increase given the expectation of stronger flows into the financial account. The authorities have taken a cautious and gradual approach in relaxing capital account regulations. They have liberalized restrictions on inflows extensively and will continue to take a gradual approach for resident-owned investment outflows as the country further integrates into the global economy and develops domestic financial markets.

C. Fiscal Policy

22. Fiscal policy should aim to keep the public debt ratio broadly stable over the medium-term, while increasing tax revenues. Staff welcomed the continued expenditure restraint and the authorities' commitment to keep deficits under the control, despite repeated revenue shortfalls relative to the budget targets. Given the economy's strong growth, there is currently no need for fiscal stimulus, and the FY18 fiscal deficit should remain at around 4.0 percent of GDP as in recent years. Looking ahead, staff argued that budgeted spending growth should continue to be aligned with realistic projections of revenue growth. In FY19, the authorities are not considering any major tax policy reforms. Therefore, it is important to continue restraining spending growth, particularly for current expenditures, in line with the revenue increase, while an urgent need to boost tax revenues remains.



23. The authorities are making welcome progress in implementing the 2016-21 public financial management reform strategy. The Integrated Budget and Accounting System (IBAS++) and the new Budget and Accounting Classification System (BACS) will significantly improve the timeliness of data reporting for both monthly and annual fiscal data. Further reforms should aim at improving the transparency and financial control of budget allocations, the real-time monitoring of budget execution, and the integration of recurrent and the Annual Development Program (ADP) spending. The Public Investment Management Assessment (PIMA) planned by Fund staff will help strengthen the relevant policy framework.

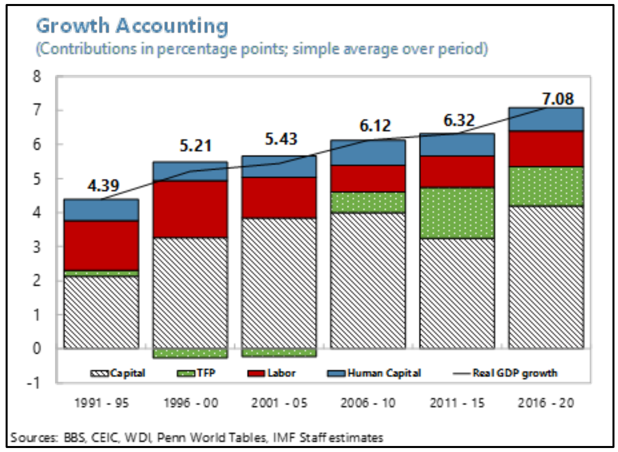
Authorities' Views

24. The authorities emphasized that they remain committed to prudent fiscal policy. They acknowledged staff's view that no additional fiscal stimulus is needed in this fiscal year given the economy's strong momentum, but also argued that fiscal policy plays an important role in supporting growth. The authorities noted that while ADP implementation will accelerate in the remainder of FY18, the deficit will stay within the 5.0 percent of GDP budget target. Given that elections are scheduled for late 2018, they are not planning on any new policy initiatives in the FY19 budget, though some budget allocation may be needed for the Rohingya refugee crisis. The authorities emphasized that fiscal policy continues to be guided by the 2009 Public Money and Budget Management Act, which stipulates that public debt as a percent of GDP should be reduced gradually every year.

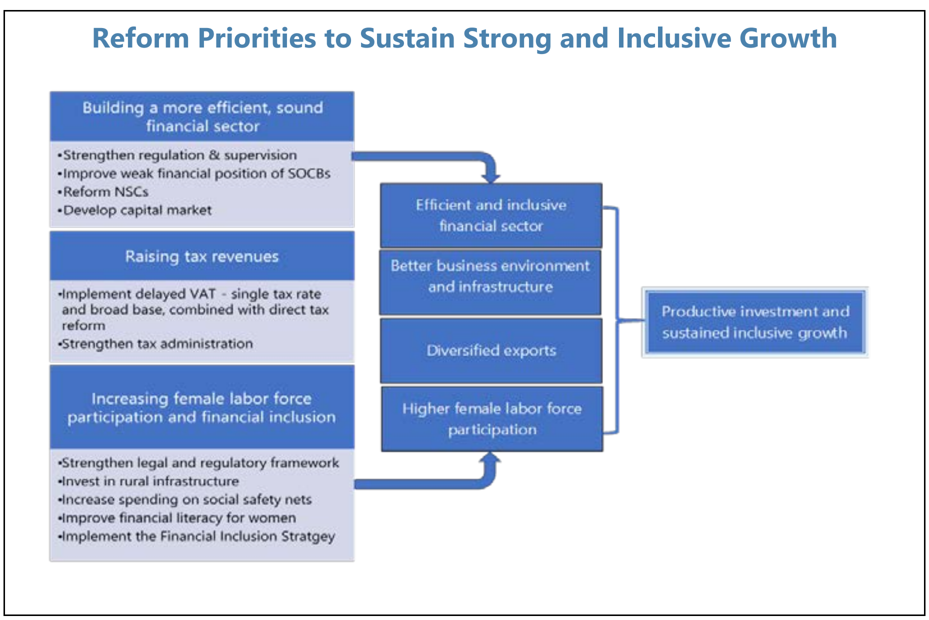
SUSTAINING STRONG AND INCLUSIVE GROWTH

A. Challenges

25. Staff projects medium-term real GDP growth to be around 7.0 percent. The authorities' 7th Five-Year Plan includes a growth target of 7.4 percent growth on average between FY16 - FY20. A growth accounting exercise (Annex V) estimates potential growth over the same period to be a little over 7.0 percent, higher than many neighboring economies with similar income levels. These estimates are broadly consistent, and maintaining this growth is conditional on continued reforms. Contributions from both the labor force and productivity are expected to be modest, leaving capital formation to be the main growth driver.



26. Sustaining strong growth will require enhancing productive investments. This requires addressing key bottlenecks in the economy. To effectively mobilize long-term capital for investment, the financial sector needs to be more efficient by reforming the banking sector and developing capital markets. In addition, the government needs to raise tax revenues to create the fiscal space to upgrade infrastructure, such as electricity, roads, rails, and ports. This will in turn improve the business environment, attract FDI, and diversify exports. Recent government efforts to improve the business environment are encouraging (Annex VI). Further efforts to boost female labor participation and financial inclusion will also help inclusive growth.



B. Building a More Efficient, Sound Financial Sector

27. Banks continue to struggle despite the strong economy. The ratio of NPLs to total loans remains high and continues to grow. The NPL problem is particularly acute for the SOCBs, with NPLs approaching 30 percent of total loans (see *Selected Issues Paper*) and provisioning below required levels by Tk. 75.7 billion (0.4 percent of GDP)[5]. Private commercial banks (PCBs) as a whole remain well capitalized at around 12 percent of regulatory assets, but two PCBs are below the 10 percent regulatory requirement.[6] Following a loan scandal, one private bank was subject to an arranged bailout, involving four SOCBs. For SOCBs, the average capital ratio is only 5.6 percent, with three out of six SOCBs having capital levels below the regulatory requirement. The recent amendment of the Bank Company Act has also raised governance concerns as it increases the number of family members allowed to sit on private bank boards from two to four. The tenure of directors has also been extended from six to nine years. Additional banking licenses under consideration could further challenge banking supervision and regulation.

28. Banking regulation and supervision should continue to be strengthened and avoid regulatory forbearance. BB should continue to move towards risk-based supervision, supported by reforms to (i) give BB regulatory power necessary for effective supervision, including the power to remove directors from a SOCB's board and (ii) strengthen banks' internal control and risk management systems and corporate governance. At the same time, the legal and financial framework needs to be enhanced to expedite the loan recovery process and strengthen creditors' rights. By avoiding regulatory forbearance, banks that fail to meet regulatory standards will face stronger incentives to improve their performance. The authorities also need to establish a resolution regime that can be used to resolve banks effectively, in line with international best practice.

29. Resolute steps are needed to improve the weak financial position of the SOCBs. If left unaddressed, the SOCBs problems would further deteriorate trust in the banking sector and risk increasing contingent liabilities and misallocation of resources. In the near-term, the authorities should focus on strictly enforcing the Annual Performance Agreements (APA) and Memoranda of Understanding (MoU) with the SOCBs as well as the fit and proper criteria in selecting SOCB management.[7] The use of public funds to recapitalize the SOCBs should be conditional on the SOCBs meeting the APA's and MoU's targets, and in case of missing the targets, strict remedial actions, including against management, should be adopted quickly. Over the medium-term, the authorities should reassess the need for several SOCBs and their roles. The public policy role assigned to SOCBs should be clearly formulated, with transparent budgetary support, and a divestment program should be implemented to reduce the number of SOCBs.

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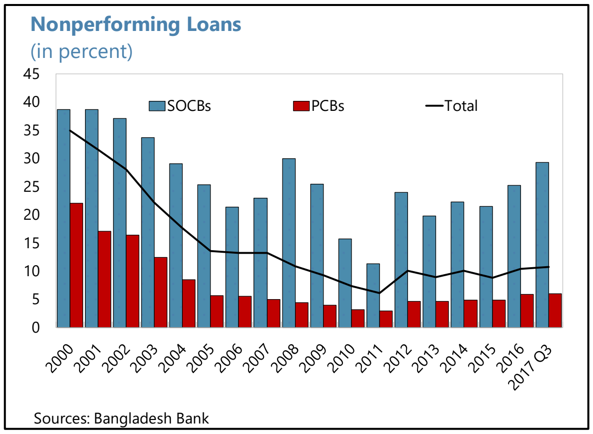
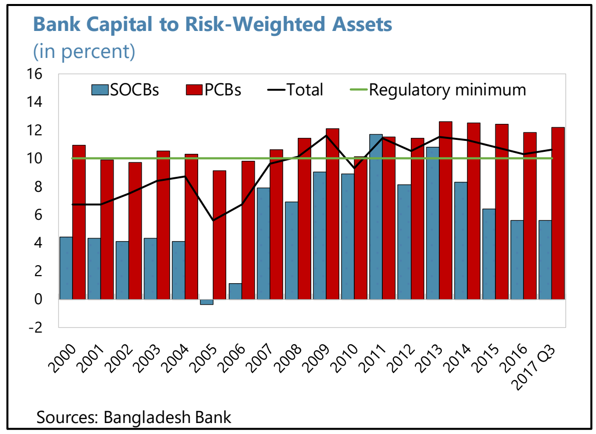
[5] The total amount of SOCBs' loans is 1,317 billion Taka (6.7 percent of GDP). Of which, NPLs are 385.9 billion Taka (2.0 percent of GDP.)

[6] There are 40 PCBs in Bangladesh.

[7] MoUs are signed annually between BB and the SOCBs, with specific quantitative targets (see *Selected Issues Papers*). In addition, SOCBs sign an APA with the Ministry of Finance. The APA sets out specific objectives for the SOCBs, such as minimum loans to agriculture or small and medium-sized enterprises.





30. Steps to strengthen the banking sector should be accompanied with continued efforts to develop the capital market. Well-functioning capital markets are needed to provide long-term financing to support investment. The authorities continue to implement their Capital Market Development Master Plan, and with the support of the Asian Development Bank, have made progress, including better regulations and demutualization of the stock exchange. However, the large issuance of National Saving Certificates (NSCs) still poses an important obstacle to capital market development and needs to be addressed urgently.

31. The continued high issuance of NSCs presents various drawbacks (see *Selected Issues Paper*)**.** In FY17, about two thirds of the fiscal deficit was financed by NSCs, with issuance reaching 2½ percent of GDP, a record high. The original objective of NSCs was to provide a means of savings and income support in the absence of a well-developed banking system and adequate safety nets. However, the banking system is now more developed and accessible, and the high level of NSCs creates wide-ranging problems, including (i) increasing the cost of government financing; (ii) weakening debt management and hindering control of the composition of deficit financing; (iii) reducing liquidity of government security markets and monetary policy effectiveness; and (iv) limiting the supply of risk-free assets for deposit-taking banks. The authorities should develop a plan to phase out and replace NSCs with more targeted transfers from the budget by:

- Tightening and strictly enforcing its eligibility to reduce the demand for NSCs. Reforms could include introducing a database recording details of existing holders, reducing the number of instruments, and reviewing eligibility criteria, limiting access only to retail investors.

- Revising the pricing mechanism to reduce the attractiveness of NSCs by linking the NSC rates directly to government security yields to reduce the spread.

Authorities' Views

32. The authorities viewed the overall banking sector as stable despite capital adequacy concerns in a few banks. They agreed that there remains scope for improving banking sector regulation and strengthening enforcement, for which they have taken various actions with a sense of urgency. Macro-prudential measures have been used to restrain unproductive lending, including closer surveillance of banks' adherence to Asset Liability Management and Forex Risk Management guidelines, strict surveillance of end use of bank loans, and encouragement of banks to limit medium- and long-term investment loans to corporate borrowers. The authorities are also planning to develop and implement a risk-based supervision framework. They agreed that corporate governance in banks should be improved to curtail risky loans and bring down high NPLs. The NPL recovery rate remains a challenge partly due to the current lengthy legal processes. With respect to the supervision of SOCBs, the authorities emphasized that the central bank has full operational autonomy without government intervention. They also pointed out that the monitoring framework of SOCBs has been strengthened which should gradually improve the situation.

33. The authorities shared staff's view about the crucial role of an effective capital market in mobilizing savings and supporting investment and growth. They also acknowledged that the high issuance of NSCs is hampering the development of the capital market and emphasized that NSC reform is a priority. A reform plan has been approved, including creating a database of existing investors as a first step and linking these to the investors' National Identity Cards, which will improve monitoring and reduce misuse. They added that in the medium to long-term, structural reforms of NSC, including the reform of the pricing mechanism, will be considered.

C. Raising Tax Revenues

34. Tax reforms are urgently needed to increase the very low tax revenues. With tax revenues below 10.0 percent of GDP, there is a pressing need to boost collection. This will create room for increased public investment and improved social safety nets, without undermining fiscal sustainability. Staff emphasized that despite repeated delays, the priority to implement the delayed VAT soon remains, preferably with a single tax rate and broad base. In addition, work on direct tax reform should continue, focusing on tax system simplification and tax base broadening.

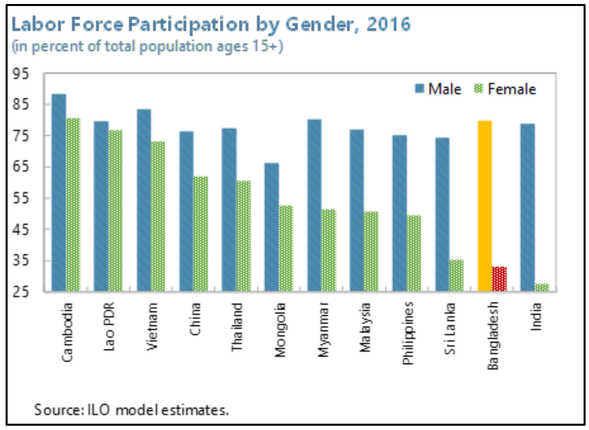
35. Tax reforms need to be accompanied by continued effort to strengthen tax administration. The authorities' efforts to increase tax compliance and facilitate tax filing appears to be delivering some positive results, with the number of registered taxpayers and tax filings increasing. Enhanced risk-based auditing, online taxpayer registration, and electronic filing of tax returns should strengthen institutional capacity and help smooth implementation of the new VAT law. However, tax administration in Bangladesh continues to lag behind international good practices in many areas, and the authorities should focus their effort on upgrading practices in these areas.

Authorities' Views

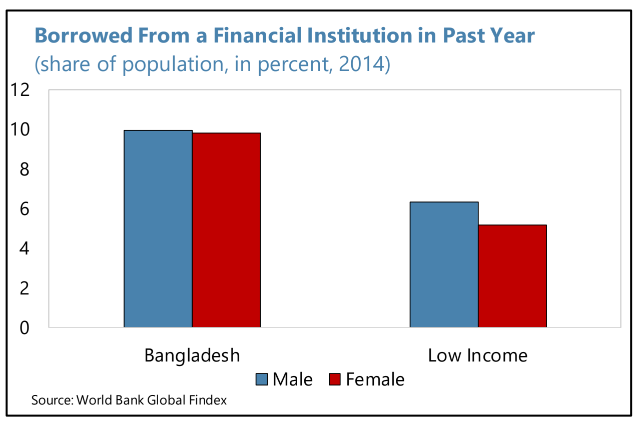
36. The authorities shared staff's view that revenue mobilization remains an important policy priority. They recognized that postponing the launch of the VAT reform will have a temporary adverse impact on planned revenue collection, but emphasized that this impact should be mitigated by their ongoing efforts to strengthen tax administration. They noted several positive achievements under the direct tax policy reforms, including the increased registration of new taxpayers (from 1.9 million in 2016 to 3.3 million in 2018 thus far) and a significant improvement in return filing. The authorities are also increasing their efforts to settle big tax arrears cases pending in the courts by applying Alternative Dispute Resolution mechanisms. Finally, progress has been made in improving customs risk management, with the objective being to implement a digitalized risk management regime.

D. Promoting Inclusive Growth

37. Boosting the low female labor force participation is key for raising potential growth (Annex VII). The female labor force participation rate remains low in Bangladesh in comparison with comparator countries. Constraints range from large informality, marital status, mismatch of skills, access to finance, poor infrastructure, and disparities in wages. Higher spending on education and vocational training is needed as it not only enhances job prospects and addresses skill mismatch, but also addresses social causes, including a reduction in female child marriages. Access to health services is critical as it helps reduce the time-consuming health care obligations in the family while quality maternal health care is vital for re-entering the labor force. Investment in rural infrastructure such as access to clean water, electricity and reliable and affordable transportation would reduce the time spent on domestic tasks and increase safety. Along with these measures, a strong legal framework will help boost participation.



38. The substantial progress on financial inclusion should continue. The steady progress in financial inclusion has been led by the diversification of service delivery channels, including digital financial services (Annex VIII). Financial literacy is improving through programs with agencies such as the Bangladesh Securities and Exchange Commission and companies like MasterCard. Confidence in the formal financial sector is still low. Strengthening the legal and regulatory framework and the prompt adoption of the new Secured Transactions Law should enhance access to credit. The forthcoming National Financial Inclusion Strategy should be implemented rigorously with a strong accountability framework.



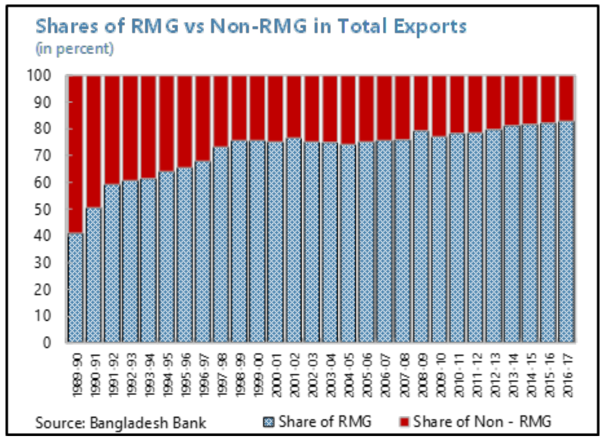
Authorities' Views

39. The authorities emphasized that Bangladesh has been a pioneer in financial inclusion and gender empowerment and agreed that progress in both will also promote inclusive

growth. They emphasized that strategies to promote financial inclusion continue to be a part of the central bank's sustainable growth agenda and are included in the seventh national five-year plan. Bangladesh's growth model has substantially benefitted from female labor force participation in the RMG, agriculture and service sectors. The authorities are working with development partners and have taken number of initiatives to address constraints such as lack of skills and education, and agreed that upgrading infrastructure will improve participation and promote inclusive growth.

E. Export Diversification

40. With limited diversification, exports remain concentrated in the RMG sector. New products and growing sectors, such as footwear, leather, and pharmaceuticals are showing potential for diversification, but the share of the low-skilled RMG sector in total exports remains high at around 80 percent. To promote diversification, the authorities should continue to invest in infrastructure and human capital, lower barriers for new businesses, and review the existing tariff structure faced by the non-RMG sector, with the objective of gradually reducing the effective tariff protection in the domestic market (see *Selected Issues Paper*).



OTHER ISSUES

41. The authorities should continue strengthening their anti-money laundering and counter-terrorist financing (AML/CFT) framework. An assessment by the Asia/Pacific Group on Money Laundering (APG) in 2016 acknowledged significant progress in AML/CFT framework, while identifying areas for further improvement (i.e., preventive AML measures, transparency of legal persons and arrangements, money laundering investigations and prosecutions, and confiscation). Customer due diligence for politically exposed persons and ensuring transparency of beneficial ownership information should be enhanced to mitigate corruption risks identified by APG. Continuous improvement in cooperation among various government agencies and capacity enhancement in the Anti-Corruption Committee (ACC) would further strengthen the framework.

42. Safeguards assessment. The 2011 safeguards assessment update of BB found that the governance and legal structure need to be updated to strengthen autonomy and thus better safeguard resources. BB continues to face significant capacity challenges in many areas that impact its changing internal control environment, including risk management, internal audit, and the quality of financial reporting. While BB's audit committee was reestablished in April 2017, its strong oversight is critical in relation to areas of importance to safeguards.

STAFF APPRAISAL

43. The Bangladesh economy continues to perform well with strong and stable growth. Growth has remained robust over the last decade with significant progress in poverty reduction and improved social indicators. Going forward, sustaining strong growth will require enhancing productive investments through a more efficient financial sector, better infrastructure, and an improved business environment.

44. The near-term growth outlook remains robust and risks to the outlook are broadly balanced. Domestic demand will continue to be the main source of growth, led by private consumption and investment. A resumption of political unrest and potential second round effects from high food prices are downside risks, while global demand for exports and recovery of remittances could provide upside surprises. Global trade conflicts could affect the outlook, depending on further developments.

45. The authorities should monitor the impact of recent monetary easing and stand ready to tighten in case inflation increases again. The BB should address liquidity problems of individual banks through targeted conditional liquidity support. Macroprudential policies should be utilized to mitigate the financial stability risk from accelerating credit growth.

46. A gradual increase in exchange rate flexibility would help buffer the economy against external shocks. It would also preserve the level of reserves, provide the flexibility to enhance monetary policy, and strengthen monetary policy autonomy.

47. Fiscal policy should continue to keep public debt broadly stable over the medium-term. With tax revenue growth limited and no major tax measures envisaged in the next fiscal year, keeping budget deficits and public debt within the authorities' objectives requires continued expenditure restraint. Donor support will continue to be essential in meeting spending needs to address the Rohingya refugee crisis.

48. Addressing weaknesses in the banking sector is a priority. Regulatory forbearance should be avoided, and banking regulation and supervision need to be strengthened, including a move from compliance-based to a risk-based supervision and enhancement of banks' internal control and risks management systems, particularly corporate governance. NPL resolution needs to be accelerated, and a robust resolution framework for troubled banks is required. The monitoring mechanism of SOCBs must be strictly enforced, and their public policy role should be clearly formulated with transparent budgetary support. The number of SOCBs could be eventually reduced through a divestment program.

49. Efforts to develop the capital market should continue to effectively mobilize long-term capital for investment. The authorities have made important progress in improving the stock market, but thus far, capital market financing remains limited. Reforming the NSC scheme is a priority.

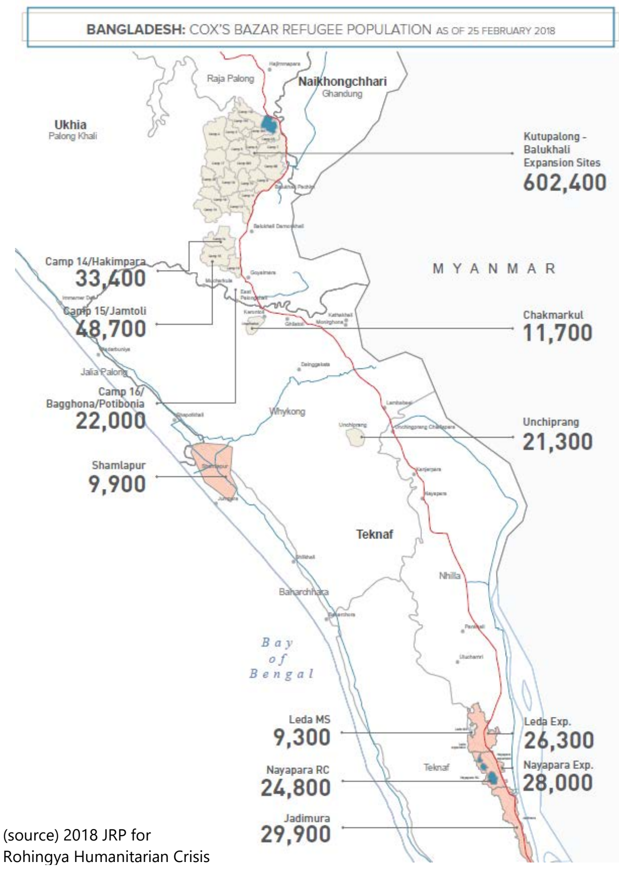
50. Tax revenues remain low and tax reform is urgently needed to create the fiscal space for improving public investment and social safety nets. This should include the implementation of the repeatedly delayed VAT reform, overhaul of the direct tax system, and continued strengthening of tax administration.

51. Higher female labor participation and further progress in financial inclusion will help sustain strong and inclusive growth. Increasing expenditure on health, aligning vocational training to market demands, improving rural infrastructure, and strengthening labor laws will help increase female labor participation. Efforts to boost financial inclusion need to continue with improving access to finance, especially for women, and instilling confidence in formal finance. Increasing financial literacy is also important.

52. Staff recommends that the next Article IV consultation be held on the standard 12-month cycle.

Box 1. Addressing the Rohingya Refugee Crisis

The Rohingya are a stateless Muslim minority in Myanmar. The latest exodus began on August 25, 2017, when violence broke out in Myanmar's Rakhine State. A majority of the refugees are women, children, and the elderly. As of March 2018, 671,000 Rohingya had crossed over into Bangladesh.[1] With an estimated refugee population of 217,000 in Cox's Bazar before August 2017, new arrivals bring the total refugee population close to 900,000. Around 336,000 members of the host community have been affected by the expansion of the Kutupalong-Balukhali site, now considered the largest refugee camp in the world, and smaller camps in Ukhia and Tekhnaf.



(source) 2018 JRP for Rohingya Humanitarian Crisis

Reacting to the crisis, the Government of Bangladesh kept its borders open, allocated forestry land, and provided assistance to incoming refugees in coordination with humanitarian agencies. An arrangement was reached between Bangladesh and Myanmar in November 2017 providing for the repatriation of refugees affected by the most recent events, a process expected to be completed by January 2020. Progress has been slow and the UNHCR has since underscored that returns should be safe and voluntary, and experts have called for third party involvement.

The international community responded in October 2017 by pledging US$360.0 million under the Rohingya Refugee Crisis Response Plan to meet the needs of existing and newly-arrived refugees until the end of February 2018. In addition, several donors announced in-kind assistance worth more than US$50.0 million, and public fundraising campaigns were launched in several countries.[2] A second Joint Response Plan was launched in March 2018 to cover the needs of both refugees and host communities until the end of 2018, with a funding request of US$951.0 million, equivalent to about 0.4 percent of GDP. The UNHCR launched a supplementary appeal for 2018, amounting to US$238.0 million, to enhance the protection of refugees and step up emergency preparedness.

Box 1. Addressing the Rohingya Refugee Crisis (concluded)

The precise impact of the crisis on the budget will depend on the comprehensiveness of relief efforts, the extent to which donor support continues, and the extent to which the government is able to address unmet needs moving forward. In this fiscal year, the authorities are addressing requests by line ministries as they emerge and are confident that, with external financing and some re-allocations, additional spending pressures can be met without exceeding the budget deficit target. In the immediate-term, with the monsoon rains, flooding and landslides present an acute risk. Congestion is a core protection challenge in Kutapalong-Balukali, with at least 150,000 refugees considered to be at risk and urgently requiring relocation.

In the medium and long term, the economic, social, and environmental impacts could be large if repatriation does not proceed as swiftly as planned. Donor support could wane. Refugees are now based in an already densely populated area, where the poverty rate is well above the national average and where there is considerable pressure on natural resources. These factors could lead to rising social tensions between the Rohingya refugees and host communities, underscoring the need for investments in key social services, economic infrastructure, and environmental rehabilitation.

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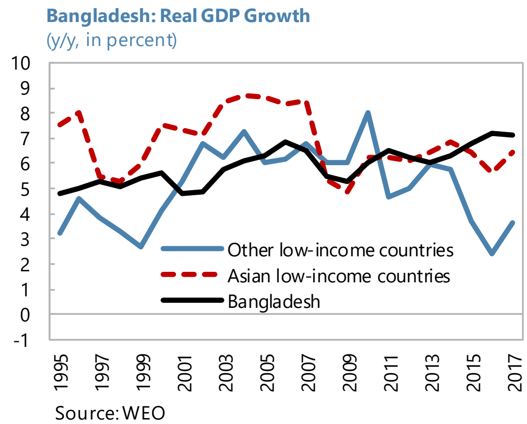
[1] https://reliefweb.int/report/bangladesh/jrp-rohingya-humanitarian-crisis-march-december-2018-0

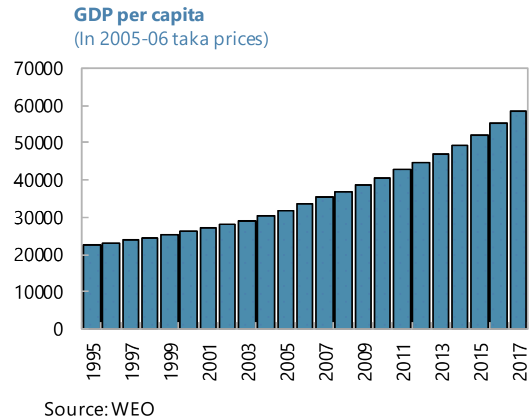
[2] http://www.unocha.org/rohingya-refugee-crisis/rohingya-refugee-cris is-pledging-conference

Figure 1. Bangladesh: Structural Transformation

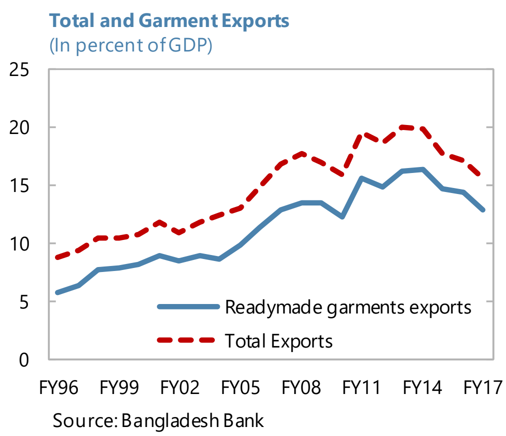
Growth in Bangladesh has been robust and stable…



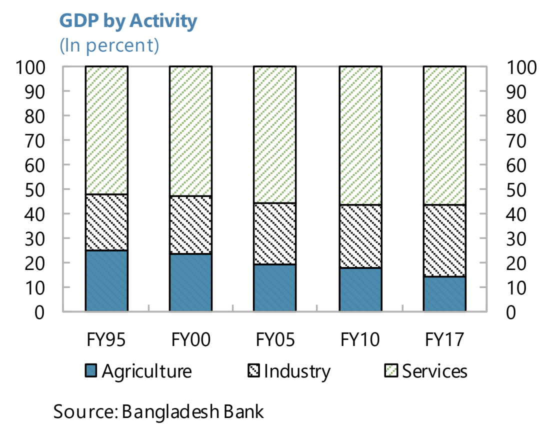
… boosting GDP per capita.



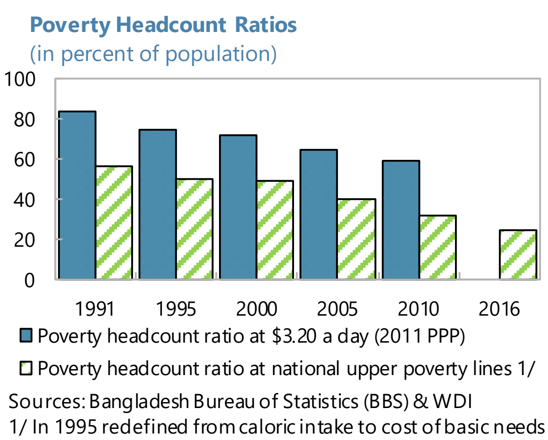
Readymade garment exports have been the main driver of exports though growth has moderated recently.



The share of agriculture has shrunk, while industry and services expanded.



Poverty has declined significantly since 1991.



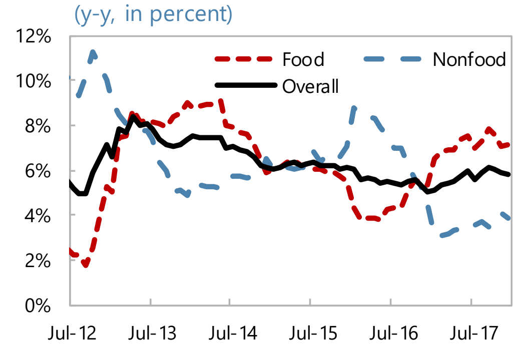
Income inequality remained broadly stable.

Figure 2. Bangladesh: Recent Macroeconomic Developments

Headline inflation slightly picked up in 2017…

Inflation Rates

(y-y, in percent)

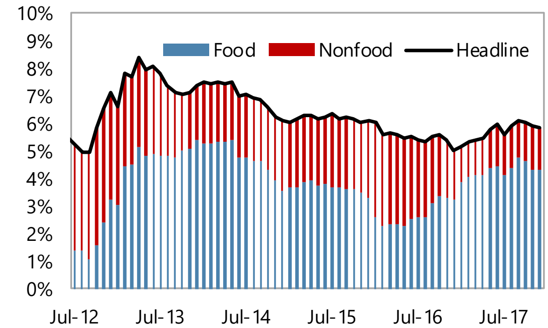


Source: Bangladesh Bureau of Statistics

… led by increases in food prices

Contributions to Inflation

(y-y, in percent)

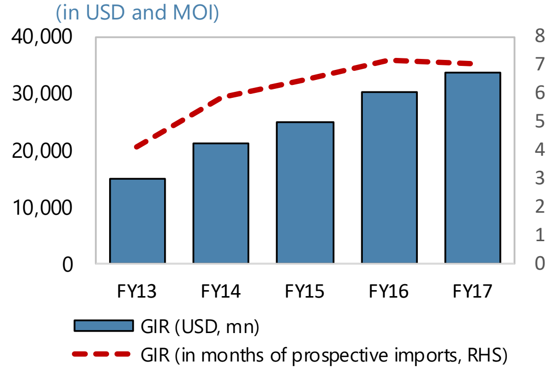


Source: Bangladesh Bureau of Statistics

Foreign exchange reserves have been stable and cover about 7 months of prospective imports at the end of FY17.

Gross International Reserves

(in USD and MOI)

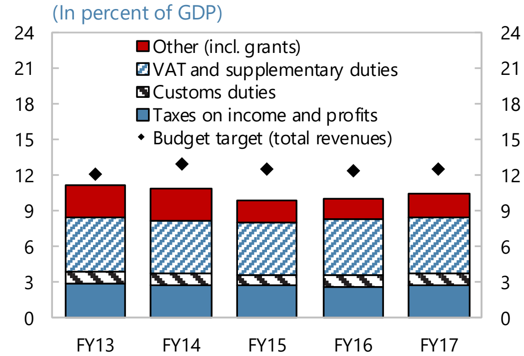


Source: Bangladesh Bank

Fiscal revenues have not increased and fell short of budget targets in recent years.

Central Government Revenue

(In percent of GDP)

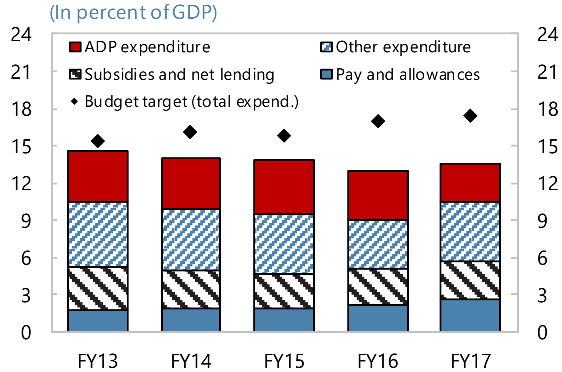


Source: Ministry of Finance

Current expenditure has been stable and capital spending has slightly declined recently.

Central Government Expenditure

(In percent of GDP)

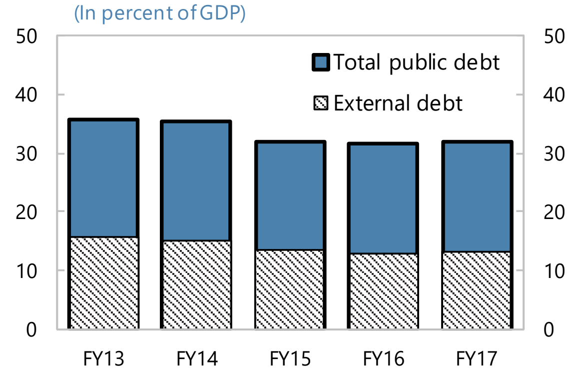


Source: Ministry of Finance

The public debt as percent of GDP has slightly declined.

Public Debt

(In percent of GDP)

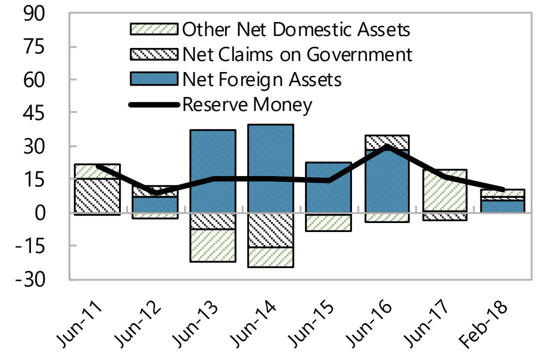


Source: Ministry of Finance

Figure 3. Bangladesh: Monetary and Financial Market Developments

Reserve money growth has moderated recently…

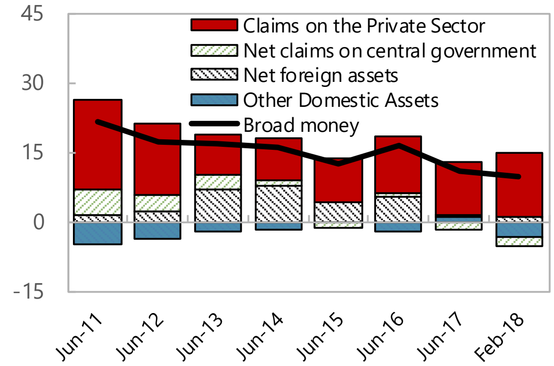
Contributions to Reserve Money Growth
(in percent, year-on-year)



Source: Bangladesh Bank

… with a similar trend for broad money growth.

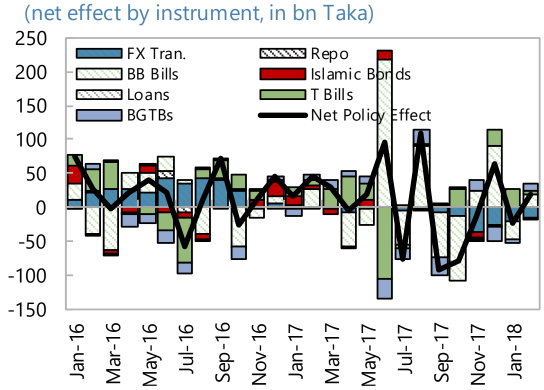
Contributions to Broad Money Growth
(in percent, year on year)



Source: Bangladesh Bank

Central bank's liquidity support declined toward the end of 2017…

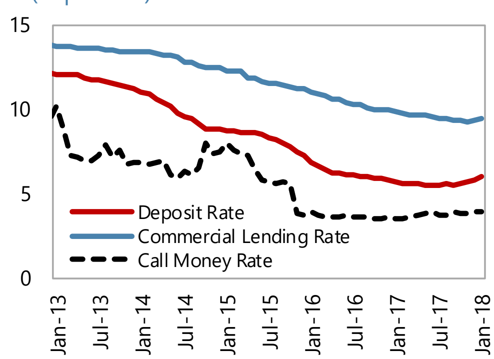
Liquidity Management Operations
(net effect by instrument, in bn Taka)



Sources: Bangladesh Bank; and IMF Staff calculations

Interest rates picked up recently.

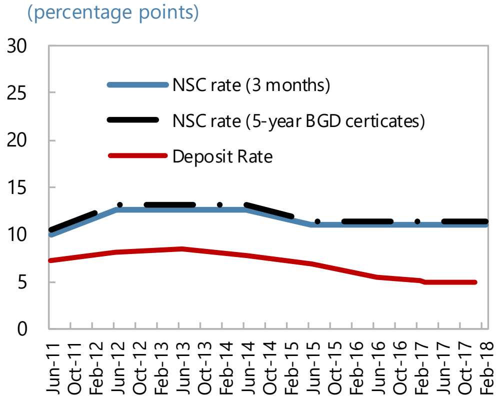
Interest Rates
(in percent)



Source: Bangladesh Bank

Wide spread between NSC rate and deposit rate remains.

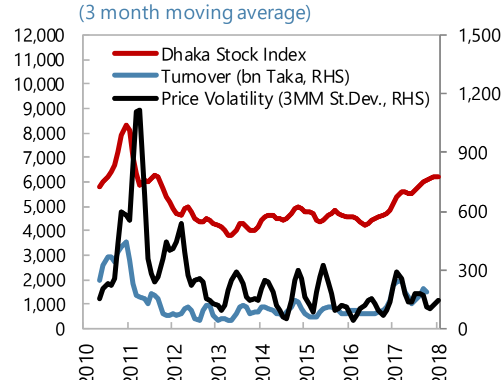
NSC and Commercial Banks' Rates
(percentage points)



Source: Bangladesh Bank

Stock market continues to perform well.

Dhaka Stock Market Performance
(3 month moving average)

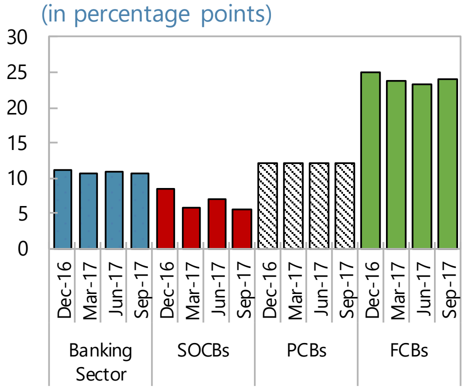


Source: Bloomberg

Figure 4. Bangladesh: Banking Sector Conditions

Banking sector as a whole has sufficient capital, while SOCBs continue to face challenges.

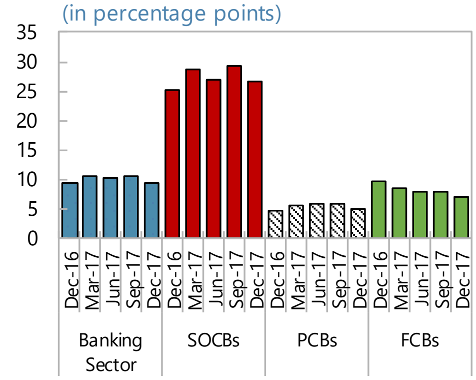
Capital Adequacy Ratio
(in percentage points)



Source: Bangladesh Bank

NPLs continue to grow, particularly in SOCBs.

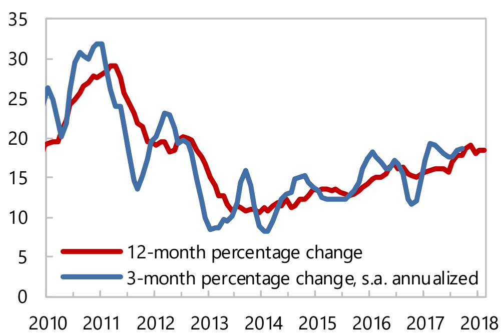
Non-Performing Loans
(in percentage points)



Source: Bangladesh Bank

Credit to the private sector continues to accelerate…

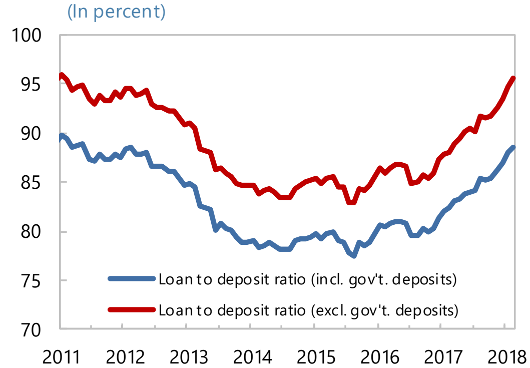
Bank Credit to Private Sector, Jan. 2010–Feb. 2018
(Percent change)



Source: Bangladesh Bank

… pushing up the loan-to-deposit ratio.

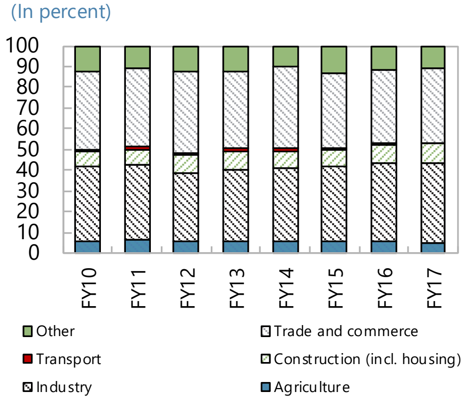
Loan-to-Deposit Ratio, Jan. 2011–Feb. 2018
(In percent)



Source: Bangladesh Bank

Bank credit mostly goes to industry and services…

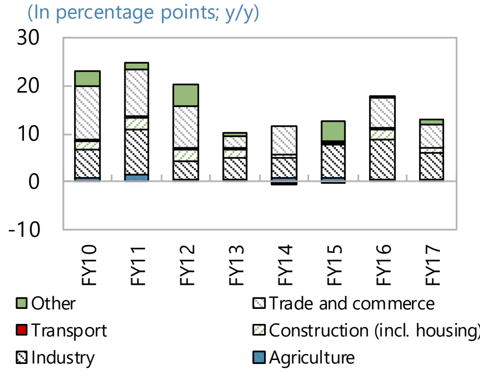
Share in Bank Advances by Economic Purposes
(In percent)



Source: Bangladesh Bank

… with a large contribution to overall credit growth.

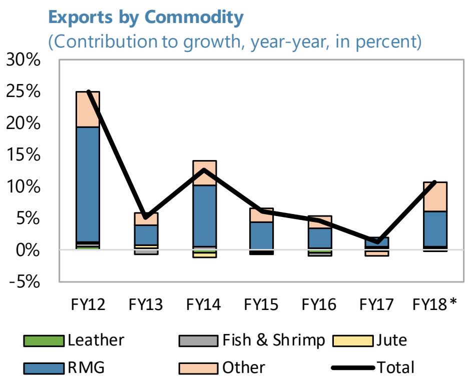
Contribution to Growth in Bank Advances by Economic Purposes
(In percentage points; y/y)



Source: Bangladesh Bank

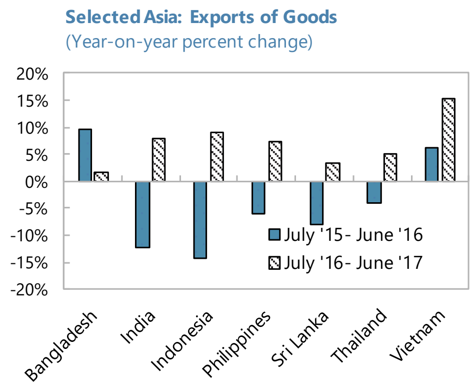
Figure 5. Bangladesh: External Sector Developments

Export growth has picked up recently with recovery in RMG exports after slower growth in FY17…



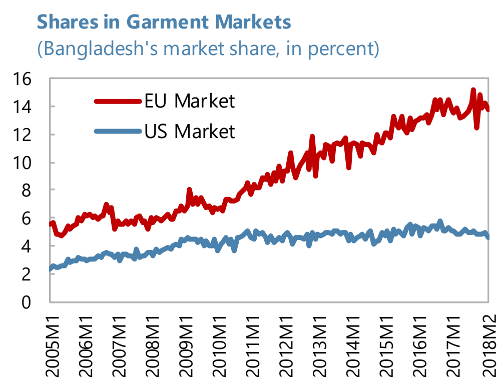
Source: Bangladesh Bank *=July 17-Jan 18 vs. previous year

… while Bangladesh's regional competitors recorded higher export growth in FY17.



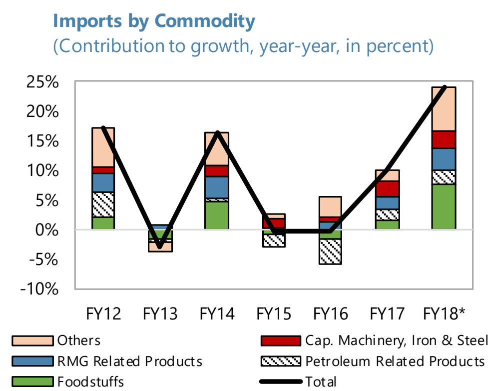
Source: Bangladesh Bank and Haver Analytics

Bangladesh's garment exports to the EU have been strong.



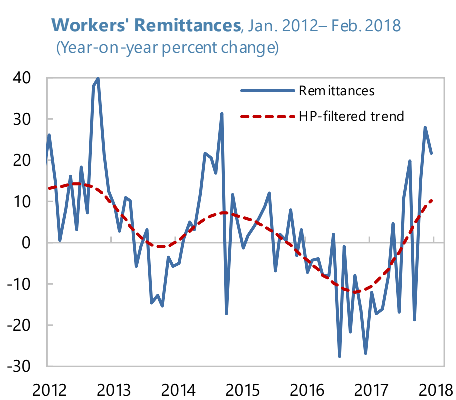
Source: Eurostat and US Department of Commerce

Imports picked up recently with higher imports of food, industrial raw materials, and capital machinery.



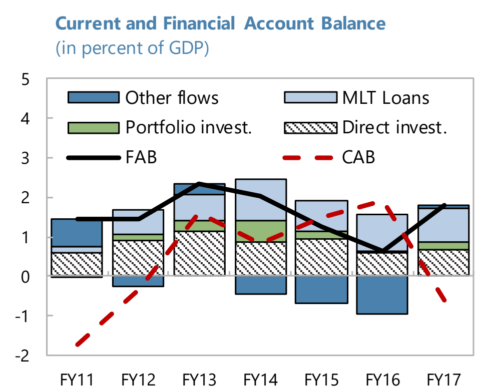
Source: Bangladesh Bank *=July 17-Jan 18 vs. previous year

Inbound remittances have recovered after decline in FY17.



Source: Bangladesh Bank and Staff Calculations

The current account turned into deficit in FY17



Source: Bangladesh Bank

Table 1. Bangladesh: Selected Economic Indicators, FY2014–18 1/

I. Social and Demographic Indicators

Population (FY16, millions; estimate)	161	Infant mortality (2015, per thousand live births)	31
GDP per capita (FY16, U.S. dollars)	1378	Life expectancy at birth (2014, years)	72
Labor force participation rate (FY10, percent; national measure)	59	Adult literacy (2015, percent of people)	62
Poverty headcount ratio (2010, national measure, percent)	32	Population dependency ratio (2015, percent)	52
Gini index (World Bank estimate)	32	Population growth (FY16, y/y, percent; estimate)	1.3

II. Macroeconomic Indicators

	FY14	FY15	FY16	FY17	FY18
				Prelim.	Staff proj.
National income and prices (annual percent change)					
Real GDP	6.1	6.6	7.1	7.3	7.0
GDP deflator	5.7	5.9	6.7	6.3	6.0
CPI inflation (annual average)	7.3	6.4	5.9	5.4	5.9
CPI inflation (end of period)	7.0	6.3	5.5	5.9	5.9
Nonfood CPI inflation (end of period)	5.4	6.2	7.5	3.7	3.9
Central government operations (percent of GDP)					
Total revenue and grants	10.9	9.8	10.1	10.2	10.7
Total revenue	10.4	9.6	10.0	10.2	10.5
Tax	8.6	8.5	8.8	9.0	9.4
Nontax	1.8	1.1	1.2	1.2	1.1
Grants	0.5	0.2	0.1	0.1	0.2
Total expenditure	14.0	13.8	13.4	13.6	14.9
Current expenditure	8.2	7.9	8.3	8.3	8.4
Annual Development Program (ADP)	4.1	4.3	4.4	4.1	5.0
Other expenditures 2/	1.7	1.6	0.8	1.1	1.4
Overall balance (including grants)	-3.1	-4.0	-3.4	-3.3	-4.2
(Excluding grants)	-3.5	-4.1	-3.5	-3.4	-4.3
Primary balance (excluding grants)	-1.5	-2.1	-1.6	-1.7	-2.6
Total central government debt (percent of GDP)	35.3	33.7	33.3	33.2	33.4
Money and credit (end of fiscal year; percent change)					
Credit to private sector by the banking system	12.3	13.2	16.8	15.7	14.6
Reserve money 3/	15.4	14.3	30.1	16.3	12.0
Broad money (M2)	16.1	12.4	16.3	10.9	12.9
Balance of payments (billions of U.S. dollars)					
Exports, f.o.b.	29.8	30.7	33.4	34.0	35.9
(Annual percent change)	12.1	3.1	8.9	1.7	5.5
Imports, f.o.b.	-36.6	-37.7	-39.9	-43.5	-49.5
(Annual percent change)	8.9	3.0	5.9	9.0	13.9
Current account balance 4/	1.4	3.5	4.3	-1.5	-4.8
(Percent of GDP)	0.8	1.8	1.9	-0.6	-1.8
Capital and financial account balance	3.5	2.4	1.4	4.8	4.2
Of which: Foreign direct investment	1.5	1.8	1.3	1.7	2.0
Overall balance	5.5	5.0	5.0	2.8	-0.7
Gross official reserves (billions of U.S. dollars) 5/	21.4	24.9	30.2	33.5	32.8
In months of prospective imports of goods and services	5.8	6.5	7.2	7.0	6.4
Exchange rate (taka per U.S. dollar; period average)	77.7	77.7	78.3	79.1	…
Exchange rate (taka per U.S. dollar; end-period)	77.6	77.8	78.4	80.6	…
Nominal effective rate (2010=100; period average)	89.7	95.4	100.4	101.2	…
Real effective rate (2010=100; period average)	107.9	120.7	133.1	139.3	…
Memorandum item:					
Nominal GDP (billions of taka)	13,437	15,158	17,329	19,758	22,414

Sources: Bangladesh authorities; World Bank, *World Development Indicators*; and IMF staff estimates and projections.

1/ Fiscal year begins July 1.

2/ Includes non-ADP capital spending, net lending, food account surplus (-)/deficit (+), and extraordinary expenditures.

3/ Reserve money excludes liabilities arising from banks' foreign currency clearing accounts at Bangladesh Bank (BB) and nonbank deposits at BB.

4/ Imports are based on customs data.

5/ Excludes deposits held in offshore accounts of resident financial institutions, noninvestment grade sovereign bonds, and foreign exchange overdrafts provided by BB to domestic banks.

Table 2. Bangladesh: Near and Medium Term Indicators, FY2014–21 1/

	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
					Staff proj.			
	(Annual percent change)							
Real GDP	6.1	6.6	7.1	7.3	7.0	7.0	7.0	7.0
GDP deflator	5.7	5.9	6.7	6.3	6.0	6.2	6.1	6.0
CPI inflation (annual average)	7.3	6.41	5.9	5.4	5.9	6.0	6.0	5.9
CPI inflation (end of period)	7.0	6.3	5.5	5.9	5.9	6.0	6.0	5.8
Credit to private sector (end of period)	12.3	13.2	16.8	15.7	14.6	14.8	13.1	13.0
	(In percent of GDP)							
Gross national savings	29.2	29.0	31.4	29.8	29.8	30.0	30.3	30.8
Public national savings	2.7	1.9	1.8	1.9	2.3	2.3	2.4	2.3
Private national savings	26.5	27.1	29.6	27.9	27.5	27.7	27.9	28.5
Gross investment	28.6	28.9	29.7	30.5	31.6	32.3	32.6	33.0
Public investment	6.5	6.8	6.7	7.4	8.5	9.1	9.1	9.0
Private investment	22.0	22.1	23.0	23.1	23.1	23.2	23.5	24.0
Net exports of goods and services	-6.5	-7.4	-4.7	-5.2	-6.3	-6.4	-6.2	-5.9
Exports of goods and services	19.0	17.3	16.6	15.0	14.6	14.3	14.3	14.4
Imports of goods and services	25.5	24.7	21.3	20.3	20.9	20.7	20.5	20.3
Current account balance	0.8	1.8	1.9	-0.6	-1.8	-2.3	-2.4	-2.2
Central government operations								
Total revenue and grants	10.9	9.8	10.1	10.2	10.7	10.7	10.8	10.7
Of which: Tax revenue	8.6	8.5	8.8	9.0	9.4	9.4	9.5	9.5
Total expenditure	14.0	13.8	13.4	13.6	14.9	15.3	15.0	15.0
Of which: Annual Development Program (ADP)	4.1	4.3	4.4	4.1	5.0	5.5	5.4	5.3
Overall balance (including grants)	-3.1	-4.0	-3.4	-3.3	-4.2	-4.6	-4.3	-4.2
(excluding grants)	-3.5	-4.1	-3.5	-3.4	-4.3	-4.8	-4.4	-4.4
Primary balance (excluding grants)	-1.5	-2.1	-1.6	-1.7	-2.6	-2.9	-2.5	-2.5
Public sector total debt 2/	35.3	33.7	33.3	33.2	34.0	35.2	36.1	37.0
Of which: central government debt	35.3	33.7	33.3	33.2	33.4	34.0	34.2	34.4
Public sector external debt	15.0	15.1	14.5	14.3	14.2	14.5	15.0	15.5
Memorandum item:								
Nominal GDP (in billions of taka)	13,437	15,158	17,329	19,758	22,414	25,464	28,920	32,807

Sources: Bangladesh authorities; and IMF staff estimates and projections.

1/ Fiscal year begins July 1.

2/ Includes central government's gross debt, including debt owed to the IMF, plus domestic bank borrowing by nonfinancial public sector and public enterprises' external borrowing supported by government guarantees, including short-term oil-related suppliers' credits.

Table 3. Bangladesh: Balance of Payments, FY2014–21 1/
(In millions of U.S. dollars, unless otherwise indicated)

	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
					Staff proj.			
Current account balance 2/	1,406	3,492	4,262	-1,480	-4,846	-6,831	-7,682	-7,899
Trade balance	-6,794	-6,965	-6,460	-9,472	-13,617	-15,203	-16,083	-16,537
Exports (f.o.b.)	29,777	30,697	33,441	34,019	35,897	38,273	41,670	45,837
Of which: Ready-made garment sector	24,492	25,491	28,094	28,150	29,500	31,300	34,000	37,400
Imports (f.o.b.) 2/	-36,571	-37,662	-39,901	-43,491	-49,515	-53,476	-57,754	-62,374
Of which: Crude oil and petroleum products	-3,100	-2,153	-2,376	-3,112	-3,320	-3,697	-3,997	-4,277
Services	-4,099	-3,186	-2,708	-3,284	-3,596	-3,936	-4,309	-4,557
Income	-2,635	-2,252	-1,915	-2,007	-2,103	-2,657	-2,927	-3,146
Transfers	14,934	15,895	15,345	13,283	14,471	14,966	15,638	16,340
Official current transfers 3/	83	75	67	44	40	30	30	30
Private transfers	14,851	15,820	15,278	13,239	14,431	14,936	15,608	16,310
Of which: Workers' remittances	14,228	15,170	14,931	12,739	13,886	14,372	15,019	15,694
Capital and financial account balance 4/	3,515	2,421	1,408	4,847	4,181	5,986	7,476	9,459
Capital account	598	496	464	314	500	500	500	500
Financial account	2,917	1,925	944	4,533	3,681	5,486	6,976	8,959
Foreign direct investment	1,474	1,830	1,285	1,653	1,950	2,239	2,449	2,762
Portfolio investment	937	379	139	458	450	320	350	395
Medium- and long-term loans, net	1,863	1,527	2,074	2,315	3,351	4,747	5,598	6,123
Government, net	1,386	1,562	2,184	2,279	2,797	3,932	4,544	4,863
Disbursements	2,404	2,472	3,033	3,174	3,931	5,188	5,870	6,244
Amortization	-1,018	-910	-849	-895	-1,134	-1,256	-1,326	-1,381
Other long-term loans, net	477	-35	-110	36	554	815	1,054	1,260
Other capital	-1,357	-1,811	-2,554	107	-2,070	-1,820	-1,420	-320
Short-term loans and trade credits, net	-445	-2,613	-2,536	-193	-1,720	-1,470	-1,070	30
Commercial banks, net	-241	802	-18	300	-350	-350	-350	-350
Other items, net	-671	0	0	0	0	0	0	0
Errors and omissions	624	-923	-634	-532	0	0	0	0
Overall balance	5,545	4,990	5,036	2,834	-665	-844	-205	1,560
Financing items	-5,545	-4,990	-5,036	-2,834	665	844	205	-1,560
Change in gross international reserves (GIR) (+ = increase)								
Contribution from financing	5,545	4,990	5,036	2,834	-665	-844	-205	1,560
Change in GIR excluding valuation changes	5,744	4,934	5,254	2,830	-691	-934	-333	1,407
Memorandum items:								
Current account balance (percent of GDP)	0.8	1.8	1.9	-0.6	-1.8	-2.3	-2.4	-2.2
Exports (annual percent change)	12.1	3.1	8.9	1.7	5.5	6.6	8.9	10.0
Imports (annual percent change)	8.9	3.0	5.9	9.0	13.9	8.0	8.0	8.0
Remittances (annual percent change)	-1.6	6.6	-1.6	-14.7	9.0	3.5	4.5	4.5
Foreign direct investment (percent of GDP)	0.9	0.9	0.6	0.7	0.7	0.8	0.7	0.8
Medium- and long-term external public debt	26,472	27,496	30,450	32,424	35,766	40,424	45,894	51,863
(Percent of GDP)	15.3	14.1	13.8	13.0	13.1	13.5	14.1	14.6
Gross official reserves 4/	21,385	24,946	30,176	33,538	32,847	31,914	31,581	32,987
(In months of imports of goods and services)	5.8	6.5	7.2	7.0	6.4	5.7	5.2	5.1
Gross official reserves (excluding Asian Clearing Union liabilitie	20,417	24,043	29,297	32,659	31,968	31,034	30,701	32,108
(In months of imports of goods and services)	5.6	6.3	7.0	6.9	6.2	5.6	5.1	4.9
Net international reserves 4/	17,846	21,618	26,654	30,021	29,356	28,512	28,306	29,866
Nominal GDP	172,887	195,147	221,398	249,695	272,615	298,543	326,518	356,361

Sources: Bangladesh authorities; and IMF staff estimates and projections.

1/ Fiscal year begins July 1.

2/ Imports are based on customs data.

3/ Excludes official capital grants reported in the capital account.

4/ Gross and net international reserves for the projection period do not include valuation adjustments. Net international reserves are reported at market exchange rates.

Table 4. Bangladesh: Central Government Operations, FY2015–18 1/

	FY15	FY16	FY17		FY18	
	Actual	Actual	Budget	Actual	Budget	Staff proj.
	(In billions of taka)					
Total revenue and grants	1,485	1,748	2,483	2,019	2,935	2,399
Total revenue	1,460	1,729	2,428	2,008	2,880	2,355
Tax revenue	1,288	1,519	2,104	1,778	2,568	2,117
National Board of Revenue (NBR) taxes	1,240	1,462	2,032	1,715	2,482	2,046
Of which : VAT and supplementary duties	665	807	1,028	953	1,297	1,135
Taxes on income and profits	407	451	719	525	852	631
Customs and excise duties	158	178	269	238	316	280
Non-NBR taxes	48	56	73	63	86	71
Nontax revenue	172	211	324	230	312	238
Foreign grants	25	18	55	11	55	44
Total expenditure	2,087	2,330	3,405	2,679	4,003	3,330
Current expenditure	1,191	1,439	1,890	1,635	2,072	1,885
Pay and allowances	288	400	508	488	538	554
Goods and services	167	183	206	216	247	225
Interest payments	310	331	400	339	415	390
Subsidies and transfers 2/	424	523	753	590	838	714
Block allocations	2	2	23	2	33	3
Annual Development Program (ADP)	648	754	1,107	818	1,533	1,126
Non-ADP capital spending	138	122	330	191	326	236
Net lending 3/	90	11	84	25	69	69
Other expenditures 4/	21	4	0	11	0	13
Overall balance (including grants)	-603	-582	-923	-660	-1,068	-930
(Excluding grants)	-628	-601	-978	-671	-1,123	-975
Primary balance (including grants)	-293	-251	-523	-320	-653	-540
(Excluding grants)	-318	-270	-578	-332	-708	-584
Net financing	603	583	923	660	1,068	930
External	116	94	363	110	464	230
Disbursements	190	237		182		323
Amortization	-74	-66		-72	-1,068	-93
Domestic	359	489	560	550	604	700
Banks 3/	-23	147	389	-84	282	264
Of which : Bangladesh Bank	-18	92		-62		-48
Nonbanks 4/	383	342	170	634	322	436

(continued)

Table 4. Bangladesh: Central Government Operations, FY2015–18 1/
(Continued)

	FY15	FY16	FY17		FY18	
	Actual	Actual	Budget	Actual	Budget	Staff proj.
			(In percent of GDP)			
Total revenue and grants	9.8	10.1	12.7	10.2	13.1	10.7
Total revenue	9.6	10.0	12.4	10.2	12.8	10.5
Tax revenue	8.5	8.8	10.7	9.0	11.5	9.4
NBR taxes	8.2	8.4	10.4	8.7	11.1	9.1
Of which : VAT and supplementary duties	4.4	4.7	5.2	4.8	5.8	5.1
Taxes on income and profits	2.7	2.6	3.7	2.7	3.8	2.8
Customs and excise duties	1.0	1.0	1.4	1.2	1.4	1.2
Non-NBR taxes	0.3	0.3	0.4	0.3	0.4	0.3
Nontax revenue	1.1	1.2	1.6	1.2	1.4	1.1
Foreign grants	0.2	0.1	0.3	0.1	0.2	0.2
Total expenditure	13.8	13.4	17.4	13.6	17.9	14.9
Current expenditure	7.9	8.3	9.6	8.3	9.2	8.4
Pay and allowances	1.9	2.3	2.6	2.5	2.4	2.5
Goods and services	1.1	1.1	1.1	1.1	1.1	1.0
Interest payments	2.0	1.9	2.0	1.7	1.8	1.7
Subsidies and transfers 2/	2.8	3.0	3.8	3.0	3.7	3.2
Annual Development Program (ADP)	4.3	4.4	5.6	4.1	6.8	5.0
Non-ADP capital spending	0.9	0.7	1.7	1.0	1.5	1.1
Net lending 3/	0.6	0.1	0.4	0.1	0.3	0.3
Other expenditures 4/	0.1	0.0	0.0	0.1	0.0	0.1
Overall balance (including grants)	-4.0	-3.4	-4.7	-3.3	-4.8	-4.2
(Excluding grants)	-4.1	-3.5	-5.0	-3.4	-5.0	-4.3
Primary balance (including grants)	-1.9	-1.5	-2.7	-1.6	-2.9	-2.4
(Excluding grants)	-2.1	-1.6	-2.9	-1.7	-3.2	-2.6
Net financing	4.0	3.4	4.7	3.3	4.8	4.2
External	0.8	0.5	1.9	0.6	2.1	1.0
Disbursements	1.3	1.4	…	0.9	…	1.4
Amortization	-0.5	-0.4	…	-0.4	…	-0.4
Domestic	2.4	2.8	2.9	2.8	2.7	3.1
Banks 3/	-0.2	0.8	2.0	-0.4	1.3	1.2
Of which : Bangladesh Bank	-0.1	0.5	…	-0.3		-0.2
Nonbanks 5/	2.5	2.0	0.9	3.2	1.4	1.9
Total central government debt (percent of GDP)	33.7	33.3	…	33.2	…	33.4
Nominal GDP (in billions of taka)	15,158	17,329	19,610	19,758	22,414	22,414

Sources: Bangladesh authorities; and IMF staff estimates and projections.

1/ Fiscal year begins July 1. Cash basis, unless otherwise specified.
2/ Comprise budget allocations for safety net programs and other social-related spending, pensions a
and direct subsidies for food and to the agriculture and export sectors. Other subsidy-related costs (i.
large energy-related state-owned enterprises (SOEs)) are included in net lending.
3/ Excludes net financing of autonomous and semi-autonomous government bodies, and government lending funds. Includes special bonds issued to the commercial banks for the noncash issued to the state-owned securitization of past subsidy-related accounts of similar operations.
4/ Includes food account surplus (+)/deficit (-) and extraordinary expenditures.
5/ Includes National Savings Certificates, net purchase of Treausry securities by nonbank entities, and financing through the General Provident Fund.

Table 5. Bangladesh: Monetary Accounts, FY2014–18

	FY14	FY15	FY16	FY17	FY18
				Prel.	Staff proj.
Bangladesh Bank (BB) balance sheet	(End of period; in billions of taka)				
Net foreign assets	1399	1695	2117	2,122	2,466
Net domestic assets	-104	-216	-191	124	49
Net credit to central government 1/	102	83	176	114	66
Credit to other nonfinancial public sector	1	12	12	12	12
Credit to deposit money banks	55	48	44	43	44
Other items, net	-261	-359	-423	-44	-72
Reserve money 2/	1,295	1,480	1,926	2,247	2,516
Currency	855	982	1323	1,513	1,920
Reserves	440	498	603	727	595
	(Contributions to reserve money growth)				
Net foreign assets	39.7	22.9	28.5	0.2	15.3
Net domestic assets	-24.3	-8.6	1.6	16.4	-3.3
Of which : Net credit to central government	-16.0	-1.4	6.2	-3.2	-2.1
Reserve money (year-on-year percentage change)	15.4	14.3	30.1	16.6	12.0
	(End of period; in billions of taka)				
Monetary survey					
Net foreign assets	1,599	1,893	2,331	2,359	2,684
Bangladesh Bank	1,399	1,695	2,117	2,122	2,466
Commercial banks	200	197	214	237	218
Net domestic assets	5,403	5,979	6,827	7,795	8,776
Domestic credit	6,544	7,230	8,279	8,842	10,250
Net credit to central government 1/	1,340	1,317	1,409	909	1,173
Credit to other nonfinancial public sector	72	111	90	91	103
Credit to nonbank financial institutions	55	56	70	82	82
Credit to private sector	5,076	5,746	6,710	7,761	8,892
Other items, net	-1,141	-1,251	-1,452	-1,047	-1,474
Broad money (M2)	7,002	7,871	9,158	10,154	11,461
	(Year-on-year percent change)				
Net foreign assets	40.4	18.3	23.2	1.2	13.8
Net domestic assets	10.4	10.7	14.2	14.2	12.6
Domestic credit	11.7	10.5	14.5	6.8	15.9
Of which : Net credit to central government	8.1	-1.7	7.0	-35.5	29.1
Credit to private sector	12.3	13.2	16.8	15.7	14.6
Broad money (M2)	16.1	12.4	16.3	10.9	12.9
Memorandum items:					
Required domestic cash reserves (in billions of taka)	423	471	500	512	568
Excess domestic cash reserves (in billions of taka)	17	28	103	215	27
Broad money multiplier	5.4	5.3	4.8	4.5	4.6
Broad money velocity	1.9	1.9	1.9	1.9	2.0

Sources: Bangladesh authorities; and IMF staff estimates and projections.

1/ Includes special bonds issued to the commercial banks for the noncash issued to the state-owned securitization of past subsidy-rel made to Bangladesh Petroleum Corporation. Excludes government lending fund and net credit to autonomous and semi-autonomou government bodies. Excluded items are included in "Other items, net."

2/ Liabilities arising from banks' foreign currency clearing accounts at BB and nonbank deposits at BB are included in "Other items, ne

Table 6. Bangladesh: Sustainable Development Goals

	Goal	Selected Indicator	Progress	Year
SDG 1	No Poverty	Proportion of population living below the International poverty line (%)	65.2	2016
SDG 2	Zero Hunger	Prevalence of undernourishment (%)	16.4	2015
SDG 3	Good Health and Well-Being	Maternal mortality ratio (per 100,000)	176	2015
SDG 4	Quality Education	Share of children under 5 who are on track in health, learning and psychosocial well-being (%)	63.9	2013
SDG 5	Gender Equality	Proportion of women in managerial positions (%)	5.4	2011
SDG 6	Clean Water and Sanitation	Proportion of population using safely managed drinking water services (%)	61.4	2015
SDG 7	Affordable and Clean Energy	Proportion of population with access to electricity (%)	51.4	2014
SDG 8	Decent Work and Economic Growth	Annual growth rate of real GDP per capita (%)	5.3	2015
SDG 9	Industry, Innovation and Infrastructure	Manufacturing value added as a proportion of GDP and per capita (%)	19.3	2016
SDG 10	Reduced Inequalities	Growth rates of income per capita among the bottom 40 per cent	1.7	2010
SDG 11	Sustainable Cities and Communities	Proportion of urban population living in slums, informal settlements or inadequate housing	55.1	2014
SDG 12	Responsible Consumption & Production	Material footprint, material footprint per capita, and material footprint per GDP	2.9	2010
SDG 13	Climate Action	Adopted and implement national disaster risk reduction strategy for Disaster Risk Reduction 2015-2030	Yes	
SDG 14	Life Below Water	Coverage of protected areas in relation to marine areas	5.4	2015
SDG 15	Life on Land	Proportion of forest area with a long-term management plan	19.0	2015
SDG 16	Peace, Justice and Strong Institutions	Number of victims of intentional homicide per 100,000 population	2.51	2015
SDG 17	Partnerships for the Goals	Debt service as a proportion of exports of goods and services	3.57	2015

Source: Bangladhes Prime Minister's Office - Access to Information (A2i), SDG Tracker

Annex I. Response to Past Fund Policy Advice

After the completion of the Extended Credit Facility in October 2015, the authorities continue to closely engage with the Fund through the Article IV consultations, periodic staff visits and the Resident Representative's office. Since the last Article IV consultation, a number of recommendations have been implemented, but some key measures will require more time.

FUND ADVICE	AUTHORITIES' RESPONSE
Increase sterilization effort to contain financial sector risk.	With the weakening of the balance of payments and pick-up in private credit growth, the need to sterilize excess liquidity has abated. To contain financial sector risk, the BB reduced the ADR limit.
Adjust monetary policy as needed to keep inflation broadly stable.	Monetary policy was eased in April 2018, reflecting concerns on liquidity, while overall inflation has picked up slightly in 2017.
Keep the public debt ratio broadly stable.	In FY17, expenditure growth was kept under the control, and the deficit was below 5 percent of GDP. Compared to FY16, public debt-to-GDP ratio has increased only moderately.
Boost low tax revenues, including the launch of new VAT.	The planned July 2017 launch of the new VAT was again postponed till July 2019. No major new revenue measures are expected in FY18.
Improve fiscal transparency and reflect government operations explicitly in the budget.	Introduction of the Integrated Budget and Accounting System (IBAS++) and the new Budget and Accounting Classification System (BACS) will improve fiscal reporting and transparency.
Continue flexible approach to exchange rate management and preserve foreign reserves buffer.	The BB has intervened occasionally in the foreign exchange market to avoid excessive exchange rate fluctuations. The currency has depreciated moderately and the foreign reserves were stable.
Improve governance and recapitalize state owned banks, enforce credit growth limits, streamline loan recovery and eliminate government influence over lending decisions.	Credit growth limits have been broadly enforced, and limited recapitalization has taken place. Governance in the state-owned banks and loan recovery remain major challenges.
Support capital market by removing regulatory and tax obstacles to corporate bond issuance, reducing budget reliance on financing from the national savings certificates, and developing a well-functioning government bond market.	The authorities continue to implement the Capital Market Development Master Plan. They plan to create a database of savings certificates holders to reduce misuse. However, obstacles to capital market development remain and corporate bond/equity issuance are limited.

Annex II. Risk Assessment Matrix (RAM)[1]

	Shocks and Likelihood (Red= high likelihood; green = low likelihood)	Potential Impact (Red= high; green=low)	Policy Response
Domestic	Resumption of intense political unrest with the upcoming election.	Resumption in poltical turmoil and a deterioration in security conditions could adversely affect confidence, investment and growth. Balance of payments (BOP) pressures could emerge from lost export production, and inflation could go up.	There should be a moderate fiscal easing by allowing automatic stabilizers (mostly on the revenue side) to operate and increasing transfers to the poor as needed. Reserve buffers could be used through sterilized intervention to cushion the shock and smooth exchange rate volatility.
	Slow progress in resolving the Rohingya refugee crisis.	Immediate needs, such as food, health, shelter, and water and sanitation, have been covered by donor support for now. As the repatriation of the refugees take time, there would be fiscal pressures, social and environmental costs, and security concerns.	Fiscal policy will have to address difficult situations of the refugees, while keeping the fiscal deficit broadly in line with the fiscal anchor. Continuous support by the international community will be essential.
	Further deterioration in the financial health of state-owned banks (SOCBs).	SBs have high NPLs, low profitability, and sizeable capital shortfalls (but do not face liquidity pressures). Further deterioration in SOCB balance sheets would potentially have a negative impact on the fiscal balance and growth.	Recapitalization should be tied to reforms to improve the long-term viability of SOCBs, including governance reforms, stricter controls over lending activities, and more aggressive recovery of bad loans. SOCBs should be held strictly accountable to numerical targets agreed with the authorities to improve their financial performance.
External	Retreat from cross-border integration. Structurally weak growth in key advanced economies.	The EU and US account for over 80 percent of exports, and weaker growth, together with retreat from trade liberalization, could adversely affect export growth, given the narrow export base, with a negative impact on BOP. However, the relatively low-income elasticity of demand for garment exports and Bangladesh's cost competitiveness would act as mitigating factors.	If the shock is temporary, the policy response should be similar to that for a resumption of political unrest. If the shock is protracted, the exchange rate should be allowed to adjust and fiscal policy would also require some adjustment to keep the deficit broadly in line with the fiscal anchor, with social spending on the poor protected via restraint in other current expenditure. Authorities should push for reforms to increase export diversification, such as improving infrastructure and trade networks, investing in human capital, supporting SME development and reducing barriers to entry for new products.
	Intensification of the risks of fragmentation/security dislocation in parts of the Middle East, Africa, Asia, and Europe. Lower energy prices	As a net oil importer, Bangladesh benefits from lower oil prices. However, low oil prices and the risks of security dislocation in the Middle East could weaken job prospects for Bangladeshi workers in the GCC (from which about two-thirds of remittances originate), and thereby affect remittances. This, in turn, would have a negative impact on domestic demand and the BOP. This impact could potentially outweigh the positive income shock from lower oil prices, as remittances are about four times larger than oil imports.	Fiscal transfers to the poor and vulnerable should be enhanced if the shock is temporary. If prolonged, there should be a moderate fiscal easing by allowing automatic stabilizers (mostly on the revenue side) to operate. The currency should be allowed to depreciate but reserve buffers could be used to smooth exchange rate volatility. The authorities should maintain their efforts to reduce transaction costs for using formal remittance channels and properly monitor migration costs.

Source: IMF staff.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

Annex III. External Sector Assessment

Overall, the external position in FY17 was broadly in line with fundamentals and desirable policies. The current account (CA) has turned into a small deficit and is expected to remain so from the expectations that investments will continue to be strong. External debt remains manageable and reserve coverage continues to be adequate. The policy mix should aim to boost both private and public investment necessary to increase competitiveness and diversification. To maintain debt sustainability while increasing infrastructure investment, prudent debt management and efforts to boost tax revenue should continue and financing on concessional terms should be negotiated to the extent possible.

1. External Debt Sustainability. The debt sustainability analysis continues to assess Bangladesh's external risk rating as low (see *2018 Debt Sustainability Analysis*). The external debt ratio is stable over the medium-term and the baseline figures for all indicators remain under their respective threshold. Adequate international reserves and concessional debt help Bangladesh buffer external shocks. Prudent debt management should continue as financing terms are expected to harden reflecting their possible graduation from lower income status.

2. Current account. In FY17, the CA turned into a small deficit (0.6 percent of GDP in FY17). Exports and imports of goods and services grew by an estimated 1.7 percent and 9.0 percent respectively, while remittances dropped by 14.7 percent. The CA deficit is projected to widen in FY18 with strong import demand for capital machinery and industrial raw materials and a temporary need for food imports. Over the longer-term, the CA is expected to remain in deficit on the expectation that investments will continue as suggested by the strong import demand for capital goods. In the EBA-lite CA model, the fitted CA equation continues to systematically underestimate the actual CA, suggesting that the EBA-Lite model does not fully capture country characteristics, such as the propensity to save from the lack of investment opportunities, or a business climate that doesn't boost investment. Adjusting for these fundamentals, staff estimate the CA norm to be -0.7 percent of GDP.[2] Consequently, the estimated CA gap in FY17 is essentially zero, as is the policy gap.

CA Norm: EBA Lite Analysis (in percent of GDP)	
CA-Actual	-0.7%
CA-Norm (from model - unadjusted)	-4.5%
CA-Norm (adjusted)	-0.7%
Cyclically adjusted CA	-0.8%
Cyclically adjusted CA Norm	-0.8%
CA-Gap	0.0%
o/w Policy gap	0.1%
REER Gap	0.1%

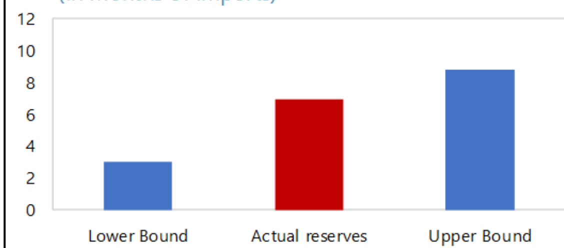
3. Real exchange rate. After a long period of appreciation, the Taka real exchange rate has recently started to depreciate. Export growth in FY17 was tepid; however, the overall share of

[2] Based on studies that reflect a high propensity to save given credit constraints, limited investment opportunities and a large migrant worker population employed mostly on short-term contracts. These studies are referenced here Center for Policy Dialogue (http://cpd.org.bd/wp-content/uploads/2015/10/Safeguarding-Interests-of-Bangladesh-Migrant-Workers-Issues-of-Financial-Inclusion-and-Social-Protection.pdf) and here Remittances Development Dynamics of Remittances in Bangladesh, Barai (2012) (http://journals.sagepub.com/doi/pdf/10.1177/2158244012439073).

exports from Bangladesh in world continues to be on an upwards trend. Export growth is expected to be a little over 5.5 percent in FY18 compared to 1.7 percent in FY17. The EBA-lite CA model, when adjusted for fundamentals, indicates a very small REER gap of 0.1 percent.[3] Structurally weak growth in key advanced economies remains a major downside risk given that the U.S., Germany, and the U.K. represent Bangladesh's three main export destinations. On the upside, the global upswing in the economic activity is strengthening recently and a boost to exports via recent trade agreements is anticipated.

4. Reserve adequacy. Compared to strong growth over the last two fiscal years, the growth in reserves was modest in FY17 reflecting the slack in export growth and the large drop in remittances. As of end-FY17, import coverage was high (seven months of imports) but on a declining path. Given that the central bank intervenes in the foreign exchange market to keep the exchange rate relatively stable against the US dollar, a benchmark closer to the upper range of the IMF's ARA-CC methodology seems appropriate.[4] Hence, staff continue to assess reserves as adequate.[5] Over the medium-term, import coverage is expected to decline due to higher imports of capital goods. However, exports and remittances are also expected to increase, keeping the coverage at over 5 months of prospective imports on average over the medium-term.

Reserve Adequacy Assessment
(In Months of Imports)



Source: IMF Staff calculations and Bangladesh Bank

[3] From the EBA-Lite REER model, the REER gap is 32 percent above what is warranted by fundamentals and desirable policies. However, the gap is largely accounted for by residuals. The external sustainability model does not apply given adequate reserves and low risks from external debt sustainability.

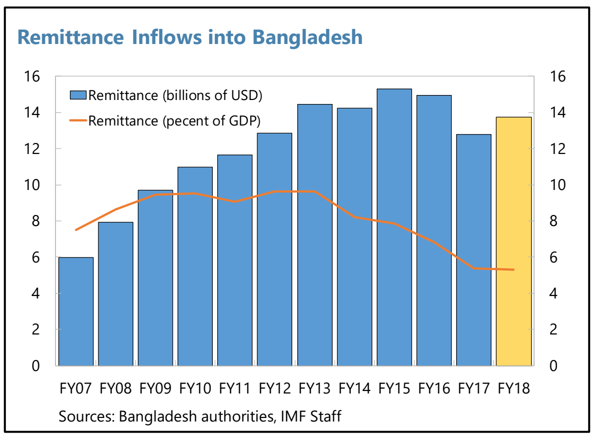
[4] The de jure exchange rate arrangement is classified as floating.

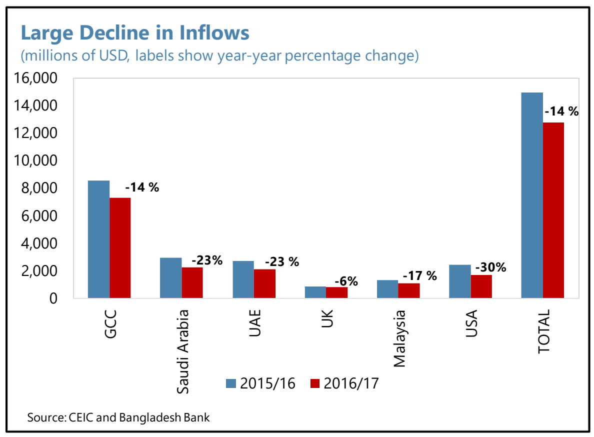
[5] The IMF's ARA-CC suggests an adequacy ranging from 3.0 (floating exchange rate) to 8.8 (fixed exchange rate) months of imports given the country-specific characteristics of Bangladesh. This is based on the cost of holding reserves set at the regional average (7.15 percent). Traditional measures that assess reserve adequacy – 3-month import rule, 20 percent broad money coverage, and 100 percent short-term debt coverage – remain important tools to measure reserve adequacy but they may not necessarily reflect country specificities.

Annex IV. Remittances in Bangladesh

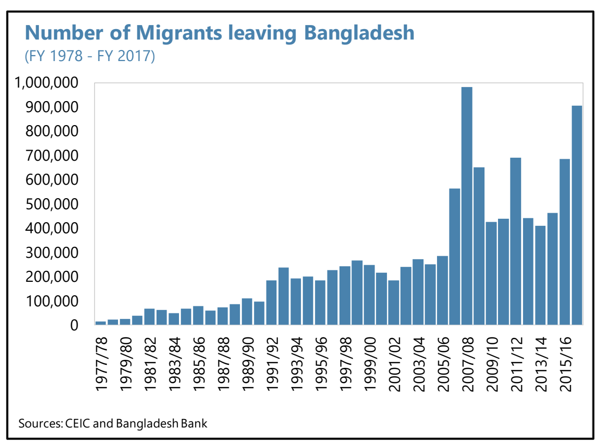
Remittances have positively affected economic growth in Bangladesh and have been key in reducing poverty. Inflows have more than doubled from ten years ago, reaching US$12.7 billion in FY17. Mirroring this is the number of Bangladeshi workers migrating abroad. A sharp decline in inflows in FY17 warrants investigation, given that the outflow of migrant workers continues to increase.

1. **Remittance inflows have been on a declining trend over the recent past.** Despite this trend, the growth in the domestic economy has been robust and poverty rates have been decreasing, suggesting that the relative importance of remittances in the economy has been declining. However, the decline in FY 2017 – a 14.0 percent drop – prompts investigating, given that remittances are still a substantial source of foreign exchange reserves. The slowdown in the GCC economies explains some of the slowdown, but other factors, such as an increase in informal channels, rising living costs, and stringent regulation globally, also help explain this drop.





2. **The outflow of workers continues to increase while oil exporting countries continue to adjust to low oil prices.** In FY17, close to a million Bangladeshi workers migrated – a 33 percent increase compared to the previous year. The GCC remained the preferred destination (78 percent) followed by Malaysia and Singapore (14 percent). Oil exporters, most of them in the GCC, are continuing to adjust to low oil prices, which have lowered growth and increased pressures on fiscal and external balances. In both 2016 and 2017, real GDP growth slowed in the GCC (Table 1).[1] Consequently, barring Qatar, inflows from all other GCC countries slowed in FY17 despite the growth in migrants



[1] Gulf Cooperation Council: The Economic Outlook and Policy Challenges in the GCC Countries; IMF, December 2017

into the GCC. Inflows from both Saudi Arabia and the UAE fell by 23 percent. Restrictions on the recruitment from Bangladesh, such as the recently lifted ban in Saudi Arabia, also explain some of the slowdown.[2]

Table 1. Real GDP Growth Rates in GCC Countries

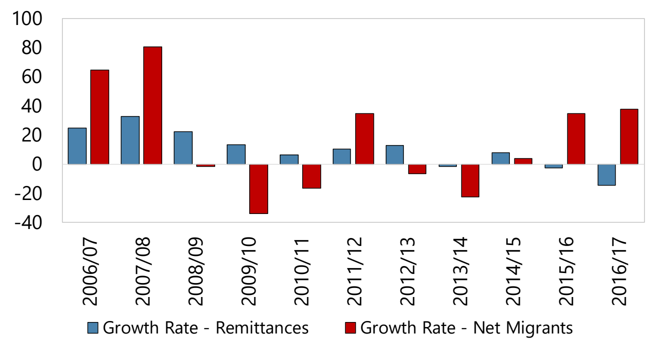
percent change	2013	2014	2015	2016	2017	2018	2019
Real Oil GDP							
Bahrain	15.3	3.0	(0.1)	(0.1)	(2.2)	0.3	0.0
Kuwait	(1.8)	(2.1)	(1.7)	2.3	(6.0)	0.0	4.5
Oman	1.0	(1.7)	5.2	2.1	(2.8)	1.0	5.0
Qatar	0.1	(0.6)	(0.5)	(1.0)	0.2	1.0	1.2
Saudi Arabia	(1.6)	2.1	5.3	3.6	(3.0)	0.9	1.7
United Arab Emirates	3.1	0.4	5.4	3.8	(2.5)	0.0	2.4
Real Non-Oil GDP							
Bahrain	3.1	4.7	3.6	4.0	4.4	3.6	2.8
Kuwait	4.0	5.0	0.0	2.0	2.5	3.0	3.0
Oman	7.9	7.1	4.3	1.5	2.0	3.0	3.5
Qatar	10.4	9.8	8.2	5.6	4.0	4.1	4.1
Saudi Arabia	6.4	4.9	3.2	0.2	1.0	2.3	2.1
United Arab Emirates	7.0	4.6	3.2	2.7	1.9	2.8	3.3
Real GDP							
Bahrain	5.4	4.4	2.9	3.2	3.2	3.0	2.3
Kuwait	0.4	0.6	(1.0)	2.2	(2.5)	1.3	3.8
Oman	4.4	2.8	4.7	1.8	(0.3)	2.1	4.2
Qatar	4.4	4.0	3.6	2.2	2.1	2.6	2.7
Saudi Arabia	2.7	3.7	4.1	1.7	(0.7)	1.7	1.9
United Arab Emirates	5.8	3.3	3.8	3.0	0.5	2.0	3.0

Source: IMF, April 2018 WEO

3. Migrant inflows to Bangladesh are not being factored into the statistics. Although official statistics are maintained by the Bangladeshi authorities on migration from Bangladesh, official statistics for those coming back are not tracked. The capacity to remit often increases over time because income tends to rise as migrants stay longer in a county. However, if the numbers coming back exceed those staying, this explains some of the slowdown. A survey by the Refugee and Migratory Movements Research Unit found that 27 percent of migrants (a total around 1,517,028 workers) had returned in the past

Illustrative Scenario: Growth Rates of Remittances and Net Migrantion

(in percent, assumes 27 percent of migrants have returned annually)



Source: CEIC and Bangladesh Bank

[2] Press release: The Ministry of Labor and Social Development of Saudi Arabia lifted the ban on the recruitment of Bangladeshi workers as of Wednesday, 10 August 2016. http://www.mofa.gov.bd/media/ministry-labor-and-social-development-saudi-arabia-lifted-ban-recruitment-bangladesh-workers

decade.[3] Given the lack of data on the distribution of immigrants returning annually, it is difficult to estimate the number of net migrants for each year. But, as an illustrative scenario, if it is assumed that 27 percent of migrants in the previous year came back to Bangladesh annually, the growth in remittances seems to have broadly followed the growth of net migration from FY07 to FY15. Only during FY16 and FY17 was there a real decline in remittances despite increases in net migrants. Migration statistics become useful not only for understanding the trends in remittances but also for targeting efforts to educate the migrant population on steps being taken to make remitting easier. Currently, these statistics are mainly collected through a population register or population census. The authorities with the help of their embassies should work with the migrant country authorities to keep records of the number of migrants leaving and heading back to Bangladesh.

4. Costs to migrate, including living costs, have increased. Another reason for the slowdown in remittances are large migration costs. Complex visa procedures, work permits, recruitment costs and airline tickets push up the costs to migrate substantially. For example, KNOMAD-ILO Migration Costs Survey (2014) indicated that Bangladeshi workers were paying some of the highest costs to migrate to Kuwait (ranging between $1,675 and $5,154) and the fees became exorbitant ($15,000, for Bangladeshi workers in 2013), if illegal crossings of international borders were expected.[4] Other examples of costs include policies such as a levy on employers hiring foreign workers in Malaysia which increases business costs that could be passed on to the foreign worker thus reducing real income.[5] Moreover, the cost of living faced by Bangladeshi immigrants in migrant countries has also increased.

5. Stricter monitoring and stringent regulations are being enforced to meet regulatory requirements. The Saudi Arabian Monetary Authority has announced that regulatory non-compliance of companies that provide money transfer services will lead to the suspension of these services.[6] Similarly, in the UAE, several domestic banks have preemptively stopped providing banking services to some charities, exchange houses, and remittance offices to deter the perception of rising AML/CFT risks.[7] In the UK, global banks have been reviewing their customer base and business lines and terminating accounts of certain categories of customers, notably money transmitters and fintech firms, amongst others. [8] Events such as these could potentially impair remittance inflows, causing a shift to less transparent and unregulated service providers.

6. While the rapid expansion of fintech and mobile technology have improved money transfers, it has also made it easier for informal channels to grow. These technologies made banking services easier, including the expedited delivery of remittances to a much larger population.

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[3] In this study, a migrant who had returned was considered part of the sample only if they had returned within the last 10 years and stayed in Bangladesh for more than 6 months.

[4] Report from KNOMAD-ILO (2014)

[5] Link from http://www.mohr.gov.my

[6] SAMA press release. http://www.sama.gov.sa/en-US/News/Pages/news25092017.aspx

[7] United Arab Emirates 2017 Article IV Consultation. Country Report No. 17/218

[8] United Kingdom: 2016 Article IV Consultation-Press Release; and Staff Report

Bangladeshi banks use platforms such as bKash, Rocket, and SureCash. These services include disbursement of inward foreign remittances, cash in/out using mobile accounts, utility bill payments, merchant payments, salary payments, government transfers and subsidies, tax payments, and person-to-person payments, amongst others. The authorities are also continuously upgrading payment systems, focusing on creating financial market infrastructure that is safe, efficient, fast, and secure.[9] However, the ease, simplicity, and reach of these platforms has also made it easier for the informal channels to grow, given that domestic cash transfers can now be made by an intermediary over the informal channels much quicker than previously possible. Since the introduction of mobile financial services (2011), total transactions and total amounts have increased tremendously. For example, over the period December 2013 to February 2018, average daily transactions and amounts using mobile financial services have increased by more than 400 and 300 percent, respectively. Between 2012 and 2017, the number of active mobile money accounts increased from 0.5 million to 27 million (IMF, Financial Access Survey database and Bangladesh Bank). Double digit growth rates of remittances seen prior to 2011 slowed down remarkably and continued to fall after 2011. This suggests that with the advent of technology a major portion of the remittances were transferred over informal channels. Even though the World Bank has reported that the cost of sending remittances has dropped, the popularity of these informal channels prevails given their convenience, substantially low costs, less scrutiny, and lack of regulation.[10]

7. Inflows are forecast to pick up slightly in FY18 but remain below historical averages. Empirical analysis has shown that the resilience of non-oil GDP growth in the GCC countries along with the large-scale hiring of migrant workers supports the persistent strength of remittances in South-Asian countries (Bangladesh, Selected Issues 2009). Real oil GDP in the GCC declined in 2017, while in contrast, non-oil growth increased, suggesting some uptick in the outflow of remittances in 2017. Furthermore, a recovery in global growth is also projected in the medium-term (April 2018, WEO). The World Bank's Migration and Development Brief (2017) also suggests that remittances to low and middle-income countries are expected to recover in 2017 after two consecutive years of decline.[11] Indeed, trends thus far points to a pickup in remittances in FY18 and are expected to reach US$14.0 billion by June 2018.

8. The authorities have proposed various measures, both in the short-term and over the medium-term, to address some of this slowdown. Over the short-term, the authorities plan on educating migrant workers on the benefits, such as safety and security, of using formal channels, introducing special help desks at airports, and initiating diplomatic talks with the relevant host countries to facilitate policies for removing caps on sending legal income through banking channels. They also plan to increase the number of authorized channels and improve the quality of services by reducing the complexity of remitting. Over the medium-term, they are considering products such as a remittance cards incentivized by receiving medical services, priority access for consulate services, and duty-free access at airports up to a specified annual limit. Other measures include: (i) working with relevant authorities in host countries to reduce the costs of migration by reducing the fees of

[9] Bangladesh Bank, Annual Report 2016 – 17.

[10] Remittance Prices Worldwide, Issue 24, World Bank, December 2017.

[11] World Bank, Press Release No. 2018/033/JOBS

the renewal process of the work permits and increasing their renewal periods and (ii) making remittance services more dependable and easily available by using the large networks of NGOs, micro credit institutions, and banks and by introducing agent banking abroad. The authorities are also going to monitor the quality of the labor force and provide more training to outgoing workers. They plan on forming a monitoring committee within the Ministry of Finance to help coordinate and implement these reforms.

Annex V. Medium-Term Growth Outlook

This annex summarizes the impressive growth performance in Bangladesh. Using a growth accounting exercise, it estimates potential growth in FY16–20 and includes some recommendations to boost growth over the medium to long term.

A. Background

1. Bangladesh is steadily emerging from its low-income status on the back of its impressive growth, improved social indicators, and a stable macroeconomic climate. Bangladesh's growth performance compares favorably to some of the fastest growing economies in the world. Its strong output growth performance over the last decade can be attributed to the country's macroeconomic stability, favorable external demand, and high remittances. After averaging a little over six percent since FY05, output growth has now exceeded seven percent in both FY16 and FY17. The poverty rate has fallen from 44.2 percent in 1991 to 18.5 percent in 2010 and is projected to fall to 14.9 percent in 2016.[1] GDP per capita has almost tripled from FY07 reaching US$1,602 in FY17. Bangladesh has met several goals under the MDGs and is now pushing to adopt the SDGs.[2, 3] The World Bank now classifies Bangladesh as a lower middle-income country.[4]

2. The Seventh Five-Year Plan (FY16 – 20) aims at increasing real GDP growth to 7.4 percent, on average, during FY16-20. Projections in the past few IMF Article IV consultations estimated that Bangladesh's medium-term real GDP growth would converge to around 7.0 percent by FY20, based on the current global slow growth environment, weak trade and investment, falling remittances, and heightened global uncertainty. A growth accounting exercise explains the contributions to growth from capital, labor, and total factor productivity (TFP) and investigates the feasibility of reaching the authorities' growth target set for FY20.

B. Growth Accounting

3. A standard Cobb‐Douglas production function of the economy is used to analyze past growth performance and over FY16 – 20.

$$Y_t = A_t K_t^{\beta}(h_t L_t)^{1-\beta}$$

[1] Unprecedented floods in 2017 may jeopardize poverty reduction rates and this expected to increase to about 18.5 percent in 2017.

[2] MDG goals available at http://www.bd.undp.org/content/bangladesh/en/home/post-2015/millennium-development-goals.html

[3] SDG tracker available at http://www.sdg.gov.bd/

[4] World Bank Groups available at https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups. Bangladesh is also currently eligible to graduate from the Least Developing Country category (UN classification).

where at time t, Y_t is the output, A_t is TFP, K_t is the aggregate capital stock, h_t is human capital per worker and L_t is the total number of workers employed. Aggregate capital share of output (β = 0.51) and the aggregate labor share of output (1- β) have been held constant throughout the analysis.[5] The exercise assumes a log-linear approximation where output growth is decomposed from the growth in A_t , K_t, h_t and L_t using the appropriate capital (β) and labor share (1- β) for K_t, h_t and L_t. *Capital stock (K_t)* has been constructed using the official data (real investment and output) data based on the capital stock to output ratios calculated in the Penn World Table (PW8.0) database and a depreciation rate of 3.2 percent.[6] The capital stock build-up is assumed to be the undepreciated capital stock from the previous period plus the investment in the current period. *Human capital per worker (h_t)* is based on the human capital index included in the PW8.0 database (based on Barro-Lee methodology) while the *total number of workers (L_t)* is calculated from the data on the working age population, labor force participation rate, and unemployment rate based on data from the World Bank's WDI indicators. *Total Factor of Productivity (A_t)*, for historical data, is calculated as a residual after taking into consideration contributions from capital and labor.

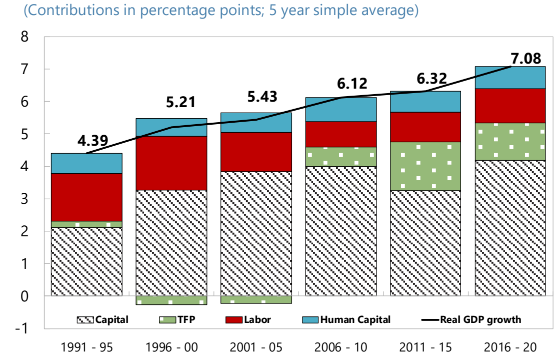
C. Results from Growth Accounting

4. Growth in Bangladesh has been steadily increasing over the last few decades. The export-led growth, on the back of the RMG sector, has averaged six percent per year over the last twenty years despite problems with infrastructure, shortage of power, political turmoil, and turbulent security.

5. Capital accumulation and labor have been the primary drivers of growth during the 1990s. The rapid increase of the RMG sector supported by an abundant low-cost labor force has supported growth. Investments were especially strong from the mid-90s until the mid-2000s, with annual growth averaging over nine percent during that time. The 90s also saw a rapid increase in the labor force, supported by an increase in female labor force participation.

Growth Accounting

(Contributions in percentage points; 5 year simple average)



Sources: BBS, CEIC, WDI, Penn World Tables, IMF Staff estimates

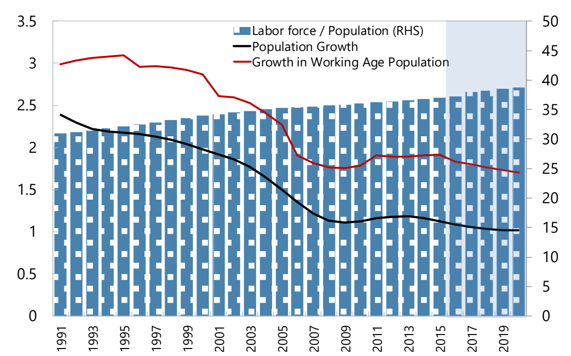
6. However, since the mid-2000s, the contribution from capital and labor has been replaced by the contribution from TFP growth. A slowdown in working age population growth during the mid-2000s and an increase in the unemployment rate around the same time explain the

[5] Based on literature (Long-Term Growth Scenarios for Bangladesh, R.Sinha 2017), using data from the Global Trade Analysis Project (GTAP). Robustness checks using various combinations of the shares of labor and capital, as recommended in the literature, also point to average growth in the same range.

[6] Based on the depreciation rate of physical capital calculated in the Penn World Tables based on a four-year backward looking average.

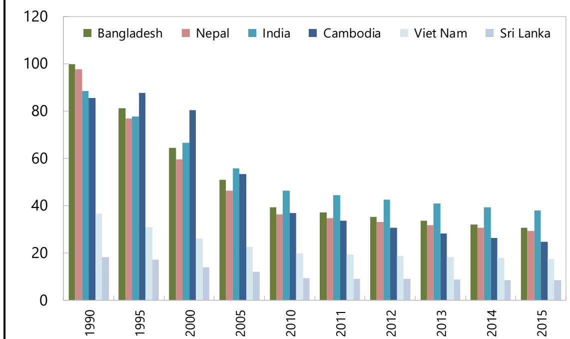
lower contribution from labor. While the share of working age population in total population is increasing, it's growth has been slowing down from lower total population growth. The population demographics in Bangladesh are currently in transition from declining mortality rates (infants, adult male and females) and fertility rates (average number of births per woman) coupled with increasing life expectancy. Programs such as the Health, Population, and Nutrition Sector Development Program have helped achieve some of these results. Investments had also slowed down since the mid-2000s, averaging an annual growth of a little under eight percent over the last decade. Various explanations, such as lack of basic infrastructure, political turmoil, and setback from security conditions explain this slowdown.

Demographic Statistics



Sources: ILO, WDI

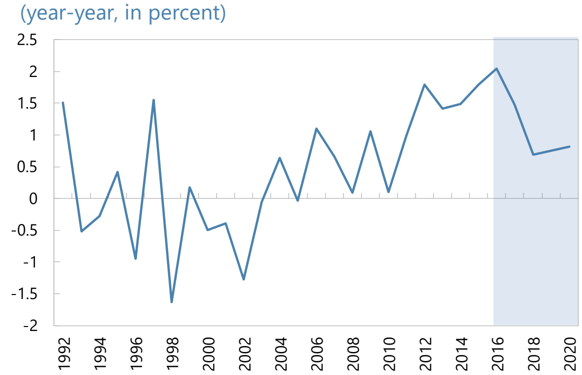
Infant Mortality Rate
(per 1,000 live births)



Sources: Human Development Reports, UN

7. **TFP growth, while volatile in the past, has experienced sustained growth more recently.** From 1996 to up until 2005, growth in investment had averaged over nine percent, and remittance flows averaged over thirteen percent. The sharp decline in TFP around the mid-1990s coincided with the Asian financial crises. Studies confirm that TFP growth across many countries fell markedly during this time.[7] Starting in the mid-2000s, the country saw a steady improvement in the business environment indicated by the better performances in their Doing Business indicators. All of these factors are reflected in the positive TFP growth from the mid-2000s.

Total Factor Productivity Growth
(year-year, in percent)



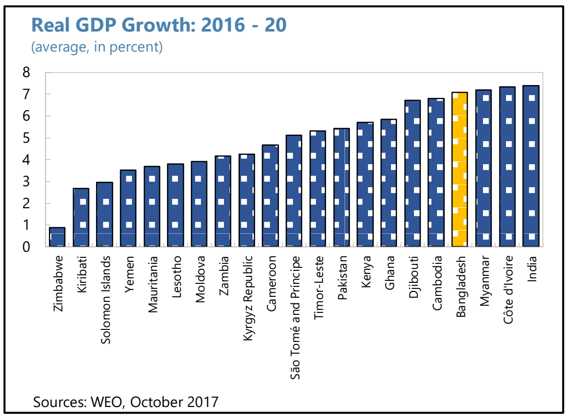
Sources: BBS, CEIC, WDI, Penn World Tables, IMF Staff estimates

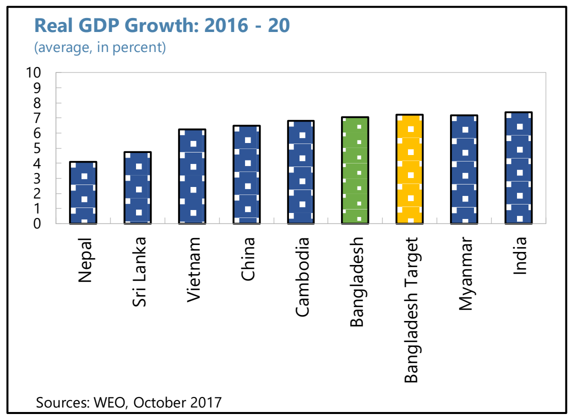
8. **The contribution from human capital has remained somewhat steady.** Bangladesh has always emphasized health and education as policy priorities, which increased enrollments in primary schools and literacy rates and improving the quality of the workforce. The country has also achieved

[7] Financial crises and total factor productivity (Meza and Quintin, 2005).

gender parity both at primary and secondary education levels. The 2016 Human Development Index ranks Bangladesh 139th out of 183 countries.

9. A growth accounting exercise estimates the potential growth over FY16–20 to be a little over seven percent, higher than many neighboring economies and economies with similar income levels, but slightly below the authorities' target. The authorities are targeting an average real GDP growth rate of 7.4 per year over FY16 – 20. Given the outturn for FY16 and FY17, the growth in FY18, FY19, and FY20 would need to average 7.5 percent to meet this target. Within the growth accounting framework, it is expected that the largest contributions will be from capital accumulation, followed by TFP, labor, and human capital. To be able to reach growth that averages 7.5 percent over the next three fiscal years, the authorities will need to boost investment by a large margin. Boosting TFP, labor, and human capital will also help.





10. Growth accounting, a mechanical approach, is subject to various criticisms given the underlying assumptions and the sensitivity of the results to these assumptions. However, it also provides a framework for identifying the sources of growth. For the projections in this exercise, capital stock accumulation is projected to reach 3.0 percent of GDP by FY20. This target is achieved by increasing the rate of growth of real investment from 8.8 percent in FY17 to reach 9.5 percent by FY20 based on the assumption that Bangladesh is expected to benefit from an increase in investment from agreements such as the Belt Road Initiative. This also puts investment as a share of GDP around 34 percent, which is the target set by the authorities in the Seventh Plan. Given the strong growth in TFP in the recent past, for the projection period, the analysis assumes the growth in TFP is the long run average starting in FY00 to account for its volatility prior to its strong growth. TFP growth is set to average 0.75 percent growth over FY18 – 20. The human capital index, included in the PW8.0 database, has grown but its growth has been slowing down since 2010. A similar observation is seen in the UN's Human Development Index.[8] Based on this, the projected growth in the human capital index is assumed to be low but positive – averaging 1.35 percent per annum from FY16 – 20. This puts the index at 2.14 as of FY20 compared to 1.97 in 2014. Projections for the

[8] Bangladesh's HDI value for 2015 is 0.579 (139 out of 188 countries and territories) and is below the average of 0.631 for countries in the medium human development group and below the average of 0.621 for countries in South Asia.

working age population are taken from the UN population projections while the projections for the labor force participation rate and the unemployment rate are based on long-run averages.

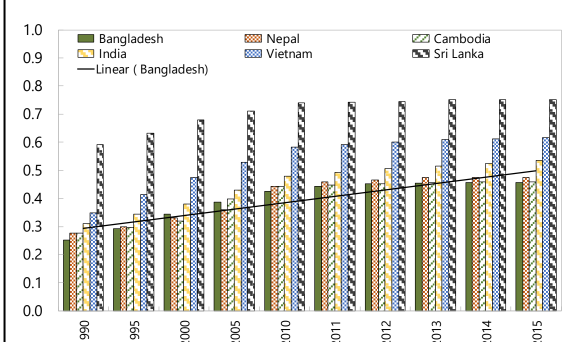
D. Boosting Growth

11. Reforms in upgrading infrastructure and the investment climate should continue. A boost in investment, especially public investment, to address the strain caused by the lack of basic infrastructure will boost the capital stock and productivity. In addition, higher public investment will also address some of the roadblocks to the much-needed private investment. Commercial access to electricity, gas to run factories, upgrading the ports, and improving connectivity via roads and rail are some areas that continue to act as hinderances to productivity. The authorities recognize that increasing the rate of investment to reach approximately 34.0 percent of GDP by FY20 remains a key challenge. A planned investment of US$409.0 billion is expected under the Seventh Plan, but the chronic under-implementation of the Annual Development Plan, despite its higher priority and continuing growth with each budget, needs to be addressed.

12. Better infrastructure should increase economic diversification and in turn output. The authorities also acknowledge that diversification is a necessary step towards higher growth and have indicated various measures in the Seventh Plan detailing their plans for diversification. Economic diversification is needed to shift away from the RMG sector into other export-oriented activities that may benefit from the low-cost labor comparative advantage. Diversification should include not only new products and trading partners but also increases in the quality of existing products. New products and growing sectors, such as agro-based products, light engineering, footwear and leather, and pharmaceuticals are now showing diversification potential. Diversification and structural transformation will lower output volatility, provide greater macroeconomic stability, and in turn boost growth.

13. Growth will also benefit from increasing both the quality and quantity of labor. Sustaining strong growth depends not only on the quantity of those employed (L_t) but also the quality of their human capital (h_t). Improving h_t entails actions such as prudent spending on health and education with the intent of improving human capital and therefore the quality of the workforce, which is considered to be a key driver of diversification and structural transformation (Elborgh-Woytek and others 2013; IMF 2014a). While both have improved, much more remains to be achieved. For example, the percent of educated person in the workforce remains very low compared to comparator countries. The education index under the Human Development Index shows that while Bangladesh has improved its ranking over the years there still has room for improvement in comparison to some others in the region. In addition, the declining labor force participation

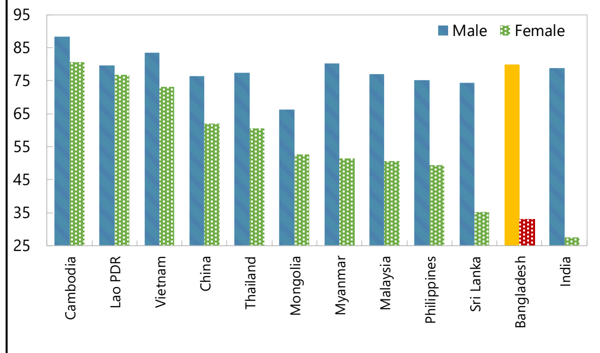
Education Index



Sources: Human Development Reports, UN

rate will benefit from policies that boost the level of female participation, which remains low relative to comparator countries. Increasing the share of women in the workforce also helps mitigate the impact of population aging in the long run. Improvements in social safety nets, such as health systems; higher spending on rural infrastructure, especially on transportation; and education all have a large potential to boost female labor force participation.[9] Bangladesh should take advantage of the shift in demographics, as shown by a declining dependency ratio, and implement the needed policies, including the necessary investments, to maximize growth potential.[10]

Labor Force Participation by Gender, 2016
(in percent of total population ages 15+)



Source: ILO model estimates.

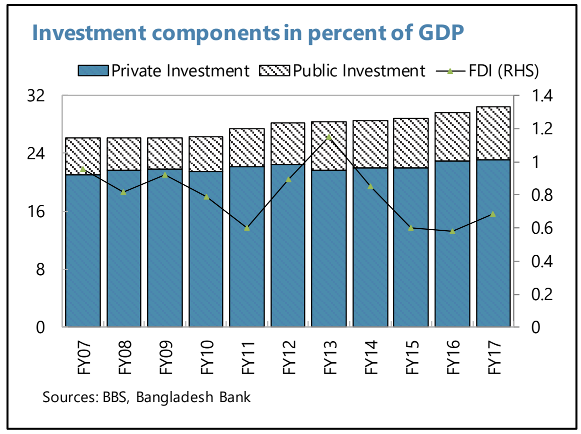
14. Boosting TFP, which includes more than just innovations related to productivity, should also help. TFP reflects, for example, the political situation, security, economic policies, and institutional changes, which affect the efficiency of an economy. Appropriate measures to reassure the business community, such as those arising from deteriorating security conditions, should be put in place. Policies to boost financial inclusion while maintaining financial stability should continue. And finally, as pointed out in the previous Article IV consultation, Bangladesh is upgrading its policy-making practices and institutions, and reforms such as capital market development should focus on improving the policy framework to support macro-stability, maintain competitiveness, build buffers against external shocks, and mobilize resources needed for public investment.

[9] Women, Work and Economic Growth (Kochhar, Jain-Chandra and Newiak, 2016)

[10] http://www.un.org/esa/sustdev/natlinfo/indicators/methodology_sheets/demographics/dependency_ratio.pdf

Annex VI. Enhancing Bangladesh's Business Environment

1. **In the context of its 7th Five-Year Plan (FY16-20), and with the objective of becoming a middle-income country by 2021, the authorities have identified the creation of an enabling environment for FDI and private sector engagement as a high priority.** They aim to raise the share of private investment from 22 to 27 percent of GDP and to mobilize an additional US$10 billion in FDI inflows by the end of the period. Efforts to create an enabling environment for the private sector are geared towards diversifying exports and increasing growth to the range of 7-8 percent annually on a sustainable basis.



2. **Reforms to enhance the business environment are currently underway and seek to address the obstacles to investment identified in the World Bank Group's most recent Doing Business report for Bangladesh.** Bangladesh currently ranks 177th out of 190 countries in the ease of doing business ranking. The report identifies several areas where significant progress could be made to facilitate private sector engagement, including on getting electricity, accessing credit, enforcing contracts, facilitating trade, and paying taxes.

3. **Considering the high growth rates achieved in Bangladesh over the recent years and the remarkable progress made in reducing poverty, the authorities emphasize that addressing these shortcomings could yield significant benefits, especially by accelerating growth and enhancing living standards.** In September 2017, the National Committee for Monitoring and Implementation of Doing Business Reforms was formed, which brings together fifteen government agencies, with the Bangladesh Investment Development Authority (BIDA) serving as its secretariat. An action plan with specific timelines has been developed to secure a double-digit ranking by 2021.

4. **Key selected reforms in the action plan include**:

- *Meeting the demand for power*: reducing the time required to obtain a commercial electricity connection from 400+ days to 4 weeks

- *Accessing Credit*: increasing coverage by the Credit Information Bureau (June 2018); enhancing online information exchange between Bangladesh Bank and the Microcredit Regulatory Authority (June 2019); and enacting a new Secured Transaction Law (December 2018)

- *Enforcing Contracts*: accelerating contract enforcement through review and analysis of the Bangladesh Arbitration Act (December 2017); creating additional courts in Dhaka and

Chittagong for commercial disputes (December 2018); and setting a 365-day limit for disposal of cases

- *Trading Across Borders*: reviewing the Customs Modernization Strategic Action Plan (March 2018); implementing an Authorized Economic Operator program (December 2018); and establishing a National Single Window for traders (June 2020)

- *Paying Taxes*: enacting the Direct Taxes code to simplify taxes on personal and business income (June 2019); implementing a risk management system to enhance auditing of tax payments (November 2019); and implementing the new VAT Law

5. **Another important reform highlighted by the authorities concerns the establishment of a One Stop Shop (OSS) for investor services.** This is an attempt to bring the different regulatory requirements of business (registration, licenses, permissions, etc.) in one place to minimize the cost and time burden for businesses and individuals. The OSS Bill was passed in parliament on February 5, 2018, proposing a 'one stop service committee' to ensure effective management, to be headed by a cabinet minister. Envisaged benefits of the OSS include:

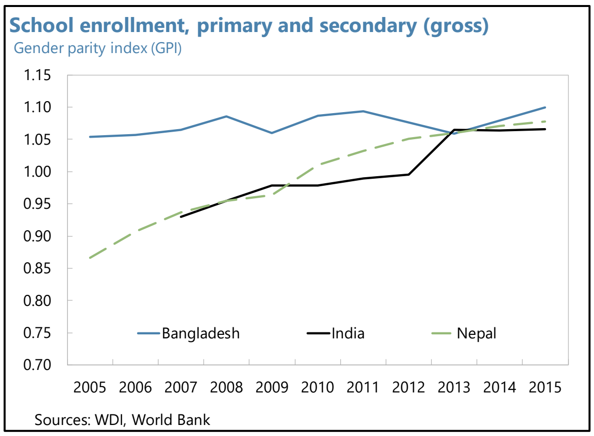
- Ensuring better coordination among respective agencies and easier entry for potential investors in Bangladesh.
- Providing a single platform for all information required by investors and individuals, including processes and forms.
- Interoperability, with the OSS facilitating an enhanced information system, better back-end information management, and a data dissemination mechanism.
- Eliminating information duplication by automatically segregating information as per the requirements of the approving agency.
- Better coordination and information transparency, by tracking application updates and channeling all investor-government communication through OSS.

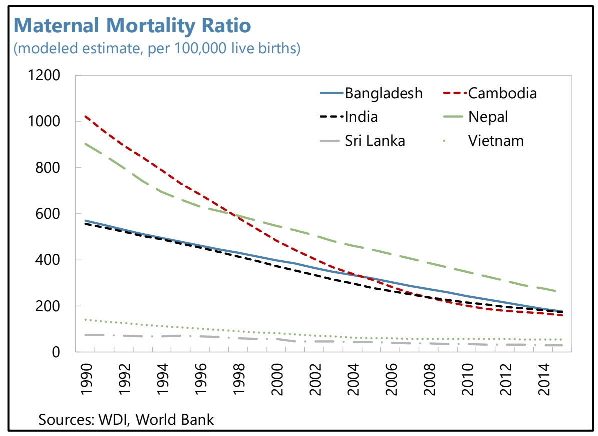
6. **BIDA recently finalized its One Stop Shop for Investor Services model, including frameworks and functions.** Five agencies—BIDA, the National Board of Revenue, the Office of the Registrar of Joint Stock Companies and Firms, the Chief Controller of Import and Export, and the Capital Development Authority—will participate in the first phase of the OSS, and BIDA developed re-engineered process maps for 15 processes delivered by these five agencies. The next step is to develop Standard Operating Procedures for the selected processes, with the launch of the pilot OSS scheduled for July 1, 2018, and the launch of the fully-fledged OSS planned for July 1, 2019 (www.bida.gov.bd)

Annex VII. Efforts to Boost Female Labor Force Participation

Background

1. **Bangladesh has made tremendous progress in gender equality as part of their five-year plans.** Gender disparity in primary and secondary education has been eliminated, and maternal mortality has declined substantially.[1] In 2005, the authorities introduced Gender Responsive Budgeting, and as of FY17 forty-three ministries have reported their progress on advancing gender equality. Bangladesh also implements the 'National Women Development Policy' which provides a regulatory framework for protecting women's rights and privileges.[2] The WEF's Global Gender Gap Report (2017) recognizes Bangladesh as South Asia's top performer for improved gender parity





2. **This progress has also been reflected in the increasing female labor force; however, participation rates are still low compared to comparator countries.** The large informal sector in the economy provides some explanation behind the low participation rates in the formal sector; however, other challenges also play an important role in explaining the low rates. [3]

Challenges

3. **The high social pressures for women to get married, including before the legal age, typically increases the tendency to drop out of school and consequently the labor force.**[4] While great strides have been made in the enrollments for primary and secondary education, this doesn't necessarily translate into skills needed for the current labor market. Women, especially those in the rural areas, are also disadvantaged from a lack of key infrastructure such as safe and reliable transportation and access to clean water. Furthermore, despite significant improvements in financial

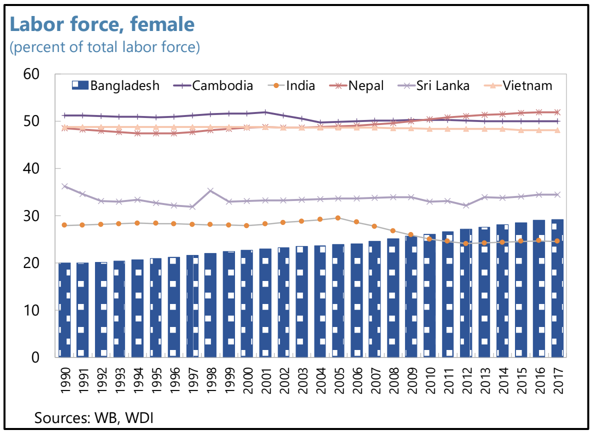
[1] The gender parity index for the gross enrollment ratio in primary and secondary education is the ratio of girls to boys enrolled at the primary and secondary levels in public and private schools.

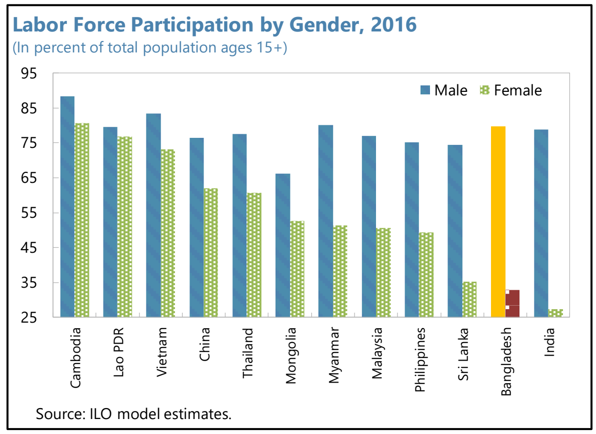
[2] 'Gender equality and women's empowerment: Suggested strategies', General Economics Division (GED) of the Planning Commission - Background Notes for 7th Five Year Plan (2015-16 to 2019-20).

[3] Quarterly Labor Force Survey 2015-16

[4] Legally, in Bangladesh the minimum age of marriage is 21 for boys and 18 for girls.

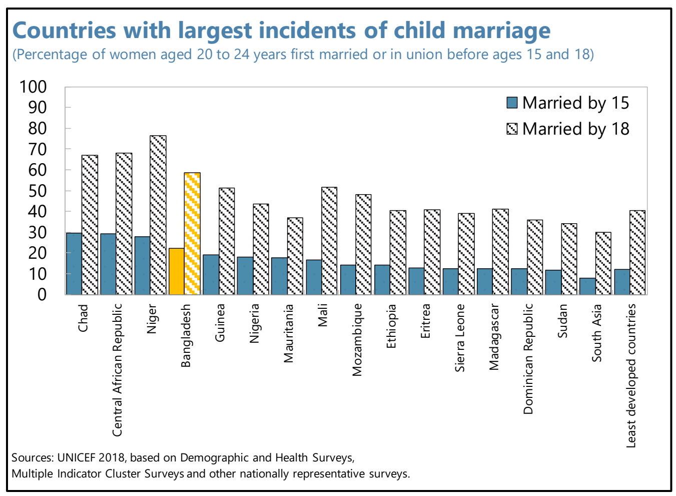
inclusion, access to finance for women continues to be limited. A recent survey by a domestic think tank on the RMG sector has shown that gender based disparity in jobs and wages, despite all the advancements made to strengthen worker's rights, still prevails. This survey also highlighted a shift towards hiring male workers resulting from automation in the RMG sector. [5]





Policy responses

4. Education and vocational training are especially important in Bangladesh given that they address not only the demands of the labor market, but also social causes such as child marriages.[6] The new Child Marriage Restraint Act was adopted in 2017 and an action plan to end child marriage is being finalized.[7] Programs like the 'Female Secondary School Assistance Program' have had success in keeping girls in school, and others such as the Technical and Vocational Education and Training (TVET) Reform, Skills Towards Employment and Productivity (STEP), and Northern Areas Reduction of Poverty Initiative (NARI) are focusing on developing necessary skill-sets with the intention of promoting better job opportunities and reducing the gender gap. [8, 9] For both education and health,



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[5] http://rmg-study.cpd.org.bd/cpd-study-stresses-need-balanced-level-upgradation-rmg-sector/

[6] https://www.unfpa.org/child-marriage

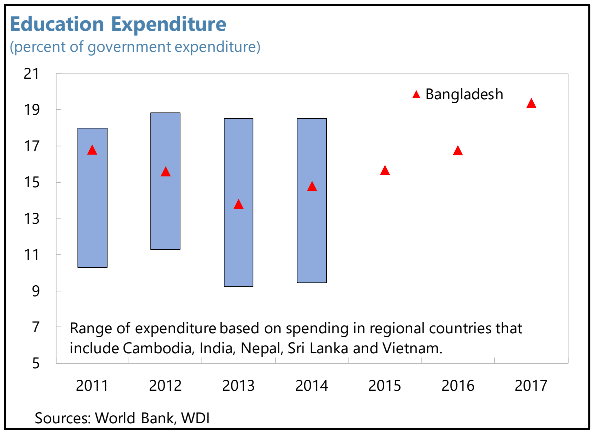
[7] A Scoping Analysis of Budget Allocations for Ending Child Marriage in Bangladesh 2017. Bangladesh Bureau of Statistics and UNICEF Bangladesh 2017, Dhaka, Bangladesh.

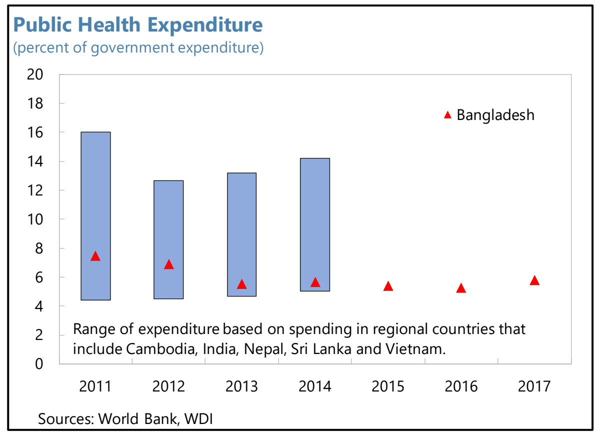
[8] Hong, Seo Yeon; Sarr, Leopold Remi. 2012. Long-term impacts of the free tuition and female stipend programs on education attainment, age of marriage, and married women's labor market participation in Bangladesh (English). Washington DC; World Bank.

[9] ILO's TVET Reform Project is an initiative of the government addresses quality of vocational educational and training. IDA's Skills and Training Enhancement Project (STEP) is an initiative helping poor, under educated students –

the current annual development plan has set various targets. However, compared with other countries in the region, Bangladesh's expenditure on health could benefit from a boost. Access to health services is crucial to help women reduce the time-consuming health care obligations in the family while quality maternal health care is vital for re-entering the labor force.

5. Reducing gender discrimination via a strong legal framework is also an important priority.[10] This will help enhance workers' rights and directly affect women in the labor force. The proposed amendments to the current labor act should be implemented promptly to ensure its compliance with international standards. The labor act governing the export processing zones (Bangladesh Export Processing Zones Authority Act) will also play important role because of the





sizable number of female workers in the EPZs.[11] In addition, the authorities should consider exploring successful policies and programs from other countries, such as bringing women back into the labor force a few years after they get married ('Back to Work' in Mauritius) to see if these may be tailored to meet the needs in Bangladesh.[12]

6. To improve access to finance for women, the authorities have adopted policies such as directed lending, refinancing facilities, and dedicated customer support. Along with this, the authorities make efforts to improve financial literacy via programs with agencies, such as the Bangladesh Securities and Exchange Commission and companies like MasterCard, that specifically aim to educate women about finance, which will also improve women's access to finance.[13, 14]

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especially women – to acquire new skills that can lead to paid work. The Northern Area Poverty Reduction Initiative (NARI) project operated by Bangladesh Export Processing Zones Authority (BEPZA) and the World Bank trains unemployed women of North Bengal to reduce poverty through employment generation.

[10] Kochhar, Jain-Chandra, Newiak, eds. 2016. Women, Work, and Economic Growth: Leveling the Playing Field. International Monetary Fund, Washington, DC

[11] In 2016, according to BEPZA, more than 450,000 workers were employed in the eight EPZs of which 65 percent were female; NARI Project http://www.bepza.gov.bd/activities/view/57a17a5c-e8f4-40fe-9f4c-48a2c0b99bee

[12] Back to Work facilitates Mauritian women over 35 years to take up or resume employment; http://www.backtowork.mu/howitworks.php

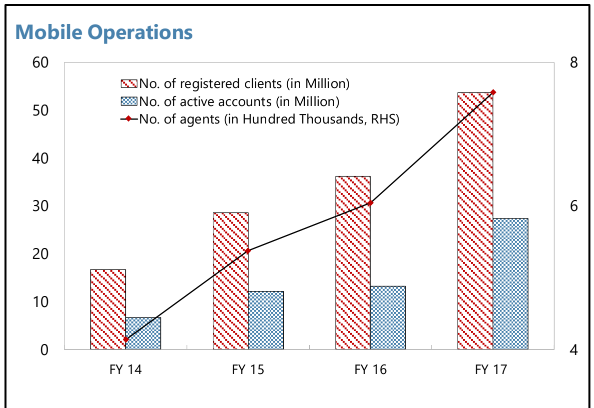
[13] Bangladesh Bank Annual Report 2016-17

[14] http://www.financialliteracybd.com/index.php and https://newsroom.mastercard.com/asia-pacific/press-releases/mastercard-buro-bangladesh-bank-reach-another-25000-in-third-phase-of-financial-literacy-program/

Annex VIII. Financial Inclusion in Bangladesh

1. The authorities continue to implement various measures to promote financial inclusion, while ensuring financial stability. No-frill accounts were introduced in 2010 for farmers as an affordable means to receive government transfers, which increased processing speeds while reducing corruption and administrative costs. Coverage was expanded later to workers from various industries, the physically challenged, and school children.

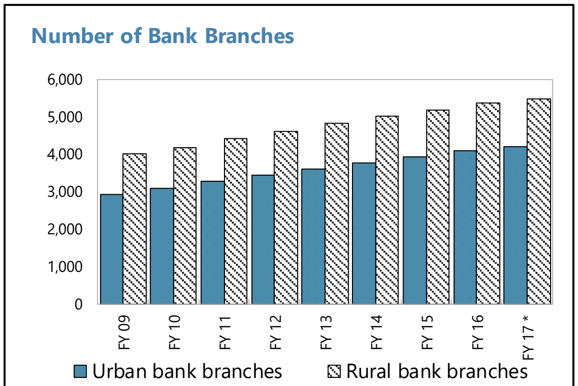
2. Rapid growth of mobile financial services and agent-based banking helped to expand coverage into geographically difficult locations. Document collection, small cash transfers, and monitoring of loan disbursements are now easily achieved with these two services. There are currently five mobile phone operators, eighteen banks with mobile financial services, and fourteen banks offering agent based banking as of December 2017. The number of agents for mobile banking services increased from 414,170 in 2014 to 758,570 in 2017, while the number of active mobile money accounts increased from 0.7 million to 27 million over the same period. Agents for agent-based banking have also grown, reaching1,847 in Jun 2017. Microcredit continues to play an important role by providing 10 percent of private sector credit extended by the banking system.



Source: Bangladesh Bank

3. Mandating banks to open fifty percent of their branches in rural areas and launching the National Payment Switch Bangladesh have also promoted financial inclusion.[1] The number of bank branches in rural areas exceed those in the urban areas, and these rural branches' deposits continue to increase. More than 9,000 ATMs exist around the country with close to 36,300 Point of Sales machines.

4. Access to finance has improved for SMEs and priority sectors. The Agricultural and Rural Credit Policy and Program set interest ceilings and disbursement targets for these sectors. Financial institutions are also encouraged to set targets for credits to SMEs, especially women entrepreneurs. Between 2010 and 2017, loan disbursements to women entrepreneurs more than doubled supported by the refinance facilities for banks and



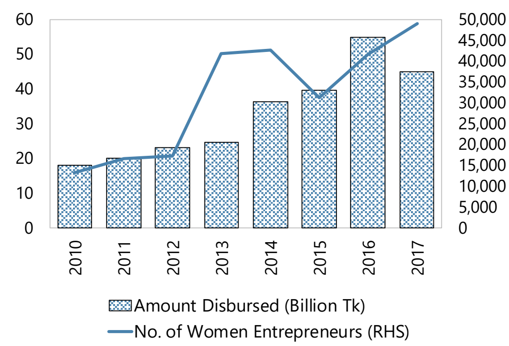
Source: Bangladesh Bank

[1] National Payment Switch Bangladesh (NPSB) is an electronic platform that provides interoperability amongst banks for card based/online retail transactions. The NPSB processes interbank ATMs, Point of Sales (POS), and Internet Banking Fund Transfer (IBFT) transactions.

NBFIs, which provide personally guaranteed uncollateralized loans at preferential rates.

5. While these efforts have yielded remarkable progress in financial inclusion, they have also presented several challenges. For example, while NPLs have decreased in the agriculture sector from three years ago, there has been a sharp increase in the SME sector during the same period. Similarly, mobile finance services have helped expand the coverage of financial services but at the same time it has increased the use of informal channels for remitting and the risks of money laundering/terrorist financing. The authorities are planning on revisiting disbursement targets for priority sectors in consultation with creditor institutions. They are also implementing better Know Your Customer (KYC) policies to enhance the monitoring of the borrowers' credit quality, such as requiring the national identity card for accessing credit. Dedicated window/desk for women and SME entrepreneurs in the creditor institutions, which serve not only as a helpdesk but also help with KYC regulations, have also been setup. For mobile financial services, the authorities have introduced caps on mobile transactions and limit the number of transactions and amounts.[2] The forthcoming National Financial Inclusion Strategy will lay out an overarching framework to make further progress. Credit growth in priority sectors, SME, gender, and rural areas will remain its focus. The strategy should be implemented rigorously with a strong accountability framework, supported by periodic surveys and impact assessment.

Female Entrepreneurs



Source: Bangladesh Bank

[2] More information on the actual amounts included in this cap are published on the Bangladesh Bank website. https://www.bb.org.bd/fnansys/paymentsys/mobilefin.php

INTERNATIONAL MONETARY FUND

BANGLADESH

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 10, 2018

Prepared By	Asia and Pacific Department (With inputs from other departments, the World Bank, and the Asian Development Bank)

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FUND RELATIONS

(As of March 31, 2018)

Membership Status

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

General Resources Account

	SDR Million	Percent Quota
Quota	1,066.60	100.00
Fund holdings of currency (exchange rate)	932.60	87.44
Reserve tranche position	134.08	12.57

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	510.40	100.00
Holdings	962.43	188.56

Outstanding Purchases and Loans

	SDR Million	Percent Quota
ECF arrangements	630.82	59.14

Latest Financial Arrangements

(In millions of SDRs)

Type	Date of Arrangement	Expiration Date	Amount Approved	Amount Drawn
ECF	Apr. 11, 2012	Oct. 29, 2015	639.96	639.96
ECF[1]	Jun. 20, 2003	Jun. 19, 2007	400.33	316.73
ECF[1]	Aug. 10, 1990	Sep. 13, 1993	345.00	330.00

[1] Extended Credit Facility (ECF), formerly PRGF.

Projected Payments to the Fund[2]

(In millions of SDRs (based on existing use of resources and present holding of SDRs))

	2018	2019	2020	2021	2022
Principal	36.57	82.28	91.42	127.99	118.85
Charges/Interest	0.02	0.02	0.02	0.02	0.02
Total	36.58	82.30	91.44	128.01	118.86

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Article IV Consultation

The previous Article IV consultation was concluded on May 26, 2017 (IMF Country Report No. 17/147).

Safeguards Assessment

- A safeguards assessment of Bangladesh Bank (BB) was concluded in July 2011. Since then, BB has implemented a number of recommendations and strengthened audit committee oversight. BB's autonomy continues to be undermined, as the present legal framework allows for considerable government influence over bank operations. Progress in establishing effective safeguards in key areas needs to be supported by effective oversight and continued capacity building.

Anti-Money Laundering and Combating the Financing of Terrorism

- Bangladesh has made progress in strengthening the anti-money laundering and counter-terrorism financing. The Asia/Pacific Group on Money Laundering (APG) completed its assessment of Bangladesh's anti-money laundering and counter-terrorist financing (AML/CFT) system. The assessment is a comprehensive review of the effectiveness of Bangladesh's AML/CFT system and its level of compliance with the FATF Recommendations. The report was formally adopted by at the APG Annual Meeting in September 2016. Bangladesh has made significant progress since the last Mutual Evaluation Report in 2009, reflecting political commitment and leadership on AML/CFT. However, level of effectiveness across the eleven immediate outcome are more mixed. The authorities prepared an action plan to address the shortcomings.

Exchange Arrangement

- The *de jure* exchange rate regime is a float. Effective January 10, 2017, the *de facto* exchange rate arrangement was reclassified from a stabilized to crawl-like arrangement.

- Bangladesh is an Article VIII member and maintains one restriction subject to Fund approval under Article VIII, Section 2(a) on the convertibility and transferability of proceeds of current international transactions in nonresident taka accounts.

Resident Representative

The resident representative office was established in 1972. Mr. Ragnar Gudmundsson is the current Resident Representative since November 2017.

Bangladesh Capacity Development, April 2017–April 2018

Department	Topic	Timing
FAD	Support the BACs Administration	April-18
	Support the BACs Administration	December-17
	Public Financial Management (Scoping Mission, SARTTAC)	July-17
STA	Price Statistics (In-country Training, SARTTAC)	April-18
	External Sector Statistics	April-18
	National Accounts (SARTTAC)	March-18
	E-GDDS (Data Standard & Dissemination Platform)	August-17
	National Accounts (SARTTAC)	July-17
	Consumer Price Index	April-17
MCM	Financal Sector Supervision (SARTTAC)	April-18
	Workshop on Foreign Exchange Market Development and Operations (SARTTAC)	April-18
	Financal Sector Supervision (SARTTAC)	December-17
ICD	Course on Financial Programming and Policies	November-17

IMF-WORLD BANK COLLABORATION

(April 2018)

1. The IMF and World Bank Group (both International Development Association (IDA) and International Finance Corporation (IFC)) work together to promote policies and critical reforms that are essential for maintaining macroeconomic and financial stability and for sustained high growth and poverty reduction in Bangladesh.

- Until recently, the IMF's priorities for macroeconomic policies and structural reforms were anchored by the Extended Credit Facility (ECF) arrangement, approved in April 2012 and completed in October 2015. With support from this arrangement, the authorities restored macroeconomic stability and undertook reforms in the areas of domestic revenue mobilization, notably enacting a new Value Added Tax Act in 2012; tax revenue administration; fiscal expenditure allocation, including the reduction in regressive energy subsidies and strengthening of social safety nets; public financial management, including strengthening the external debt management; banking supervision and regulation, including amending the Banking Companies Act in 2013; addressing weaknesses in the state-owned commercial banks; improving central bank operations; and liberalizing foreign exchange regulations. The priorities for macroeconomic policies and reforms going forward are identified in the main text of this report.

- The Bank's strategy is reflected in the Country Partnership Framework (CPF) for FY16-20, endorsed by the Bank Board in April 2016. The CPF, which is aligned with the Government's Seventh Five Year Plan, is anchored in the Bangladesh Systematic Country Diagnostic (SCD), which was completed in 2015. The SCD identified five transformational investments needed for Bangladesh to create more and better jobs and to accelerate poverty reduction. These are in the areas of energy; inland connectivity and logistics; regional and global integration; urbanization; and adaptive delta management. In addition, the SCD identified three foundational priorities which represent important prerequisites for growth and where policy attention must be sustained: macroeconomic stability; human development; and institutions and business environment.

2. The teams note that collaboration between the IMF and the World Bank Group is strong, both at headquarters and in the field (through the IMF Resident Representative's Office and the World Bank's Country Office). For instance:

- There are frequent formal and informal exchanges of information on each other's activities and on assessments of developments, the outlook, and key policy issues.

- The teams invite each other to participate in critical internal discussions, share key documents, and seek comments on them.

- Staffs are also invited to relevant Board meetings.

- The teams regularly discuss the division of labor between the two institutions, and collaborate on the Debt Sustainability Analysis (DSA).
- The World Bank and IMF are now also in the same building in Dhaka, facilitating yet deeper collaboration.

3. The teams agree that the two institutions should remain focused on the following reform areas, and based on the following division of labor:

4. Tax policy and administration. Bangladesh has one of the lowest tax-to-GDP ratios in the world. To boost growth, higher public investment in critical infrastructure and human development is needed and for that purpose it is necessary to improve revenue generation. Under the ECF arrangement, the authorities enacted a new Value Added Tax (VAT) Act, 2012, which was to be implemented from July 2017; however, the implementation was again postponed to July 2019. Nevertheless, the postponement of the implementation of the VAT Law, 2012 does not impede National Board of Revenue (NBR) from moving from a paper-based organization to a fully automated institution. Accordingly, IDA-financed Value Added Tax (VAT) Improvement Program is being restructured to place a strong emphasis on automation and process simplification (irrespective of the legislative agenda). Automation plays a key role in decreasing tax administration and taxpayers’ costs of compliance, increasing transparency of tax administration, and fostering voluntary compliance thereby broadening the tax base.

Division of labor: The new VAT law and the VAT implementation plan continue to receive technical assistance (TA) from the IMF. A resident advisor was in place until late 2014 to help with VAT implementation. IDA is providing financial and TA support for several aspects of implementation, including designing organizational reforms, new business processes, and taxpayers’ outreach which are urgent priorities under the VAT Improvement Program (VIP). In early 2017, a joint Bank-Fund mission carried out the Tax Administration Diagnostic Assessment Tool (TADAT). Both institutions are currently providing TA to the NBR.

5. Public financial management (PFM). Sound PFM is important for maintaining fiscal discipline and improving the quality of public expenditure. The Government of Bangladesh (GoB) has undertaken a series of public financial management reform programs since the 1990s. Since 2007, the WB-administered a multi-donor funded Strengthening Public Expenditure Management Program (SPEMP) for supporting GoB PFM Vision and Medium-Term Rolling Action Plan 2007-12. Through three discrete projects, SPEMP supported improving core PFM issues in the executive branch of government, as well as strengthening public expenditure oversight functions in Parliament (Public Accounts Committee) and Auditor General. In FY 2016, the GoB approved a new PFM strategy 2016-2021. The PFM reform strategy draws on Bank-supported five policy notes (legal and regulatory framework; Integrated Budget and Accounting System (iBAS++); strengthening policy-budget link and integration of non-development and development budgets; civil servants’ pensions; and State-Owned Enterprises (SOE) financial reporting and oversight) and IMF Fiscal Affairs Department Technical Assistance Report 2015 on Strengthening the Budget Formulation Process, and other IMF analyses.

Division of labor: IDA has provided assistance through its administration of the Strengthening Public Expenditure Management Program. The SPEMP was extended for five-years until December 2021 to allow the WBG and the SPEMP Donors to support the PFM Strategy implementation as a key element of a broader engagement with the Government in this area. The Government has also requested IDA financing for the effective implementation of the PFM Strategy and a scoping mission will be soon conducted. Concurrently, IDA is also leading on public procurement reform and capacity building. It has been assisting the Government for over a decade through three consecutive credits (Public Procurement Reform Project- PPRP; PPRPII, and PPRPII Additional Financing), with the recent introduction of electronic government procurement that is rapidly expanding. Another project, Digitizing Implementation Monitoring and Public Procurement Project (DIMAPPP), has just become effective. The IMF is providing support through several TA missions on cash flow forecasting and management, on budget and accounting classification, and on the budget formulation process.

6. Debt management. There had been significant progress on strengthening debt management practices under the ECF arrangement, but more needs to be done.

Division of labor: The IMF and IDA will continue working jointly in this area, including on the DSA, with the IMF coordinating views on main macroeconomic assumptions and outlook and supporting structural reforms on debt management through Article-IV consultations, and IDA providing technical support on debt management capacity through the Public Expenditure and Revenue Analysis (PERA) work, analytical work on PFM reforms as well as a Debt Management Performance Assessment (DeMPA).

7. Monetary and exchange rate policies. The IMF takes the lead in this area. IDA is playing a complementary role through operations to strengthen payments systems at Bangladesh Bank (BB).

8. Financial sector reforms. Capital shortfall in some banks, accumulated non-performing loans (NPLs) in SOBs, and weakening corporate governance across the board have affected stability of the financial sector. Technical support from the Bank and IMF would benefit Bangladesh Bank, and the financial sector as a whole, at this time when the art of balancing stability and growth is so important. The IMF had provided TA on banking supervision, including through a resident advisor until late 2014, and on strengthening the state-owned commercial banks (SOCBs). The IMF will continue to support banking sector reforms through the Article-IV consultations. IDA will provide support to improve the regulatory and oversight capacity of BB through policy dialogue and just in time notes.

9. Energy sector reform. Over the last three years, spending on subsidies, particularly on energy, has declined as a share of GDP, through the domestic price adjustments. Electricity price adjustments will need to continue in the near term to match the increased costs of generation. The gas sector is overly dependent on the domestic gas company for aggregating gas supply, exploring for onshore gas, and regulating the gas sector. The prevailing legal framework supports strong state involvement in exploration and production. A gradual adjustment of domestic gas prices will be important. Current efforts to increase gas tariffs face strong public opposition. Reducing financial and operational inefficiencies in state-owned enterprises in the energy sector is also critical. Despite strong resistance from the worker's union, Bangladesh Power Development Board has been able to corporatize one of its distribution utilities in the recent past with the support of strong political will. Bangladesh ranks poorly among the low-income countries in terms of availability of electricity. Reliance on expensive liquid fuel for power generation needs to be reduced which eventually would reduce the subsidy burden on the government. Proper regulations and further incentives are needed for stepping up private investment in the energy sector. Institutionalization of transparent and competitive procurement processes can send the right signal to the market and help attract qualified sponsors. Import of electricity from India, a cheaper option than running liquid fuel-based plants, has started and more interconnections with India are being planned. The long-run option of tapping into the hydropower resources of Nepal and Bhutan should be seriously considered.

Division of labor: IDA will lead on policy dialogue and investment in this area, with the IMF focused on policies to address fiscal implications.

10. Social protection. Under the ECF arrangement social spending as a share of GDP was protected. However, further improvement is needed, particularly through better targeting, and consolidation of a large number of programs. Rationalization of regressive subsidies will also help provide additional room for enhanced spending on social safety net programs.

Division of labor: IDA is leading in this area through support to the development of the National Household Database to be used for objective and transparent beneficiary selection and strengthening administrative platforms at the central and local levels for improved management and better coordination of Social Safety Nets (SSN).

11. Trade and investment climate reform. To boost productivity and investment, it is vital to create a level playing field for all sectors and reduce the cost of doing business.

Division of labor: Two WBG Global Practices, Finance, Competitiveness, and Innovation (FCI) and the Macroeconomics, Trade, Investment (MTI), both joint IDA-IFC Units, are targeting trade and investment reforms through a holistic approach. As part of integrated solution, IDA is providing investment financing (including pipeline) while IFC provides complementary advisory services in areas of business environment reforms, special economic zones, transport logistics, and trade and sectoral competitiveness for export diversification. Both these units will provide implementation support to address institutional and policy reforms (including those addressed in the Diagnostic Trade Integration Study and Doing Business analytics) to improve the investment climate, and boost trade and sectoral competitiveness. The IMF provided support in reviewing the foreign exchange regulations.

12. Statistical policy. *Division of labor*: IDA is working on poverty, social, development statistics, and statistical infrastructure including IT needs and the IMF on macroeconomic and financial statistics. IDA is currently in the approval phase of a new investment loan to support the implementation of key elements of the National Strategy for Development of Statistics (NSDS). The objective of the investment loan is to improve the capacity of the Bangladesh Bureau of Statistics

(BBS) to produce quality core statistics and make them accessible in a timely manner to policy makers and the public. The project will focus on (a) improving data collection and quality of data in several areas, including gender disaggregation where appropriate and (b) strengthening capacity of the BBS for better management and dissemination of improved statistics. The proposed project will build on progress made thus far in some reform areas of the NSDS while complementing investments by the GOB and other development partners.

13. Other structural policies. The World Bank keeps the IMF informed about its work on governance and anti-corruption, local government and decentralization, and private sector development. Upstream sharing allows the IMF to comment on such work before it is finalized.

14. The teams agree to continue to keep each other informed of their respective activities, coordinate financial and technical support, and share key documents.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

(March 2018)

Lending and Technical Assistance Operations

1. **Bangladesh had cumulative public sector borrowing from the Asian Development Bank (ADB) of US$19.4 billion (260 loans) as of December 31, 2017, and technical assistance (TA) grants of US$258.4 million (432 projects). The country has been one of the largest borrowers of concessional resources.** The loans and TA have supported all key sectors, including energy and transport, social infrastructure, and agriculture and natural resources.

2. **In 2017, the ADB approved a total amount of US$1.4 billion in sovereign loans.** This included loans for (i) Power System Enhancement and Efficiency Improvement Project (US$616 million of which US$16 million is from concessional ordinary capital resources loans (COL)); (ii) Third Public Private Infrastructure Development Facility (Tranche 1) (US$260 million of which US$10 million is from COL); (iii) Third Urban Governance and Infrastructure Improvement Project (Additional Financing) (US$200 million of which US$100 million is from COL); and (iv) South Asia Subregional Economic Cooperation Dhaka-Northwest Corridor Road, Phase 2 (Tranche 1) (US$300 million of which US$50 million is from COL).

3. **The ADB has also supported 14 private sector projects worth US$1,005 million as of December 31, 2017.** A US$253 million loan and US$330 million political risk guarantee were approved in 2017 for the construction and operation of a 718 MW combined cycle gas-fired power plant in Meghnaghat and an offshore LNG import terminal. The project represents phase 1 of the Reliance Bangladesh Liquified Natural Gas (LNG) and Power Project, providing a total of 3,000 MW of power generation capacity.

Country Partnership Strategy

4. **The Country Partnership Strategy (CPS) 2016-2020, approved on September 28, 2016, focuses on the following priority investments for projects and programs:** (i) easing infrastructure constraints in key sectors such as energy, transport and urban development; (ii) improving human capital through better education and skills development; (iii) promoting economic corridor development; (iv) improving rural livelihoods; and (v) providing climate and disaster resilient infrastructure and services. The CPS is closely aligned with the government's Seventh Five-Year Plan (FY2016-FY2020) priorities and aims to contribute to faster, inclusive and environmentally sustainable economic growth. Under the CPS, ADB aims for lending totaling US$8 billion for the period of 2016-2020, including non-sovereign lending. ADB's market-based financing from its ordinary capital resources would be used for major revenue-generating infrastructure projects. An average of US$4.3 million per annum and above in TA resources was included. In addition, TA loans

[1] Bangladesh joined the Asian Development Bank in 1973.

and project design advances under the lending programs will support project and program preparation and advance their readiness.

5. The CPS prioritizes the drivers of change—higher private sector participation, addressing institutional capacity constraints and improving governance, deepening regional cooperation and integration and promoting gender equality. The CPS will combine financial support with knowledge. The CPS is operationalized through the Country Operations Business Plans (COBPs). The COBP 2018–2020 was approved in August 2017.

6. Over a five-year cumulative period from 2013–2017, Bangladesh leveraged US$3.8 billion of cofinancing. By the end of 2017, cumulative direct value-added official cofinancing for Bangladesh amounted to US$8.2 billion for 61 investment projects and US$85.7 million for 108 technical assistance projects. In 2017, five projects received cofinancing: (i) from Japan International Cooperation Agency for South Asia Subregional Economic Cooperation Road Connectivity-Additional Financing (US$279.27 million); (ii) from Japan International Cooperation Agency for South Asia Subregional Economic Cooperation Dhaka-Northwest Corridor Road Project, Phase 2-Tranche 1 (US$242.52 million); (iii) from Export Import Bank of Korea for South Asia Subregional Economic Cooperation Chittagong-Cox's Bazar Railway Project, Phase 1-Tranche 1 (US$99.04 million); (iv) from Export Import Bank of Korea for Secondary Education Sector Investment Program-Tranche 2-Additional Cofinancing (US$76.02 million); and (v) from Japan Fund for Poverty Reduction for Bangladesh Power System Enhancement and Efficiency Improvement Project (US$2 million).

Economic and Sector Work Program

7. Each year, the ADB publishes its Asian Development Outlook and Asian Development Outlook Update, in which it assesses macroeconomic performance. The ADB's Bangladesh Resident Mission (BRM) also prepares a bimonthly Economic Indicators Update. In addition, BRM commissions studies on economic and thematic areas, relevant to the country's development issues. In 2017, ADB completed a study titled Southwest Bangladesh Economic Corridor Comprehensive Development Plan, which discusses the imperatives for economic corridor development in Bangladesh and provides future areas of focus to ensure a holistic development strategy for the country's southwest region. The Comprehensive Development Plan is a strategic document that outlines broad categories of industries that are candidates to be promoted, infrastructure that needs to be developed, and the necessary institutional frameworks, policies and regulations.

STATISTICAL ISSUES

(April 2018)

Assessment of Data Adequacy for Surveillance

1. General. Data provision has some shortcomings, but is broadly adequate for surveillance. The most affected areas are national accounts, fiscal, and external sector statistics.

2. National Accounts. Bangladesh's annual GDP time series has a base year of 2005/06 based on a benchmark compiled and published by the Bangladesh Bureau of Statistics (BBS) in 2013. Two shortcomings include: (a) value added of residential dwelling construction is dependent upon data collected in a 1980/81 survey; and (b) the absence of a comprehensive producer price index reduces the quality of estimates of price change used to compile industry value added. A revision of the entire GDP time series based on the new 2015/16 benchmark is expected to be published in financial year 2019/20. Final annual GDP estimates are now published four, rather than ten, months after the reference period. The BBS has been provided with technical assistance to use value-added tax data to compile quarterly estimates of GDP and construct a statistical business register.

3. Price Statistics. A new CPI series with base year 2005/06 was introduced in July 2012 and improved coverage. However, data users such as Bangladesh Bank have raised concern about the reliability of the CPI data. The CPI series is currently undergoing further improvements, including incorporating the recent household survey and Classification of Individual Consumption According to Purpose (COICOP). The IMF provided technical assistance TA in these areas. The producer price index has an outdated base year (1988/89) and requires urgent attention**.**

4. Government Finance Statistics. The Ministry of Finance (MoF) is currently revising the Budget and Accounting Classification System (BACS) to follow the latest international standard (GFSM 2014) and integrate the accounting and reporting systems for the budgetary central government. The new BACS is expected to be incorporated into the FY18 Budget. Bangladesh currently reports budgetary central government flow data, including COFOG data, for the GFS yearbook. No stock data is reported. The coverage of extrabudgetary and local government units outside central government is inadequate and is an area for future attention. The Bangladesh Bank (BB) provides data to the World Bank-IMF Quarterly Public Sector Debt Statistics database.

5. Monetary and Financial Statistics. BB compiles monetary data using the standardized report forms (SRFs) framework. The SRFs are reported electronically to the IMF on a regular basis. As a result, a consistent time series based on SRF data is available from December 2001. A survey of Other Financial Corporations (OFCs) is not yet available.

6. Financial Soundness Indicators. Bangladesh reports all 12 core and 9 encouraged Financial Soundness Indicators (FSIs) for deposit takers and two FSIs for real estate markets for posting on the FSI website. However, FSIs are reported with semi-annual frequency and long lag.

7. External Sector Statistics (ESS). A quarterly BPM6 compliant time series covering the period 2005 to 2017 inclusive for balance of payments and international investment position; a biannual time series covering the period June 2014-June 2017 for the IMF's coordinated portfolio investment survey; an annual time series until 2016 inclusive for the IMF's coordinated direct investment survey; and a quarterly time series until 2017 Q3 for external debt statistics have been published by BB and reflect improved coverage of indicators, as well as of periodicity and dissemination. These were possible with TA support from the Japan Subaccount Project on the Improvement of ESS in the Asia and Pacific region. Despite the important progress made, steps remain to be taken by the BB to further improve the quality of ESS and ensure the continuous timely compilation and dissemination of Bangladesh's ESS. To assist the authorities in continuing developing Bangladesh's capacity development, they will receive TA under the new South Asia Regional Training and Technical Assistance Center (SARTTAC) ESS follow-up project.

8. Data Standards and Quality. Bangladesh participated in the General Data Dissemination System (GDDS) in March 2001, which was superseded by the enhanced GDDS (e-GDDS) in 2015 with a focus on data dissemination to support transparency and surveillance. In implementing the e-GDDS, Bangladesh began publishing in October 2017 a set of macroeconomic data in both human- and machine-readable (SDMX) formats. This marks a major milestone in Bangladesh's statistical development and facilitates the authorities' efforts to achieve their goal of subscribing to the Special Data Dissemination Standard, a higher tier of the IMF's data dissemination standards.

Bangladesh: Table of Common Indicators Required for Surveillance

(As of April 24, 2018)

	Date of latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	03/2018	April 2018	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	03/2018	April 2018	D	D	D
Reserve/Base Money	03/2018	April 2018	D	D	D
Broad Money	03/2018	April 2018	M	M	M
Central Bank Balance Sheet	03/2018	April 2018	M	M	M
Consolidated Balance Sheet of the Banking System	03/2018	April 2018	M	M	M
Interest Rates[3]	4/24/17	4/24/17	W	W	D
Consumer Price Index	03/2017	April 2018	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]—General Government[5]	n/a	n/a	n/a	n/a	n/a
Revenue, Expenditure, Balance and Composition of Financing[4] —Central Government	Dec. 2016	April 2017	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Jun. 2016	Nov. 2016	Q/M	Q/M	Q/M
External Current Account Balance	Q4/2017	April 2018	M	M	M
Exports and Imports of Goods and Services	01/2018	April 2018	M	M	M
GDP/GNP	FY2016	Jan/2018	A	A	A
Gross External Debt	FY2016	Nov. 2016	A	A	A
International Investment Position[7]	Q4/2017	April 2018	Q	Q	A

[1] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); not available (NA).
[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[3] Both market-based and officially determined, including discount rates, money market rates, and rates on treasury bills, notes, and bonds.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The general government consists of the central government (budgetary funds, extra-budgetary funds, and social security funds) and state and local governments. Data for the general government are currently not being compiled due to capacity limitations.
[6] Currency and/or maturity composition may not be available for the most recent data.
[7] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

BANGLADESH

STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

May 10, 2018

Approved By
Kenneth Kang and Kevin Fletcher (IMF) and John Panzer (IDA)

Prepared by
International Monetary Fund
International Development Association

This debt sustainability analysis (DSA) fully updates the May 2017 joint IMF/WB DSA. Bangladesh's risks of external debt distress and overall debt distress continue to be assessed as low. The FY17 fiscal deficit remains well below the 5 percent of GDP budget target. Spending control and slower implementation of development projects more than compensated for revenue underperformance. The issuance of National Savings Certificates (NSCs) remains high. Over the medium term, debt ratios are projected to remain on a sustainable path, assuming continued spending restraint, with the deficit used to finance productive investment. Boosting budget revenue is key to creating fiscal space for diversification and growth. The authorities are delaying the implementation of the VAT reform further by two years. Any additional costs from spending pressures ahead of the parliamentary elections and from the Rohingya refugees remain key risks.[1]

[1] For the purposes of this DSA, the public sector comprises the central government and nonfinancial public enterprises. This analysis is based on the joint Fund-Bank debt sustainability framework for conducting debt sustainability analysis in low-income countries. Under IDA's Country Policy and Institutional Assessment (CPIA), Bangladesh is assessed to be a medium performer, with an average rating of 3.32 during 2014–16. This DSA uses the indicative thresholds for countries for this category.

A. Background

1. This DSA presents staffs' macroeconomic outlook and assumptions about the public sector's external and domestic borrowing paths. The DSA is based on estimates of the stock of public external, domestic, and private external debt as of end-FY17 and analyzes the likely trajectories of standard debt sustainability (solvency and liquidity) ratios through FY38.[2]

2. As of end-FY17, total public and publicly guaranteed (PPG) external debt is estimated to be US$35 billion (14.3 percent of GDP).[3] Multilateral creditors account for a large share of the total public and publicly guaranteed debt, with the World Bank and the Asian Development Bank being the largest creditors while China and Japan are the largest bilateral creditors.

Table 1. External (PPG) and Domestic Debt
(end-FY17)

end- FY 2017	US$ billion	Percent of PPG debt
Total PPG Debt	35.0	100.0
Multilateral	23.3	66.6
of which		
World Bank (IDA)	13.1	37.4
Asian Development Bank	8.2	23.5
Bilateral	5.8	16.7
of which		
Japan	3.2	9.2
China	1.0	2.9
Short Term Debt	2.5	7.3
Guarantees (SOE)	3.3	9.5

end-FY 2017	Taka billion	Percent of Domestic Debt
Total Domestic Debt	3731.6	100.0
Bangladesh Bank	158.7	4.3
Deposit Money Banks	1407.0	37.7
T-bills	235.2	6.3
T-bonds	1117.6	29.9
Others	54.3	1.5
Nonbanks	2165.9	58.0
NSCs	1909.0	51.2

Source: Bangladesh Authorities

3. Total public sector domestic debt as of end-FY17 amounted to 18.9 percent of GDP, or 180 percent of central government revenues, including grants. Domestic debt comprises mostly commercial banks' holdings of treasury instruments and non-banks' holdings of NSCs. It also includes net credit by Bangladesh Bank. The issuance of expensive NSCs increased sharply in FY17 and has remained high in FY18.

B. Underlying Assumptions

4. The main changes to the macroeconomic assumptions relative to the previous DSA are described below, primarily reflecting revisions to FY17 and the projections:

- **Real GDP growth.** Real GDP growth further strengthened to 7.3 percent in FY17 from 7.1 percent in FY16, driven by domestic demand. Growth is expected to moderate slightly to 7.0 percent in FY18, led by private consumption and investment. The Seventh Five-Year

[2] Fiscal year is defined from July to June.

[3] PPG external debt consists of medium to long term loans from multilateral and bilateral creditors, short term debt and borrowings of the state owned enterprises. Domestic debt does not include the outstanding liabilities of state-owned enterprises to the banking system.

Plan (FY16 – 20) aims at increasing real GDP growth to 7.4 percent on average during FY16-20. However, staff estimate growth to be around 7 percent, below the authorities' target. A growth accounting exercise explains that to be able to reach their growth target over the next three fiscal years, the authorities will need to boost investment by a large margin.

- **Inflation.** Headline inflation increased slightly to 5.9 percent in FY17 (y/y) towards the end of fiscal year due mainly to higher food prices. After picking-up in mid-2017 due to higher flood-related food prices, inflation is expected to decline to below 6 percent, close to the central bank's 5.5 percent average inflation target.

- **Fiscal deficit.** The FY17 fiscal deficit was 3.4 percent of GDP, well below the 5 percent of GDP budget target. Spending control and slower implementation of development projects more than compensated for revenue underperformance. The projected larger fiscal deficit in FY18 is mainly driven by increases in the annual development program spending, which would compensate for the slower implementation in FY17 and expedite infrastructure development. Over the medium term, it is assumed that spending growth will be aligned to projections of revenue growth which currently do not include the VAT implementation.

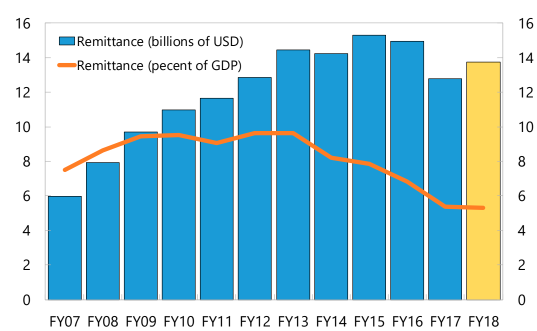
- **Current account.** In FY17, the CA turned into a small deficit (0.6 percent of GDP in FY17). Exports and imports of goods and services grew by an estimated 1.7 percent and 9.0 percent, respectively, while remittances dropped by 14.7 percent. The CA deficit is projected to widen in FY18, with strong import demand for capital machinery and industrial raw materials and a temporary need for food imports. Over the longer term, the CA is expected to remain in deficit in the expectation that investments will continue, as suggested by the strong import demand for capital goods.

Table 2. Macro Assumption Comparison FY16 – FY20

	FY16	FY17	FY18	FY19	FY20
Real GDP growth					
Current DSA	7.1	7.3	7.0	7.0	7.0
Previous DSA	7.1	6.8	7.0	7.0	7.0
Inflation (annual average)					
Current DSA	5.9	5.4	5.9	6.0	6.0
Previous DSA	5.9	6.8	6.0	5.5	5.5
Fiscal deficit (in percent of GDP)					
Current DSA	-3.5	-3.4	-4.3	-4.8	-4.4
Previous DSA	-3.5	-4.9	-4.7	-4.6	-4.4
Current account (in percent of GDP)					
Current DSA	1.9	-0.6	-1.8	-2.3	-2.4
Previous DSA	1.7	-0.4	-1.0	-1.6	-2.0
Remittance growth					
Current DSA	-1.6	-14.7	9.0	3.5	4.5
Previous DSA	-3.0	-17.0	3.5	3.5	4.5

- **Remittances.** After a significant decline in FY17, inflows are expected to pick up this year based on the increase in non-oil growth in the GCC and a recovery driven by relatively stronger global growth. Remittances are expected to grow modestly in FY18, reaching US$14 billion by June 2018. However, attaining historical levels of growth will be an uphill task.

Remittance Inflows into Bangladesh



Sources: Bangladesh authorities, IMF Staff

C. External DSA

5. All debt indicators under the baseline remain well within the respective policy-dependent solvency thresholds. Under the baseline scenario, the PV of PPG external debt to GDP ratio is projected to increase from 10.4 percent of GDP in FY17 to 13.1 percent in FY23. It is projected to remain stable reaching 9.2 percent of GDP by FY38. Other PPG indicators remain well within the respective policy-dependent solvency thresholds under the baseline scenario (Figure 1 and Tables 2–3). The stress tests with the biggest impact on debt indicators are those involving a large depreciation, borrowing on less favorable terms, and an export shock. The threshold for external debt service to revenue is breached under the extreme stress test scenario under the depreciation shock, however, this breach is small and temporary.

6. External risks include contracting large amounts of short term debt, a protracted slowdown in key export markets, a rapid build-up of non-concessional debt, or a combination thereof.

- **Short term debt.** The risk from contracting short term external debt is highlighted by the small and temporary breach of the threshold in the short term.

- **A protracted slowdown in key export markets**. The RMG sector continues to maintain a large and steady share in total exports at around 80 percent. The growth in the sector has been tepid while its production costs continue to increase. Growth in FY 2017 was only 0.2 percent – the lowest observed in the last fifteen years – while the average growth in the past five years has been half of what it used to be in the five years preceding. Therefore, any slowdown in demand in the sector is flagged as a risk given how narrow the export basket currently is.

- **Rapid build-up of non-concessional debt.** Per Hong Kong Trade Development Council, under the Belt and Road Initiative, the Chinese authorities have planned to finance several infrastructure projects, including investments from Chinese entrepreneurs in several sectors like telecom, agriculture, power, and energy. A line of credit with India totaling US$4.5 billion has been signed in October 2017. While the investments are much needed to boost infrastructure and address a shortage of power, higher non-concessionally externally-financed infrastructure spending could push up the debt path.

D. Public DSA

7. The authorities remain committed to the 5 percent of GDP deficit target for FY18. As in previous years, the budget targets ambitious increases for both expenditures and revenues – 26 percent and 32 percent, respectively. But the authorities are likely to adjust their spending in response to weaker revenues partly due to the delay in the VAT reform. NSC issuance continues at a rapid pace, exceeding the budgeted amount by a large margin and leading to a net reduction in domestic bank financing. By the end of 2017, the stock of NSCs reached more than double the amount compared to outstanding government borrowing from the banking sector. The budget faces risks, including from spending pressures ahead of the parliamentary elections and additional costs associated with the Rohingya refugees. International support will continue to be essential in addressing the influx of Rohingya refugees. Per the DSA, the PV of public debt to GDP ratio is projected to increase from 29.2 percent in FY17 to 35 percent in FY23 and then trends down over the long term, remaining well within the benchmark value under the baseline and for all standard stress tests (Figure 2 and Tables 4-5). The relatively high level of the total public debt service to revenue ratio underscores the need to boost revenues, including by implementing the delayed VAT reform.

8. Contingent liabilities from high non-performing loans (NPLs) in state owned commercial banks (SOCBs) could result in higher domestic debt. However, the potential impact appears to be manageable. While the NPLs approach 30 percent of total SOCBs loans, the total amount represents only about 2.0 percent of GDP. This amount provides a magnitude of the potential risk to the government's balance sheet. Actual NPLs could be higher than reported and could increase in the future, but bank's provisions against bad loans mitigate the fiscal risk. Moreover, the authorities are taking steps to address the NPLs in the SOCBs (see Staff Report). Liquidity concerns in the SOCBs are currently limited.

E. Staffs' Illustrative Scenario

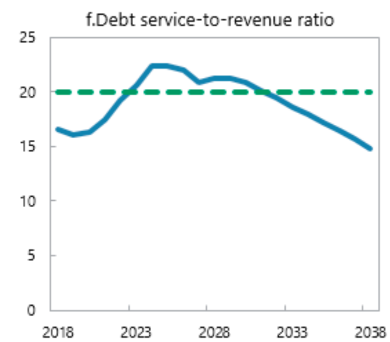
9. To highlight risks from the expenditure arising from the Rohingya crises, staff includes the impact of the costs and its effects on debt sustainability as an illustrative scenario. The Rohingya are a stateless Muslim minority in Myanmar, a majority of whom are women, children, and the elderly. As of March 2018, close to 900,000 refugees reside in Bangladesh. In the medium and long term, the economic, social, and environmental impacts of the crisis could be large if repatriation does not proceed as swiftly as planned.

a. In October 2017, the international community pledged US$360 million under the Rohingya Refugee Crisis Response Plan to meet expenses until February 2018. Several donors have announced in-kind assistance worth more than US$50 million. A second Joint Response Plan was launched in March 2018 to cover the needs of both refugees and host communities from March until December 2018, with a funding request of US$951 million. The UNHCR launched a supplementary appeal of US$238 million for 2018 to enhance protection and step up emergency preparedness.

b. The impact on the budget will depend on relief efforts and the extent to which donor support continues. Currently, the authorities are coping with costs as they emerge, but are confident that with external support and some re-allocations, additional spending pressures can be met without exceeding the budget deficit target.

c. However, donor support could wane, which would then increase the burden on the authorities. To illustrate the impact of these costs, it is assumed that the authorities will meet these costs from domestic and external resources. Over the next six years, it is presumed that approximately Tk. 440 billion (US$5.4 billion) will be raised domestically borrowed with a higher interest rate and a little over US$ US$1 billion will be borrowed externally on non-concessional terms given donor fatigue. Additionally, it is also expected that import growth will increase from 8 percent (baseline) to 9 percent to meet increased demands.

10. Under the illustrative scenario, the debt sustainability outlook is affected by the worsening of the PV of public debt-to-GDP ratio and the external debt service ratios. On the external side, the most important result is the deterioration and breach of the external debt service-to-revenue over the medium term. The other external indicators also deteriorate but remain below their respective thresholds. On the public debt, the PV of public debt-to-GDP ratio deteriorates by almost 1.5 percentage points of GDP on average over the projection period. This scenario strengthens the argument to create the fiscal space by implementing the VAT and the need for continued donor support from the international community to address the refugee crisis. In the case of needs that arise from the refugee crisis, it is also important to continue to rely on concessional financing to the extent possible to maintain sustainability.



F. Conclusion

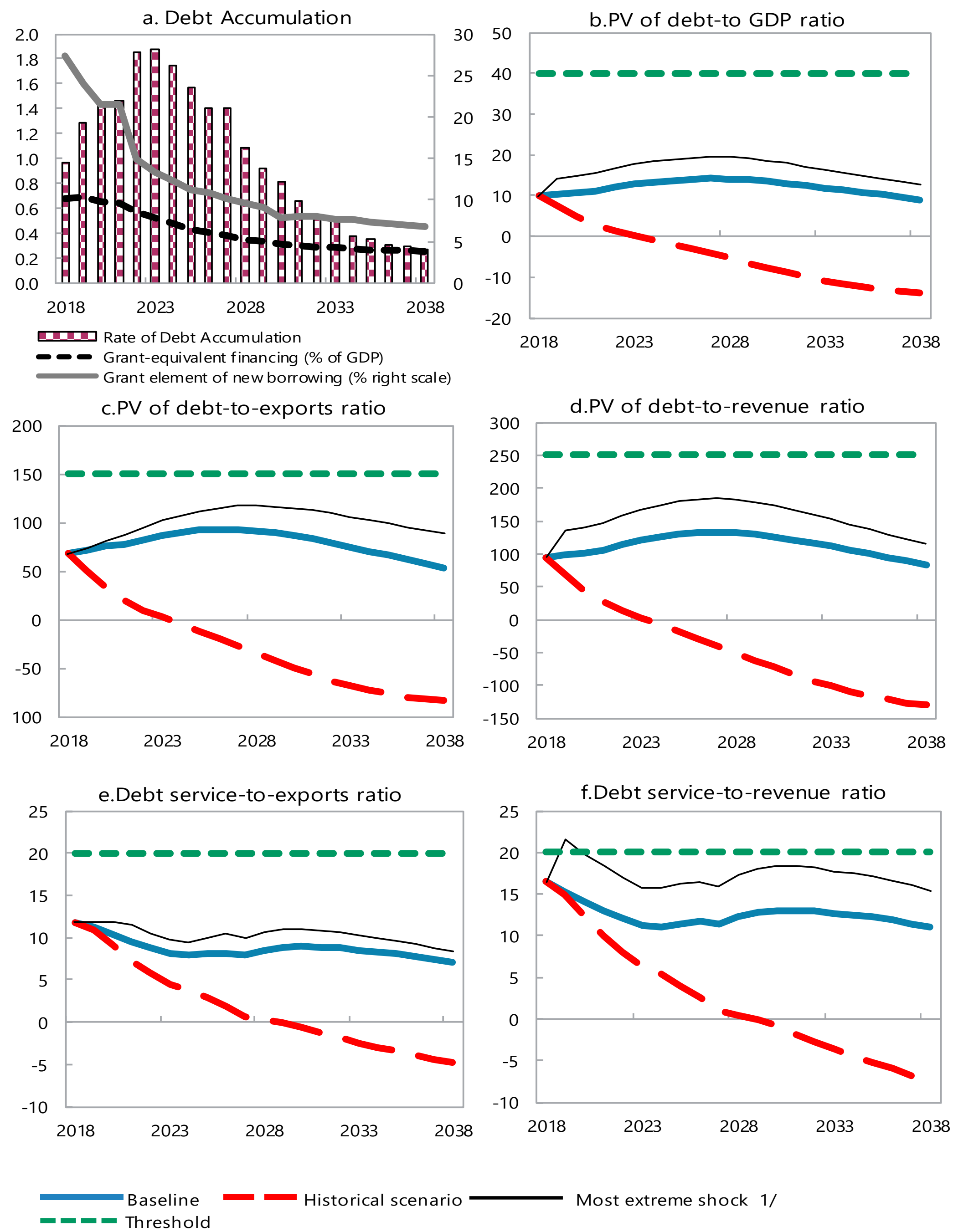
11. The risk of external debt distress and overall debt distress remains low. While the threshold for the external debt service to revenue is breached temporarily under the most extreme stress test scenario, staff judge the risk of external debt distress to be low given the small and temporary nature of the breach. The need for donor support to mitigate the impact of the refugee crisis, especially over the next few years, is highlighted. As in the case of project financing, it is important that the authorities rely on concessional financing to address the needs stemming from the refugee crises.

G. Authorities Views

12. The authorities agree with the low risk of debt distress and consider the level of debt as manageable. The composition of the current stock of public and publicly guaranteed external debt is largely concessional. However, they recognized the need for prudent debt management as terms from creditors are expected to harden reflecting the country's graduation from lower income status. They clarified that the current large disbursements reflect debt for large infrastructure. They emphasized that fiscal policy continues to be guided by the 2009 Public Money and Budget Management Act, which stipulates that public debt as a percent of GDP should be gradually declining. The authorities noted that the Rohingya refugee crisis is not expected to have a major impact on government deficits and public debt. An internal debt sustainability analysis has also been planned.

Figure 1. Bangladesh: Indicators of Public and Publicly Guaranteed External Debt, 2018–2038 1/

(In percent, unless otherwise mentioned)

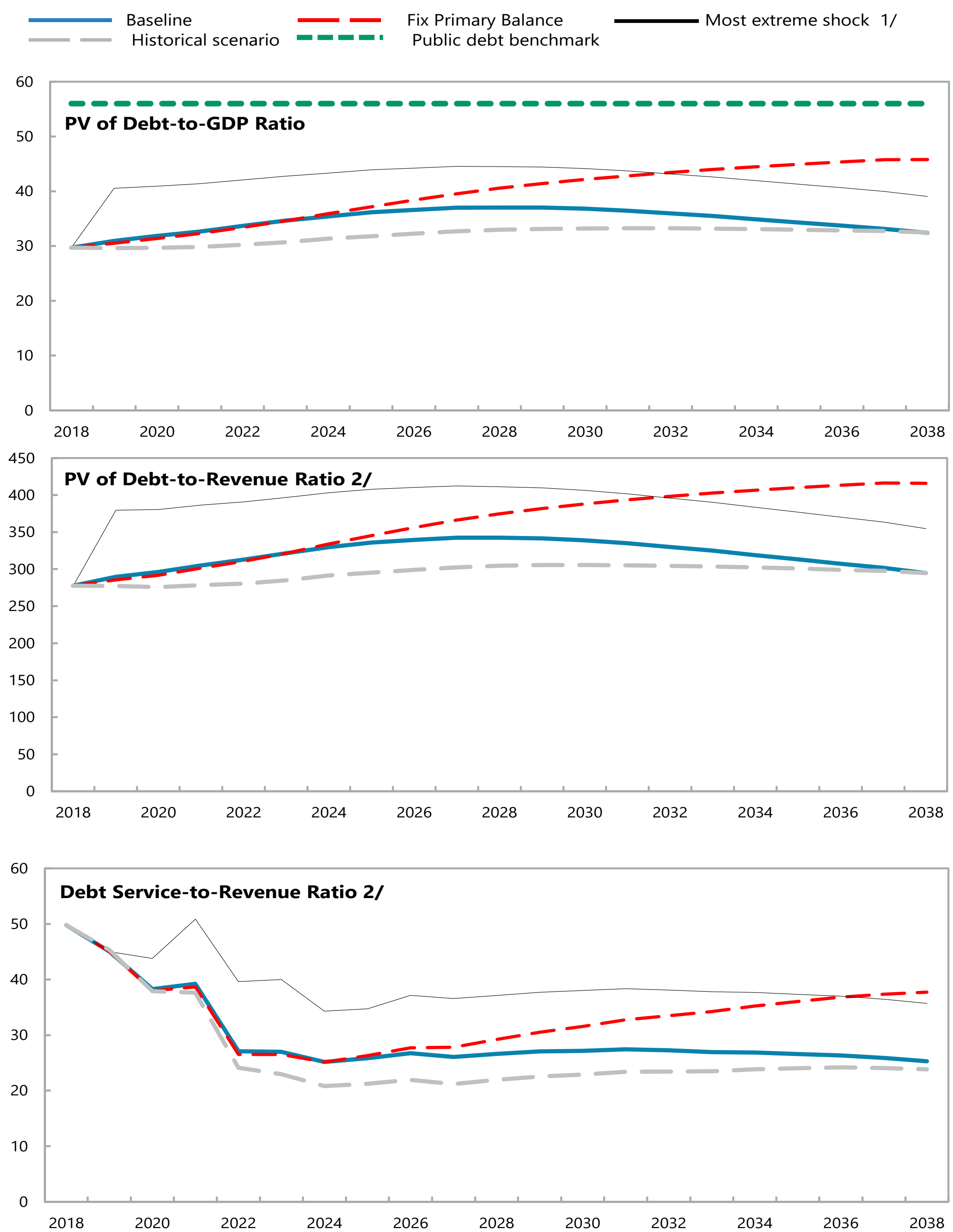


Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2028. In figure b. it corresponds to a One-time depreciation shock; in c. to a Terms shock; in d. to a One-time depreciation shock; in e. to a Exports shock and in figure f. to a One-time depreciation shock

Figure 2. Bangladesh: Indicators of Public Debt, 2018–2038 1/

(In percent)



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2028.
2/ Revenues are defined inclusive of grants.

Table 1. Bangladesh: External Debt Sustainability Framework, Baseline Scenario, 2015–2038 1/

(In percent of GDP, unless otherwise indicated)

	Act	Act	Est	Historical 6/ Average	Standard 6/ Deviation	Projections									
	2015	2016	2017			2018	2019	2020	2021	2022	2023	2018-2023 Average	2028	2038	2024-2038 Average
External debt (nominal) 1/	**19.1**	**18.5**	**18.5**			**17.5**	**17.2**	**17.2**	**17.6**	**18.2**	**18.8**		**19.7**	**20.8**	
of which: public and publicly guaranteed (PPG)	15.1	14.5	14.3			14.2	14.5	15.0	15.5	16.2	16.9		17.5	10.9	
Change in external debt	1.5	-0.6	0.0			-0.9	-0.4	0.0	0.4	0.6	0.6		0.1	-0.1	
Identified net debt-creating flows	-4.7	-4.8	-2.2			-0.1	0.4	0.5	0.4	0.1	-0.1		0.1	0.4	
Non-interest current account deficit	**-2.2**	**-2.3**	**0.0**	**-1.2**	**1.4**	**1.2**	**1.7**	**1.8**	**1.6**	**1.4**	**1.1**		**1.6**	**1.5**	1.5
Deficit in balance of goods and services	5.2	4.1	5.1			6.3	6.4	6.2	5.9	5.5	5.2		4.9	4.7	
Exports	17.3	16.7	15.1			14.6	14.3	14.3	14.4	14.5	14.7		15.3	16.8	
Imports	22.5	20.8	20.2			20.9	20.7	20.5	20.3	20.1	19.9		20.2	21.5	
Net current transfers (negative = inflow)	-8.1	-6.9	-5.3	-8.8	1.6	-5.3	-5.0	-4.8	-4.6	-4.4	-4.2		-3.7	-2.9	-3.5
of which: official	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other current account flows (negative = net inflow)	0.7	0.5	0.2			0.2	0.3	0.3	0.3	0.2	0.2		0.4	-0.3	
Net FDI (negative = inflow)	**-0.9**	**-0.6**	**-0.7**	**-0.8**	**0.2**	**-0.7**	**-0.8**	**-0.7**	**-0.8**	**-0.8**	**-0.8**		**-1.1**	**-1.2**	-1.1
Endogenous debt dynamics 2/	**-1.6**	**-1.9**	**-1.5**			**-0.6**	**-0.5**	**-0.5**	**-0.5**	**-0.5**	**-0.5**		**-0.4**	**0.2**	
Contribution from nominal interest rate	0.4	0.4	0.6			0.6	0.6	0.6	0.6	0.7	0.7		0.8	1.4	
Contribution from real GDP growth	-1.0	-1.2	-1.2			-1.2	-1.1	-1.1	-1.1	-1.1	-1.2		-1.2	-1.3	
Contribution from price and exchange rate changes	-1.0	-1.1	-0.9			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**6.2**	**4.1**	**2.2**			**-0.8**	**-0.8**	**-0.5**	**0.0**	**0.5**	**0.7**		**0.1**	**-0.6**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	14.1			13.3	12.9	12.9	13.3	14.0	14.6		16.2	18.9	
In percent of exports	...	...	93.5			90.7	90.4	90.6	92.4	96.0	99.4		105.6	112.4	
PV of PPG external debt	**...**	**...**	**9.9**			**9.9**	**10.3**	**10.8**	**11.2**	**12.0**	**12.7**		**14.0**	**9.0**	
In percent of exports	**...**	**...**	**65.5**			**67.9**	**71.9**	**75.4**	**77.9**	**82.4**	**86.6**		**91.4**	**53.4**	
In percent of government revenues	**...**	**...**	**97.1**			**94.6**	**97.8**	**101.5**	**106.0**	**113.3**	**120.2**		**131.8**	**83.1**	
Debt service-to-exports ratio (in percent)	**7.6**	**8.6**	**10.3**			**16.7**	**15.5**	**14.1**	**13.0**	**11.9**	**11.0**		**11.3**	**28.6**	
PPG debt service-to-exports ratio (in percent)	**3.9**	**4.5**	**4.4**			**11.8**	**11.2**	**10.4**	**9.5**	**8.7**	**8.0**		**8.5**	**7.0**	
PPG debt service-to-revenue ratio (in percent)	**7.1**	**7.6**	**6.5**			**16.5**	**15.2**	**14.0**	**13.0**	**12.0**	**11.2**		**12.2**	**11.0**	
Total gross financing need (Billions of U.S. dollars)	-0.3	3.4	9.2			17.9	17.8	16.7	15.3	14.8	14.0		21.2	84.8	
Non-interest current account deficit that stabilizes debt ratio	-3.7	-1.7	0.0			2.1	2.1	1.8	1.2	0.7	0.5		1.4	1.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	6.6	7.1	7.3	6.3	0.7	7.0	7.0	7.0	7.0	7.0	7.0	7.0	6.5	6.5	6.5
GDP deflator in US dollar terms (change in percent)	5.9	5.9	5.1	5.5	3.2	2.0	2.3	2.2	2.0	2.0	2.0	2.1	2.0	2.0	2.0
Effective interest rate (percent) 5/	2.7	2.2	3.6	1.7	0.9	3.5	3.6	3.7	3.9	4.1	4.3	3.9	4.4	7.4	5.6
Growth of exports of G&S (US dollar terms, in percent)	2.7	9.4	1.8	11.1	9.5	6.0	7.0	9.0	10.0	10.3	10.3	8.8	9.5	9.8	9.7
Growth of imports of G&S (US dollar terms, in percent)	0.3	5.0	9.2	11.6	15.7	13.3	8.3	8.3	8.0	8.0	8.0	9.0	9.4	9.2	9.2
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	27.3	24.0	21.4	21.5	15.0	13.4	20.4	9.6	6.8	8.7
Government revenues (excluding grants, in percent of GDP)	9.6	10.0	10.2			10.5	10.5	10.6	10.6	10.6	10.6		10.6	10.8	10.7
Aid flows (in Billions of US dollars) 7/	2.8	3.3	3.3			4.5	5.7	6.4	6.8	8.3	8.7		9.2	15.3	
of which: Grants	0.3	0.2	0.1			0.5	0.5	0.5	0.5	0.8	0.8		1.2	2.8	
of which: Concessional loans	2.5	3.0	3.2			3.9	5.2	5.9	6.2	7.6	7.9		8.0	12.5	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			0.7	0.7	0.6	0.6	0.6	0.5		0.4	0.3	0.3
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			34.6	29.8	26.7	26.3	21.1	19.7		18.9	21.5	19.7
Memorandum items:															
Nominal GDP (Billions of US dollars)	195.1	221.4	249.7			272.6	298.5	326.5	356.4	388.9	424.5		645.1	1476.2	
Nominal dollar GDP growth	12.9	13.5	12.8			9.2	9.5	9.4	9.1	9.1	9.1	9.2	8.6	8.6	8.7
PV of PPG external debt (in Billions of US dollars)			24.2			26.6	30.1	34.4	39.2	45.8	53.1		88.9	132.8	
(PVt-PVt-1)/GDPt-1 (in percent)						1.0	1.3	1.4	1.5	1.8	1.9	1.5	1.1	0.3	0.8
Gross workers' remittances (Billions of US dollars)	15.2	14.9	12.7			13.9	14.4	15.0	15.7	16.5	17.3		23.0	41.3	
PV of PPG external debt (in percent of GDP + remittances)	...	...	9.4			9.5	9.8	10.3	10.7	11.5	12.2		13.5	8.7	
PV of PPG external debt (in percent of exports + remittances)	...	...	48.9			50.4	53.8	57.0	59.6	63.8	67.8		74.1	45.8	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	3.3			8.8	8.4	7.8	7.3	6.8	6.3		6.9	6.0	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - \rho(1+g)]/(1+g+\rho+g\rho)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ 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 for Public and Publicly Guaranteed External Debt, 2018–2038

(In percent)

	Projections							
	2018	2019	2020	2021	2022	2023	**2028**	2038
PV of debt-to GDP ratio								
Baseline	10	10	11	11	12	13	**14**	9
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	10	7	5	3	1	0	**-5**	-14
A2. New public sector loans on less favorable terms in 2018-2038 2	10	11	12	12	14	15	**18**	15
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	10	10	11	11	12	13	**14**	9
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	10	11	13	13	14	14	**15**	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	10	10	11	11	12	12	**14**	9
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	10	8	7	7	8	9	**11**	8
B5. Combination of B1-B4 using one-half standard deviation shocks	10	7	5	6	7	8	**10**	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	10	14	15	16	17	18	**19**	13
PV of debt-to-exports ratio								
Baseline	68	72	75	78	82	87	**91**	53
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	68	51	34	19	9	2	**-35**	-83
A2. New public sector loans on less favorable terms in 2018-2038 2	68	74	81	87	95	102	**118**	88
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	68	70	74	76	81	85	**89**	53
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	68	79	101	103	107	110	**110**	62
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	68	70	74	76	81	85	**89**	53
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	68	57	46	50	55	61	**74**	49
B5. Combination of B1-B4 using one-half standard deviation shocks	68	52	38	42	49	55	**71**	49
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	68	70	74	76	81	85	**89**	53
PV of debt-to-revenue ratio								
Baseline	95	98	102	106	113	120	**132**	83
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	95	69	45	26	13	3	**-50**	-129
A2. New public sector loans on less favorable terms in 2018-2038 2	95	101	109	118	130	142	**170**	137
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	95	97	102	107	114	121	**132**	84
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	95	102	120	124	130	136	**141**	85
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	95	96	99	104	111	118	**129**	82
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	95	77	61	67	76	84	**106**	76
B5. Combination of B1-B4 using one-half standard deviation shocks	95	69	49	55	64	73	**98**	74
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	95	136	141	147	157	167	**182**	116

Table 3. Bangladesh: Sensitivity Analysis for Key Indicators for Public and Publicly Guaranteed External Debt, 2018–2038 (Concluded)

(In percent)

				Debt service-to-exports ratio				
Baseline	12	11	10	10	9	8	**8**	7
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	12	11	9	7	6	5	**0**	-5
A2. New public sector loans on less favorable terms in 2018-2038 2	12	11	10	10	9	8	**10**	10
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	12	11	10	10	9	8	**8**	7
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	12	12	12	11	11	10	**11**	8
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	12	11	10	10	9	8	**8**	7
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	12	11	10	8	8	7	**7**	6
B5. Combination of B1-B4 using one-half standard deviation shocks	12	11	10	8	8	7	**6**	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	12	11	10	10	9	8	**8**	7
				Debt service-to-revenue ratio				
Baseline	16	15	14	13	12	11	**12**	11
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2018-2038 1/	16	15	12	10	8	6	**0**	-7
A2. New public sector loans on less favorable terms in 2018-2038 2	16	15	14	13	12	12	**15**	16
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2019-2020	16	15	14	13	12	11	**13**	11
B2. Export value growth at historical average minus one standard deviation in 2019-2020 3/	16	15	14	14	13	12	**14**	12
B3. US dollar GDP deflator at historical average minus one standard deviation in 2019-2020	16	15	14	13	12	11	**12**	11
B4. Net non-debt creating flows at historical average minus one standard deviation in 2019-2020 4/	16	15	13	11	10	10	**10**	10
B5. Combination of B1-B4 using one-half standard deviation shocks	16	15	13	11	10	9	**9**	9
B6. One-time 30 percent nominal depreciation relative to the baseline in 2019 5/	16	22	20	18	17	16	**17**	15
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	7	7	7	7	7	7	**7**	7

Sources: Country authorities; and staff estimates and projections.

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 (implicitly a
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 4. Bangladesh: Public Sector Debt Sustainability Framework, Baseline Scenario, 2015–2038
(In percent of GDP, unless otherwise indicated)

	Act 2015	Act 2016	Est 2017	Average 5/	Standard Deviation 5/	Projections 2018	2019	2020	2021	2022	2023	2018-23 Average	2028	2038	2024-38 Average
Public sector debt 1/	33.7	33.3	33.2			34.0	35.2	36.1	37.0	37.9	38.8		40.5	34.3	
of which: foreign-currency denominated	15.1	14.5	14.3			14.2	14.5	15.0	15.5	16.2	16.9		17.5	10.9	
Change in public sector debt	-1.6	-0.4	-0.2			0.8	1.2	0.9	0.9	1.0	0.9		-0.2	-0.9	
Identified debt-creating flows	0.0	-0.7	-0.3			1.1	1.4	1.1	1.0	1.1	0.9		0.0	-0.5	
Primary deficit	1.8	1.4	1.6	1.4	0.4	2.5	2.9	2.5	2.4	2.4	2.2	2.5	1.4	1.0	1.3
Revenue and grants	9.8	10.1	10.2			10.7	10.7	10.8	10.7	10.8	10.8		10.8	11.0	
of which: grants	0.2	0.1	0.1			0.2	0.2	0.2	0.1	0.2	0.2		0.2	0.2	
Primary (noninterest) expenditure	11.6	11.5	11.9			13.2	13.6	13.3	13.1	13.1	13.0		12.2	12.0	
Automatic debt dynamics	-1.8	-2.1	-2.0			-1.7	-1.9	-1.9	-1.9	-1.9	-1.9		-1.8	-1.7	
Contribution from interest rate/growth differential	-1.3	-1.5	-1.8			-1.7	-1.9	-1.8	-1.8	-1.8	-1.8		-1.7	-1.5	
of which: contribution from average real interest rate	0.9	0.8	0.5			0.4	0.3	0.5	0.5	0.6	0.7		0.7	0.7	
of which: contribution from real GDP growth	-2.2	-2.2	-2.3			-2.2	-2.2	-2.3	-2.4	-2.4	-2.5		-2.5	-2.1	
Contribution from real exchange rate depreciation	-0.6	-0.6	-0.2			0.0	0.0	-0.1	-0.1	-0.1	-0.1		...	...	
Other identified debt-creating flows	0.0	0.1	0.1			0.3	0.4	0.5	0.5	0.6	0.6		0.4	0.2	
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	0.1	0.1			0.3	0.4	0.5	0.5	0.6	0.6		0.4	0.2	
Residual, including asset changes	-1.6	0.3	0.1			-0.2	-0.2	-0.2	-0.2	-0.1	-0.1		-0.2	-0.4	
Other Sustainability Indicators															
PV of public sector debt	...	...	28.8			29.7	31.0	31.8	32.7	33.7	34.6		37.0	32.4	
of which: foreign-currency denominated	...	...	9.9			9.9	10.3	10.8	11.2	12.0	12.7		14.0	9.0	
of which: external	...	...	9.9			9.9	10.3	10.8	11.2	12.0	12.7		14.0	9.0	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	7.8	6.5	9.2			9.8	8.5	7.2	7.1	5.7	5.4		4.4	3.9	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	281.4			277.6	289.7	296.1	305.1	313.1	321.5		342.3	294.5	
PV of public sector debt-to-revenue ratio (in percent)	...	...	282.9			282.8	294.6	300.6	309.4	318.8	327.4		348.4	299.6	
of which: external 3/	...	...	97.1			94.6	97.8	101.5	106.0	113.3	120.2		131.8	83.1	
Debt service-to-revenue and grants ratio (in percent) 4/	26.8	25.5	55.4			49.8	45.0	38.3	39.2	27.1	27.0		26.6	25.3	
Debt service-to-revenue ratio (in percent) 4/	27.3	25.7	55.7			50.7	45.8	38.9	39.8	27.6	27.5		27.1	25.7	
Primary deficit that stabilizes the debt-to-GDP ratio	3.4	1.7	1.8			1.7	1.7	1.6	1.5	1.4	1.3		1.5	1.9	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	6.6	7.1	7.3	6.3	0.7	7.0	7.0	7.0	7.0	7.0	7.0	7.0	6.5	6.5	6.5
Average nominal interest rate on forex debt (in percent)	1.5	1.4	1.4	1.1	0.2	2.2	2.6	2.9	3.1	3.3	3.6	2.9	3.5	4.0	3.8
Average real interest rate on domestic debt (in percent)	4.7	4.2	2.8	3.9	1.1	2.3	1.4	1.5	1.7	1.9	1.8	1.8	2.0	2.0	1.9
Real exchange rate depreciation (in percent, + indicates depreciation)	-4.0	-4.5	-1.8	-3.4	3.8	0.0	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	5.9	6.7	6.3	7.0	0.9	6.0	6.2	6.1	6.0	5.7	5.5	5.9	5.5	5.5	5.6
Growth of real primary spending (deflated by GDP deflator, in percent)	4.2	5.4	11.0	2.1	3.7	19.1	10.5	4.2	5.6	7.4	5.6	8.7	4.5	6.8	6.0
Grant element of new external borrowing (in percent)	...	...	...	...	...	27.3	24.0	21.4	21.5	15.0	13.4	20.4	9.6	6.8	...

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 5. Bangladesh: Sensitivity Analysis for Key Indicators of Public Debt, 2018–2038
(In percent)

		Projections						
	2018	2019	2020	2021	2022	2023	2028	2038
PV of Debt-to-GDP Ratio								
Baseline	30	31	32	33	34	35	37	32
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	30	30	30	30	30	31	33	32
A2. Primary balance is unchanged from 2018	30	30	31	32	33	35	41	46
A3. Permanently lower GDP growth 1/	30	31	32	33	34	35	38	36
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-2020	30	31	33	34	35	37	40	37
B2. Primary balance is at historical average minus one standard deviations in 2019-2020	30	30	30	31	32	33	36	32
B3. Combination of B1-B2 using one half standard deviation shocks	30	30	30	31	33	34	38	35
B4. One-time 30 percent real depreciation in 2019	30	35	36	36	37	38	41	39
B5. 10 percent of GDP increase in other debt-creating flows in 2019	30	41	41	41	42	43	44	39
PV of Debt-to-Revenue Ratio 2/								
Baseline	278	290	296	305	313	322	342	295
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	278	277	276	278	281	285	305	295
A2. Primary balance is unchanged from 2018	278	285	292	302	310	321	375	416
A3. Permanently lower GDP growth 1/	278	290	297	307	315	325	352	323
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-2020	278	295	307	319	329	340	371	336
B2. Primary balance is at historical average minus one standard deviations in 2019-2020	278	279	280	289	298	307	330	286
B3. Combination of B1-B2 using one half standard deviation shocks	278	280	281	293	304	315	347	315
B4. One-time 30 percent real depreciation in 2019	278	329	331	338	345	353	382	350
B5. 10 percent of GDP increase in other debt-creating flows in 2019	278	380	381	386	391	397	411	355
Debt Service-to-Revenue Ratio 2/								
Baseline	50	45	38	39	27	27	27	25
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	50	45	38	38	24	23	22	24
A2. Primary balance is unchanged from 2018	50	45	38	39	27	27	29	38
A3. Permanently lower GDP growth 1/	50	45	38	39	27	27	27	28
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2019-2020	50	46	39	41	28	29	29	30
B2. Primary balance is at historical average minus one standard deviations in 2019-2020	50	45	38	38	25	25	25	24
B3. Combination of B1-B2 using one half standard deviation shocks	50	45	38	38	25	25	27	27
B4. One-time 30 percent real depreciation in 2019	50	48	45	46	34	34	36	38
B5. 10 percent of GDP increase in other debt-creating flows in 2019	50	45	44	51	40	40	37	36

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

Statement by Subir Vithal Gokarn, Executive Director for Bangladesh, and Mohua Roy, Advisor to the Executive Director
May 30, 2018

1. Our Bangladesh authorities thank staff for the recent frank and productive discussions, and convey their appreciation to Management and staff for their continued engagement. Our authorities look forward to continuing this engagement, especially through Fund technical assistance. The authorities broadly agree with staff's assessment and recommendations regarding the economy, although there are some differences in views. Broadly, they reiterate their strong commitment to maintain macroeconomic stability and promote inclusive growth.

2. The year 2017 was particularly good for the economy of Bangladesh with output growth further accelerating to 7.3 percent in FY17 from 7.1 percent in FY16, benefitting from robust domestic demand. The economy continues to diversify away from agriculture with strong contribution from manufacturing and services. As noted in the report, this impressive performance builds upon the momentum of GDP growth which has averaged more than 6.0 percent over the last two decades, significantly lifting GDP per capita, reducing poverty and improving other social indicators. The authorities are confident that this strong performance will continue over the medium term. Their projection for FY18 growth is about 7.65 percent, aided by strong domestic demand, exports and remittances. The government's reform initiatives to improve the business climate and ease infrastructure bottlenecks, including by developing special economic zones, should help crowd in both private domestic and foreign direct investment (FDI) that can create more jobs and increase productivity, thereby raising potential growth.

3. In the context of its 7th Five-Year Plan (FY16-20), and with the objective of becoming a middle-income country by 2021, the authorities have identified the creation of an enabling environment for FDI and private sector engagement as a high priority. They aim to raise the share of private investment from 22 to 27 percent of GDP and to mobilize an additional US$10 billion in FDI inflows by the end of the period. To attract more FDI in Bangladesh, the central bank has recently simplified and rationalized the sale process of foreigners' equity investment in both public and private entities. Also, higher infrastructure-related imports are

being undertaken currently to improve infrastructure so as to attract FDI and increase economic diversification and output.

4. After picking up in 2017 following higher flood-related food prices, inflation has declined due to government efforts to increase food imports, and is expected to stabilize further in the second half of FY18 with an expected recovery in crop harvests. Non-food inflation has remained broadly stable. In March 2018, year-on-year inflation stood at 5.7 percent. Broad money growth remains close to nominal GDP growth and inflationary pressures are not expected to arise from monetary developments. The monetary policy stance will remain prudent, and the authorities are vigilant against upside risks to inflation and ready for appropriate adjustments in both policy rates and reserve requirements.

5. The authorities broadly share staff's assessment on risks, including potential second round effects from higher food prices and the impact of higher non-performing loans (NPLs) in the banking system. Sustained increases in NPLs and weak governance in banking sector could impair its ability to extend credit and support growth. The authorities do not see the likelihood of economic activity in the country getting disrupted by political unrest in the run up to the elections in December 2018. In fact, the incidents of political unrest have remained contained over the last several months.

6. An emerging macro risk is emanating from the slow progress in resolving the Rohingya refugee crisis. While immediate needs, such as food, health, shelter, water and sanitation, have been covered by donor support for now, delay in repatriation of the refugees could result in fiscal pressures, social and environmental costs, and security concerns. It is crucial that donor support is expanded and sustained for meeting spending needs for the Rohingya, especially with an urgent need to upgrade infrastructure before the upcoming monsoon season.

7. Our authorities agree that the recent increase in current account deficit (CAD) emanates from large capital imports related to mega-projects and food-grain imports due to crop loss and that this deficit is likely to continue over the short to medium-term. However, reserve coverage continues to be adequate at about seven months of imports and, going ahead, is expected to benefit from the strong growth in export earnings and a rebound in remittances. Authorities are confident of an improved export performance both in readymade garments (RMG) and other sectors with the help of bilateral and multilateral trade negotiations towards widening market access and diversifying the export basket. The recent depreciation of the Taka reflects an increased demand for foreign currency from higher imports. The authorities continue to view excessive exchange rate fluctuations as undesirable, given the foreign exchange market structure, and thus intervene in the market as needed to contain volatility.

8. The fiscal deficit (excluding grants) in FY18 is expected to remain at around 5.0 per cent. Budget financing is to be mainly done through National Savings Certificates (NSCs) and from banks and non-NSC sources. Given the encouraging growth projections, no additional fiscal stimulus is planned this year. While no new budget measures are expected in

the FY19 budget to be presented in June 2018, some budget allocation may be needed for the Rohingya refugee crisis.

9. The authorities recognize the urgent need for increasing government revenues, and raising the tax-to-GDP ratio from its current low level. They also recognize that postponing the launch of the VAT reform may have a temporary adverse impact on revenue collection, but expect that this impact would be mitigated by their ongoing efforts to strengthen tax administration. There have been several positive achievements under the direct tax policy reforms, including the increased registration of new taxpayers, a significant improvement in return filing and increase in efforts to settle big tax arrears cases pending in the courts. Finally, progress has been made in improving customs risk management, with the objective being to implement a digitalized risk management regime.

10. Staff's recommendations on strengthening tax administration, control of budget allocations, monitoring of budget execution, and the dovetailing of recurrent and the Annual Development Program (ADP) spending have been carefully noted and efforts will be made for improvements in these areas. The authorities are making steady progress in implementing the 2016-21 public financial management reform strategy with significant improvements in the timeliness of data reporting for both monthly and annual fiscal data.

11. The authorities share staff's view about the crucial role of an effective capital market in mobilizing savings and supporting investment and growth and emphasized that NSC reform is a priority. They recognize the need to promote market-based saving instruments, but feel that the transition cannot be abrupt and a balance has to be maintained in terms of access to savings instruments while market development is being pursued. A reform plan has been approved, including creating a database of existing investors which will improve monitoring and reduce misuse. In the medium to long-term, structural reforms of NSC, including the reform of the pricing mechanism, will be considered.

12. The central bank is engaged in strengthening supervision and corporate governance in banks that can lead to lower credit and concentration risks and, subsequently, lower NPLs. The overall banking sector is stable despite capital adequacy concerns in a few banks. There remains scope for improving banking sector regulation and strengthening enforcement, for which authorities are taking urgent steps. Macro-prudential measures have been used to restrain unproductive lending, including closer surveillance of banks' adherence to guidelines, strict surveillance of end-use of bank loans, and encouragement of banks to limit medium- and long-term investment loans to corporate borrowers. Corporate governance in banks should be improved to curtail risky loans and bring down high NPLs. The NPL recovery rate remains a challenge partly due to the current lengthy legal processes. The central bank has full operational autonomy with respect to the supervision of state-owned commercial banks (SOCBs). Reform of the state-owned banks continues to be a priority for the government. These banks are being recapitalized in a phased manner. The compliance of SOCBs with their MOUs with Bangladesh Bank is being closely monitored.

13. Bangladesh has been a pioneer in financial inclusion. Strategies to promote financial inclusion continue to be a part of the central bank's sustainable growth agenda and are

included in the 7th Five-Year Plan. While maintaining the overall flow of microfinance sector (MFS) transactions in the country, the central bank is attempting to enhance the financial stability of the microfinance sector through restrictions on opening multiple accounts and instituting transaction ceiling. Another proposal to establish a microfinance credit information bureau for the microfinance regulator is expected to create a sound credit culture and help reduce the transaction cost for both borrowers and lenders. The agent banking system, rolled out two years ago, has been expanding significantly as a low-cost, accessible alternative to branch-based banking services such as cash deposits, withdrawals, remittance disbursement, small value loan disbursement and recovery of loans, and cash payments under the government's social safety net programs. Agent banking service has been playing a valuable role in bringing the unbanked people of remote areas under the mainstream financial system.

14. Bangladesh's economic transformation was driven in large part by social changes, starting with the empowerment of women and female labor force participation in the RMG, agriculture and service sectors. Bangladesh has made significant strides towards educating girls and giving women a greater voice, both in the household and the public sphere. These efforts have translated into improvements in children's health and education and increase in average life expectancy compared to peer countries. The Government of Bangladesh has also prioritized gender equality in its 7th Five-Year Plan and are working with development partners to address constraints related to gender equality such as lack of skills and education, and are taking steps to upgrade infrastructure that will improve participation.