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Bangladesh Development Update

Recovery and Resilience Amid Global Uncertainty

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Summary

This report provides an assessment of the state of the economy in Bangladesh, the outlook, risks, and key reform challenges. It covers real sector developments, focusing on growth and its components; inflation; monetary and financial sector developments; external sector trends, focusing on the balance of payments, foreign exchange reserves and the exchange rate; and fiscal outcomes, focusing on revenue mobilization, public expenditures, and deficit financing.

Acknowledgements

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Abbreviations

ADP	Annual Development Program
ADR	Advance-to-Deposit Ratio
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BDT	Bangladeshi Taka
BOP	Balance of Payment
CPIA	Country Policy and Institutional Assessment
CRAR	Capital to Risk-Weighted Assets Ratio
DSA	Debt Sustainability Analysis
DSEX	Dhaka Stock Exchange
DSL	Debt Service Liabilities
EMDE	Emerging Market and Developing Economies
EPZ	Export Promotion Zone
GDP	Gross Domestic Product
LDC	Least Developed Country
M2	Broad Money
MLT	Medium and Long-Term
NBR	National Board of Revenue
NDA	Net Domestic Assets
NFA	Net Foreign Assets
NPL	Non-Performing Loan
NSC	National Savings Certificate
PFM	Public Financial Management
PIM	Public Investment Management
RMG	Ready-made garments
UMIC	Upper Middle-Income Country
VAT	Value-added Tax

Executive Summary

A robust economic recovery in Bangladesh is facing new headwinds. Higher global commodity prices are widening the current account deficit and increasing inflationary pressure in the context of the war in Ukraine. Real GDP growth accelerated to 6.9 percent in FY21 as pandemic-related restrictions were eased, led by a rebound of manufacturing and service sector activities. On the demand side, exports and private consumption led growth. High-frequency indicators point to a resilient recovery in the first half of FY22, although the pace of growth slowed modestly.

Estimated poverty declined in FY21 as the economic recovery accelerated. However, recent survey data point to persistent job losses and reduced earnings due to the COVID-19 pandemic, with a disproportionate impact on women.

Inflationary pressure is rising. After remaining stable in FY21, inflation rose in FY22 with higher commodity prices and domestic demand growth. However, the transmission of higher commodity prices to consumers has been dampened by price subsidies and tax and tariff reductions on imported food items. Monetary policy remained accommodative. A gradual acceleration in private sector credit growth began in FY21 and continued in H1 FY22. In the financial sector, preexisting vulnerabilities have been exacerbated by ongoing regulatory forbearance measures.

After a substantial balance of payments surplus in FY21, the surplus turned into a deficit in H1 FY22 as the current account deficit widened. Payments on account of consumer, intermediate, and capital goods imports rose sharply with the economic recovery and increased world prices. Official remittance inflows declined as the use of informal payment channels normalized after COVID-19 travel restrictions were eased. The financial account surplus also narrowed as loan disbursements and portfolio investments slowed. Bangladesh Bank foreign exchange interventions moderated the depreciation of the exchange rate.

The fiscal deficit narrowed to an estimated 3.6 percent of GDP in FY21, as revenue growth outpaced expenditure growth. As in previous years, both revenue and expenditure fell short of their targets. Public debt remained sustainable, with a low risk of debt distress. A reduction in interest rates on high-cost National Savings Certificates, a major source of domestic debt, led to a sharp decline in issuance in FY22.

Despite a modest deceleration in FY22, GDP growth is expected to remain resilient in the medium term, as pandemic-related economic disruptions ease. Inflation is projected to remain elevated due to both demand-pull and cost-push factors. External and fiscal sustainability will be stressed by rising global commodity prices and increased uncertainty following the war in Ukraine. Downside risks include continued high commodity prices that could worsen inflation dynamics and impact the external balance, weaker global demand for Bangladesh's exports, and potential new waves of COVID-19 that could require further containment measures. Economic disruptions and extended regulatory forbearance could worsen financial sector vulnerabilities.

Structural reforms provide an opportunity to accelerate growth and job creation. Rationalizing the tariff structure with lower overall protection and modernizing import and export processes would help Bangladesh compete in the world as well as regional export markets. An improved business climate, a predictable regulatory framework and a deeper financial sector would support innovation and attract higher foreign and domestic investment.

Addressing climate vulnerabilities would strengthen the resilience of the recovery. Climate change adaptation investments will be critical to protect vulnerable sectors and people, while mitigation measures can reduce emissions growth. Implementation of long-term plans to address climate change will also require resolution of institutional constraints, including more efficient public investment and public financial management.

Recent Developments

Context

A robust economic recovery in Bangladesh faces new headwinds, as higher global commodity prices exacerbate the current account deficit and inflationary pressure. The economic impacts of the COVID-19 pandemic are waning. Infections and deaths surged during the Delta (July to August 2021) and Omicron (January to February 2022) waves of the pandemic. However, narrow targeting of movement restrictions and wider vaccine coverage limited the impact on economic activity. As of April 1, 2022, approximately 66.7 percent of the population received two vaccine doses, and 75.1 percent received at least one dose.[1] Officially recorded real GDP growth rebounded to 6.9 percent in FY21 and high frequency indicators of trade, industrial activity, and credit growth pointed to a continuing expansion in the first half of FY22. However, the recovery faces new headwinds following the surge in global commodity prices in the context of the war in Ukraine.

Real Sector

A robust recovery in FY21 continued in the first half of FY22. On the supply side, growth was driven by a rebound of manufacturing and service sector activities. On the demand side, acceleration in exports and private consumption led growth. After remaining stable in FY21, inflation rose in FY22, driven in part by rising global commodity prices. Estimated poverty declined in FY21 as household income recovered.

Table 1: Contributions to Growth

	FY15	FY16	FY17	FY18	FY19	FY20	FY21
GDP Growth	6.6	7.1	6.6	7.3	7.9	3.4	6.9
	Contribution of Production Sectors (%)						
Industry	2.7	4.2	2.6	3.2	3.8	1.2	3.5
Services	3.0	3.6	3.3	3.3	3.5	2.0	2.9
Agriculture	0.5	-0.9	0.4	0.5	0.4	0.4	0.4
Import duty	0.3	0.3	0.3	0.3	0.2	-0.2	0.2
	Contribution of Expenditure Components (%)						
Consumption	4.6	2.6	4.6	6.6	4.1	2.1	5.7
Private consumption	4.1	2.1	4.2	6.3	3.3	2.0	5.3
Government consumption	0.5	0.5	0.4	0.3	0.8	0.1	0.4
Investment	2.1	2.7	2.5	3.7	2.2	1.3	2.6
Private Investment	1.4	2.4	1.4	3.4	2.2	0.1	1.9
Government Investment	0.7	0.3	1.2	0.3	0.0	1.2	0.7
Resource Balance	-1.1	1.7	-1.2	-3.3	1.4	-0.2	-1.5
Exports, goods & services	-0.5	0.3	-0.3	0.8	1.5	-2.3	1.0
Imports, goods & services	0.7	-1.4	0.9	4.1	0.1	-2.1	2.4
Statistical discrepancy	1.0	0.1	0.6	0.3	0.2	0.3	0.1

Source: Bangladesh Bureau of Statistics (BBS), Growth in constant terms, FY16 base year.

Growth

While the global economy has continued to recover, commodity prices have surged. The global trade in goods reached new highs, despite persistent supply bottlenecks. Economic activity rebounded in both advanced and emerging market and developing economies (EMDEs) in 2021. High vaccination rates and

[1] Source: Director General of Health Services (DGHS) COVID-19 Dashboard for Bangladesh.

sizable fiscal support have helped cushion some of the adverse economic impacts of the pandemic in advanced economies. On the other hand, waning policy support and tighter financial conditions dampened the pace of recovery in many EMDEs in 2021. Global energy prices rose in the second half of 2021 as demand recovered and supply remained constrained, particularly natural gas and coal.[2] Commodity prices surged further in early 2022 in the wake of the war in Ukraine, including energy, food and agricultural products. By February 2022, energy commodity prices surged by 66.4 percent (y-o-y) and non-energy commodity prices rose by 22.7 percent.

Bangladesh's economy kept pace with the global recovery in FY21. Bangladesh entered the pandemic with strong policy buffers to mitigate the negative impacts of the pandemic. An extensive stimulus program and accommodative macroeconomic policies protected productive capacity in the manufacturing sector and helped offset income losses. Officially recorded real GDP growth rebounded to 6.9 percent in FY21 after decelerating to 3.4 percent in FY20. Economic data and high frequency indicators[3] point to a continued recovery in July-December 2021 (H1 FY22), as new COVID-19 infections moderated, and the global economy recovered.

On the supply side, growth was underpinned by a rebound of manufacturing and service sector activity. The Quantum Index for Large and Medium Scale Manufacturing rose by 14.6 percent (y-o-y) in FY21 and 27.8 percent (y-o-y) in July-October of FY22, driven by a recovery in external and domestic demand. In the service sector, retail sales, hotel, and restaurant activity rebounded as movement restrictions eased. Food production grew by 2.8 percent in FY21, reflecting a robust rice harvest.

On the demand side, growth was led by exports and a rebound of private consumption. After declining in FY20, exports grew by 9.2 percent in FY21 and 28.4 percent in H1 FY22, with recovery in global demand for readymade garments (RMG). Bangladesh gained market share in Europe and the United States, as buyers diversified global supply chains. In addition to RMG, exports of home textiles, pharmaceuticals, engineering, and agricultural products also recorded strong growth. A 55.8 percent increase in imports of consumer goods in H1 FY22 points to a strong recovery in private consumption. Public investment rose by 9 percent (y-o-y) in FY21 as government infrastructure megaproject implementation progressed, although preliminary data from FY22 points to a slower pace of expenditure growth. A gradual acceleration in growth of credit to the private sector and a sharp increase in capital goods imports demonstrate a continued recovery of private investment as well.

Box 1: National Accounts Rebasing

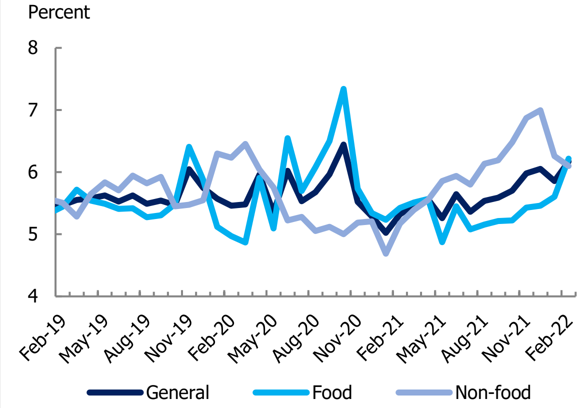
The Bangladesh Bureau of Statistics (BBS) has rebased national accounts statistics. The FY06 base year was updated to FY16 in a December 2021 update to national accounts. Several new industry and service sub-sectors were added to national accounts. As a result, FY20 nominal GDP increased to US$ 373.9 billion, 15.7 percent higher than nominal GDP under the FY06 base year. The Bangladesh Development Update uses the FY16 base year.

[2] "Global Economic Prospects." The World Bank, January 2022.

[3] Electricity consumption rose by 7.8 percent (y-o-y). The Google Community Mobility Reports index for retail and recreation places, grocery stores, and workplaces increased by approximately 517 percent, 80 percent, and 160 percent, respectively, between the first and second half of 2021.

Inflation

Figure 1: Inflation (Base:2005-06, y-o-y)



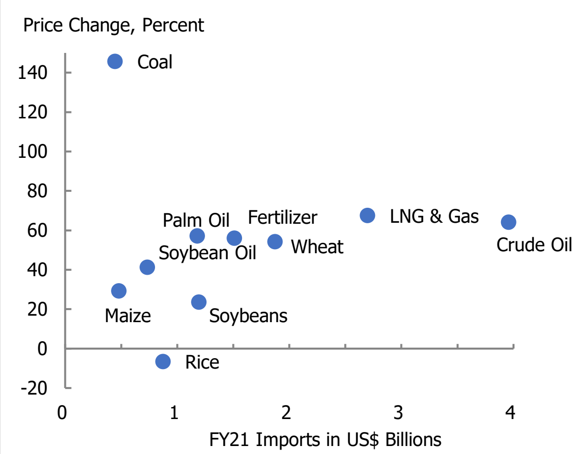
Source: Bangladesh Bureau of Statistics

Inflation accelerated in FY22, driven by higher commodity prices and domestic demand growth. Inflation was moderate in FY21, reaching 5.6 percent by the end of the fiscal year. However, headline inflation rose to 6.2 percent in February 2022, driven by a rise in both food and non-food prices. Food inflation rose by 114 basis points to 6.2 percent, as the prices of edible oil, rice, and potato, remained elevated. Surveys indicate that marginalized households faced food inflation that is more than twice the officially reported number.[4] Non-food inflation also accelerated, reaching 6.1 percent by February 2022. Non-food inflation was driven by higher prices for transport and communication, clothing and footwear, household equipment, and services. Transportation costs surged by more than 20 percent following the adjustment of government-administered fuel and transportation prices.

Box 2 - Commodity Prices and the War in Ukraine

Crude oil, gas, wheat, fertilizer, and palm oil,[5] will make the largest impact on the current account deficit, based on prior year import data (Figure 2). Price changes reflect the difference between March 2022 and average 2021 prices, using World Bank commodity price data. However, the pass-through of higher commodity prices will depend on the extent of adjustments in subsidies, tariffs, and taxes. Subsidies are provided by state-owned enterprises and are ultimately borne by the central government via transfers to cover operating losses. While some energy prices have been adjusted to partially compensate for the increase in global prices, VAT at import has been reduced on palm and soybean oil to dampen the transmission of higher prices to consumers, and subsidized food sales have been increased under various social protection programs.

Figure 2: Selected Commodities by Imports and Price Change



Poverty and welfare

Estimated poverty declined in FY21 in the context of a stronger economic recovery. Estimated poverty declined to 11.9 percent in FY21 from 12.5 percent in FY20 using the international poverty line ($1.9 a day in 2011 PPP). However, a nationwide high-frequency phone survey by the World Bank illustrated the persistent labor market impacts of the pandemic through widespread job losses and reduced earnings.

[4] "Inflation for the Marginalized People in Bangladesh: Beyond the official arithmetic". South Asian Network for Economic Modelling (SANEM). Thinking Aloud: Volume VIII, Issue 10: March 2022.

[5] Palm oil and soybean oil prices have surged due to an increase in sunflower oil prices.

Only half of the respondents who were working in January 2020 found work from April 2020 to June 2021. About 26 percent of respondents worked for less than 12 months, and 1.4 percent did not work after April 2020. The results also underscore the disproportionate impact of job losses on women, who have experienced a slower recovery in employment. COVID-19 has also had widespread health and financial impacts on the host community and displaced Rohingya population in Cox's Bazar. The second wave of infections strained the financial resources of households as evidenced by increased reliance on risky coping strategies in rapid welfare tracking surveys in mid-2021.[6]

Monetary and Financial Sector Developments

Monetary policy remained accommodative. Reserve and broad money growth accelerated in FY21, but slowed in FY22, led by a decline in growth of net foreign assets. Private sector credit growth increased modestly in FY21 and accelerated in H1 FY22. Preexisting vulnerabilities in the financial sector have been exacerbated by regulatory forbearance measures introduced in response to the pandemic.

Table 2: Monetary Program Performance (Y-o-Y Growth in Percentage)

	FY19	FY20	FY21	FY22		
	Actual	Actual	Actual	Target (Dec-21)	Target (Jun-22)	Actual (Dec-21)
Net Foreign Assets	2.9	9.2	27.1	13.0	10.4	3.4
Net Domestic Assets	12.1	13.6	9.8	14.1	16.5	11.6
Domestic credit	12.3	14.0	10.3	14.1	17.8	12.4
Public	19.8	59.9	21.2	30.6	32.8	22.6
Private	11.3	8.6	8.4	11.0	14.8	10.7
Broad Money	9.9	12.6	13.6	13.8	15.0	9.6
Reserve Money	5.3	15.6	22.4	14.0	10.0	6.5
Inflation (end of period average)	5.5	5.7	5.6	-	5.3	6.1
Growth	8.1	5.2	6.9	-	7.2	-

Source: Bangladesh Bank Monetary Survey and Bangladesh Bureau of Statistics (BBS)

Monetary policy remained accommodative. Bangladesh Bank (BB) adopted accommodative monetary policies in response to the COVID-19 pandemic in FY20, reducing the cash reserve ratio to 4 percent (from 5.5 percent) and the repo rate to 4.75 percent (from 6 percent) and increasing the advance-to-deposit ratio (ADR) to 87 percent (from 85 percent).[7] These policies remained in place in FY21. As a result of accommodative monetary policy and BB foreign exchange interventions to limit the appreciation of the taka, reserve money growth increased to 22.4 percent in FY21, exceeding the 13.5 percent BB target. Consequently, broad money growth accelerated to 13.6 percent in FY21.

Monetary growth slowed in FY22, led by a decline in net foreign assets (NFA). BB foreign exchange interventions to defend the value of the taka, which contributed to slower NFA growth (y-o-y), resulted in a decline in reserve money growth to 6.5 percent in December 2021. The broad money (M2) growth rate consequently declined to 9.6 percent in December 2021, below the BB's target of 13.8 percent. In contrast to NFA, the growth of net domestic assets (NDA) increased on the back of rising credit to the public and private sector.

[6] Cox's Bazar Panel Survey: Rapid Follow-up Round 3. World Bank.

[7] ADR = Total Loans and Advances / (Total Time and Demand Liabilities + Interbank Deposit Surplus)

Private sector credit growth has increased modestly. Credit to the private sector recovered in FY21, as pandemic-related restrictions were lifted. As activity regained pace, demand for private credit rose in FY22, reaching a growth rate of 10.7 percent in December 2021, approaching the BB's target of 11.0 percent. However, the overall advance-to-deposit ratio (ADR) remained at 72 percent in September 2021, well below the regulatory limit of 87 percent. This largely reflected underperformance by state-owned commercial banks.

The COVID-19 pandemic exacerbated longstanding financial sector vulnerabilities. The government's pandemic response program provided firms with access to subsidized loans through commercial banks, which were supported by refinancing facilities and suspension of the recognition of non-performing loans (NPLs) in FY20 and FY21. While forbearance measures buffered the impact of the COVID-19 pandemic shock, accommodation has exceeded what is necessary as the recovery accelerates. In December 2021, BB extended forbearance measures, allowing borrowers to avoid default by paying 15 percent of outstanding installments. It also permitted banks to report interest income from unpaid installments of such loans. This measure inflated bank operating profits for 2021 while increasing the risks to the health of the banking sector in the long run. As a result of forbearance measures, gross NPLs as a share of banking sector credit and advances decreased to 8.1 percent in September 2021, down from 8.9 percent one year earlier.

Financial soundness indicators may not accurately reflect financial sector conditions. The aggregate banking sector capital to risk-weighted assets ratio (CRAR) decreased to 11.2 percent in September 2021 from 11.9 percent in September 2020, one of the lowest levels in South Asia. However, deviations from international reporting standards and regulatory forbearance measures have made financial soundness indicators such as the CRAR less informative. Systemic risks remain a concern, with 11 out of 60 banks reported by the BB as failing to meet the minimum CRAR of 10 percent, of which seven are state-owned banks.

Investors showed renewed interest in capital markets in 2021. The main index of the Dhaka Stock Exchange (DSE-X) increased by 22.6 percent (y-o-y) to 6,926.3 in January 2022. Market capitalization of listed companies increased to BDT 5,569.8 billion in January 2022 from BDT 4,790.3 billion a year ago. The first ever green bond in Bangladesh was approved in May 2021, followed by another green Sukuk bond in January 2022. The Bangladesh Securities and Exchange Commission issued the Debt Securities Rule in May 2021. A strengthened regulatory framework will support further development of domestic capital markets.

External Sector

The pressure on external balance has increased. The current account deficit widened in H1 FY22 in the face of a sharp increase in import payments and a decline in official remittance inflows. The financial account surplus narrowed as loan disbursements and portfolio investments slowed. This resulted in a balance of payments deficit in H1 FY22. BB intervened to defend the exchange rate, while allowing modest depreciation of the taka.

Table 3: Balance of Payments
US$ millions unless otherwise stated

	FY18	FY19	FY20	FY21	FY22 (Jul-Dec)
Current account balance	**-9,567**	**-4,490**	**-5,435**	**-4,575**	**-8,180**
Trade balance	-18,178	-15,835	-18,569	-23,778	-15,617
Merchandise export f.o.b. (inc. EPZ)	36,285	39,604	32,121	36,903	23,354
Merchandise import f.o.b. (inc. EPZ)	-54,463	-55,439	-50,690	-60,681	-38,971
Services	-4,201	-3,176	-2,578	-3,002	-1,740
Income	-2,641	-2,382	-3,070	-3,172	-1,407
Current transfers	15,453	16,903	18,782	25,377	10,584
Official	51	41	19	33	12
Private	15,402	16,862	18,763	25,344	10,572
o/w Workers' remittance	14,982	16,420	18,205	24,778	10,240
Capital account	**331**	**239**	**256**	**221**	**138**
Financial account	**9,011**	**5,130**	**8,654**	**13,093**	**6,660**
Foreign direct investment (net)	1,778	2,628	1,271	1,355	870
Portfolio investment (net)	349	171	44	-269	-90
MLT loans (excludes suppliers' credit)	5,987	6,263	6,996	6,726	4,025
MLT amortization payments	-1,113	-1,202	-1,257	-1,417	-778
Other long term loans (net)	141	302	499	1,684	972
Other short term loans (net)	1,508	272	1,142	2,064	1,402
Trade Credit (net)	-1,270	-3,493	236	3,498	-450
Commercial Bank	1,631	189	-277	-548	709
Errors and omissions	-632	-700	-306	535	-409
Overall Balance	**-857**	**179**	**3,169**	**9,274**	**-1,791**
Official Reserves (in US$ billions)[1]	**32.9**	**32.7**	**36.0**	**46.4**	**46.2**

Source: Bangladesh Bank
Note: 1/ All the numbers are in US$ millions expect mentioned otherwise.

The large balance of payments (BoP) surplus in FY21 turned into a deficit in H1 FY22. Despite a widening trade deficit, the BoP surplus increased to US$ 9.3 billion at the end of FY21, led by a 36.1 percent (y-o-y) surge in official remittance inflows. The surge in official remittance inflows in FY21 correlates with substantial disruptions in informal remittance transfer channels as the movement of people and goods was constrained by COVID-19 travel restrictions. The surplus in the financial account reflected increasing foreign direct investment (39.3 percent) and medium and long-term (MLT) loan disbursements (78.3 percent). However, these trends reversed in FY22. The current account deficit widened in H1 FY22 due to a sharp increase in import payments (52.4 percent) and a decline in official remittance inflows (-20.9 percent). Official remittance inflows declined as travel restrictions were lifted, supporting normalization of informal transfer channels. This trend was reinforced by a rising informal exchange rate premium, which reached 2.7 percent by March 2022. The financial account surplus narrowed as loan disbursements and portfolio investments slowed. As a result, the BoP deficit reached US$ 1.8 billion in H1 FY22, compared to a surplus of US$ 6.1 billion during the same period of FY21.

The BoP deficit has put downward pressure on foreign exchange reserves. The Bangladeshi taka (BDT) remained stable against the US dollar at 84.8 BDT/US$ throughout FY21. The exchange rate depreciated to BDT 85.8 per US$ in December 2021 as imports surged, international travel resumed, and official remittance inflows declined. BB sold US$2.5 billion of reserves in H1 FY22, reversing the direction of its FY21 foreign exchange interventions. Gross foreign exchange reserves declined in H1 FY22 but remained adequate at US$ 44.5 billion. In the context of an elevated BoP deficit, vigilance, and greater exchange rate flexibility are required to safeguard reserves. The use of reserves for non-monetary purposes such as investment project financing under the Bangladesh Infrastructure Development Fund and the expansion of the Export Development Fund should be reconsidered.

Fiscal Trends and Debt Sustainability

The fiscal deficit narrowed to an estimated 3.6 percent of GDP in FY21. Revenue growth outpaced expenditure growth. As in previous years, both revenue and expenditure fell short of their targets. The use of National Savings Certificates (NSCs) declined in FY22 as NSC interest rates were lowered and enforcement of regulations on sales limits was strengthened. Public debt as a share of GDP increased modestly.

Revenue collection recovered from a low base. The revenue target for FY21 was an aspirational 42.3 percent nominal increase over FY20 collections. Though revenue collection rose by 23.5 percent (y-o-y) based on provisional estimates, it was still 14 percent lower than the target. Nominal tax revenues increased by 16.8 percent in H1 FY22, led by growth in trade-related tax revenues (22.4 percent growth) as imports rose. Government revenues remained among the lowest in the world at 9.4 percent of GDP, with limited adoption of tax policy or structural reforms in recent years and persistent weaknesses in tax administration systems.

Public expenditure growth remained modest. Despite the ambitious target in the budget to expand expenditure to expedite the economic recovery and support vulnerable sectors, total nominal expenditure grew only 9.8 percent in FY21, below the average growth rate of the previous ten years (16.5 percent) and 19.3 percent below the budget target. Current expenditure rose modestly in FY21 as the government continued a policy to limit non-essential expenditure such as the purchase of vehicles, construction of office buildings, and travel of government officials. Though construction of infrastructure megaprojects progressed, overall capital expenditure grew by only 4.2 percent in FY21, reflecting deferral of smaller projects and slow implementation in the fourth quarter due to movement restrictions. In the health sector, only 59.9 percent of the FY21 budget allocation was executed, despite the ongoing pandemic response. The percentage of the Annual Development Program (ADP) executed in H1 FY22 remained below the pre-pandemic level.[8]

[8] Detailed expenditure data for FY22 is not yet available.

Table 4: Fiscal Outcomes (% of GDP)					
	FY17	FY18	FY19	FY20	FY21
Total revenue	8.7	8.2	8.6	8.5	9.4
Tax revenue	7.7	7.4	7.7	7.0	7.7
Total expenditure	11.6	12.2	13.3	13.3	13.0
Current expenditure	7.1	6.8	7.4	7.4	7.5
Capital expenditures	3.7	4.7	5.2	5.1	5.1
Deficit 1/	-2.9	-4.0	-4.7	-4.9	-3.7
Net external financing	0.5	1.0	1.1	1.3	1.3
Net domestic financing	2.4	3.0	3.6	3.4	2.3
General government debt stock	26.3	27.2	28.5	31.7	32.1
External	9.6	10.4	10.4	11.8	12.2
Domestic	16.7	16.8	18.1	19.9	19.9

Source: Ministry of Finance
1/Excluding grant

The fiscal deficit narrowed to an estimated 3.7 percent of GDP in FY21, according to preliminary fiscal data. FY21 deficit financing was dominated by domestic borrowing. Net sales of National Savings Certificates (NSCs) almost tripled from FY20 to FY21, as savers turned to these high-yielding instruments amidst a decline in bank deposit interest rates. As a result, net borrowing from the banking sector declined by 40.5 percent (y-o-y) in FY21 in nominal terms. However, these trends reversed in FY22 as the interest rates on NSCs were reduced, and regulations on purchase limitations were enforced. Net NSC sales declined by 47.4 percent (y-o-y) in the first five months of FY22 (July-November 2021), while borrowing from the banking sector increased by 59.2 percent (y-o-y). Net foreign financing also increased by 11.6 percent (y-o-y) over the same period.

Bangladesh remains at a low risk of debt distress. Estimated public debt rose to 32.1 percent of GDP in FY21, from 31.7 percent in FY20. External debt amounted to 12.2 percent of GDP, just over one-third of the total debt stock. External debt is predominantly owed to multilateral creditors (61.1 percent of total external debt), although their share in overall external debt has been declining in recent years with increased borrowing from bilateral creditors to finance large infrastructure projects. The March 2022 joint World Bank-IMF Debt Sustainability Analysis (DSA) assessed that Bangladesh remained at low risk of external and public debt distress.

Underlying fiscal vulnerabilities remain. In the latest joint Bank-Fund DSA, the debt carrying capacity has been downgraded from strong to medium, driven mostly by a lower score in the World Bank's Country Policy and Institutional Assessment (CPIA) in 2020. Use of non-concessional loans and high cost NSCs have increased the debt service to revenue ratio. However, the recent reduction in NSCs interest rates and a decline in NSC issuance will support lower debt service costs. Guarantees to 49 SOEs stood at BDT 738.4 billion (approximately US$ 8.7 billion), increasing by 21.6 percent (y-o-y). Based on data from 120 SOEs and local governments, total Debt Service Liabilities (DSL) of these institutions stood at BDT 1,755.7 billion (approximately US$ 20.6 billion or 5 percent of FY21 GDP) as of May 2021, increasing by 31.6 percent (y-o-y). Control of these rapidly growing contingent liabilities will be critical.

Budget credibility remains a challenge. The gap between the original and executed budgets has grown substantially in recent years. In FY20, only 70.3 percent of revenue and 80.3 percent of expenditure in the original budget was executed.[9] Accurate revenue and expenditure forecasts are a key input to the preparation of a credible budget. In Bangladesh, overly optimistic expenditure allocations are presented with aspirational revenue targets. The large gap between budget and execution limits the ability to enforce accountability in public finances and weakens the credibility of the budget. It also reduces effective implementation of public investment and service delivery, affecting the overall development outcomes of government programs.

Outlook and Risks

GDP growth is expected to remain resilient in the medium term with waning pandemic-related economic disruptions and continuation of supportive macroeconomic policies. Inflation is projected to remain above the BB's target of 5.3 percent. External and fiscal sustainability will be stressed by rising global commodity prices and increased uncertainty following the war in Ukraine. Downside risks include continued high commodity prices that could worsen inflation dynamics and impact the external balance, weaker global demand for Bangladesh's exports, and potential new waves of COVID-19 that could require further containment measures.

After rebounding to an estimated 5.5 percent in 2021, global growth is expected to decelerate markedly to 4.1 percent in 2022. The downgrade reflects the impact of the Ukraine crisis, continued COVID-19 flare-ups, diminished fiscal support, and lingering supply bottlenecks. In contrast to advanced economies, output in EMDEs will remain substantially below the pre-pandemic trend over the forecast horizon. Growth in EMDEs is forecast to moderate, as macroeconomic policy support is phased out and the rebound in China eases. The pace of recovery in EMDEs is likely to remain uneven, with output and investment remaining well below pre-pandemic trends in many economies.[10]

Near and Medium Term Outlook

Bangladesh's GDP is expected to maintain robust growth in the medium term. Real GDP growth in FY22 is projected to decelerate modestly to 6.4 percent, driven by slower manufacturing sector growth as pent-up consumption demand subsides. Agricultural production is expected to maintain trend growth, subject to the risks of disruptions from natural disasters. As the vaccination campaign progresses, growth is projected to remain strong at 6.7 to 6.9 percent in FY23-24. Private investment is likely to recover gradually, and the government is expected to continue investing in infrastructure projects envisioned under the 8th Five Year Plan. Remittance inflows are expected to grow with increasing outflows of Bangladeshi migrant workers overseas, supporting growth in private consumption.

Table 5: Selected Macroeconomic Indicators
(annual percentage change, unless indicated otherwise)

	FY19	FY20	FY21	FY22 f	FY23f	FY24f
Real GDP growth, at constant market prices	7.9	3.4	6.9	6.4	6.7	6.9
Private Consumption	4.9	3.0	8.0	7.9	5.9	5.8
Government Consumption	13.4	2.0	6.9	7.7	8.3	8.8
Gross Fixed Capital Investment	6.9	3.9	8.1	8.4	7.7	8.1
Exports, Goods and Services	11.5	-17.5	9.2	25.5	5.8	6.8

[9] Final data is not yet available for FY21.
[10] Global Economic Prospects. The World Bank, January 2022.

Imports, Goods and Services	0.5	-11.4	15.3	28.8	5.7	5.6
Real GDP growth, at constant factor prices	8.0	3.8	7.0	6.4	6.8	6.9
Agriculture	3.3	3.4	3.2	3.2	3.5	3.6
Industry	11.6	3.6	10.3	10.4	10.3	10.1
Services	6.9	3.9	5.7	4.4	4.9	5.1
Inflation (Consumer Price Index)	5.5	5.6	5.6	6.2	6.0	5.8
Current Account Balance (% of GDP)	-1.3	-1.5	-1.1	-4.0	-3.4	-3.2
Net Foreign Direct Investment (% of GDP)	0.7	0.3	0.3	0.4	0.5	0.6
Fiscal Balance (% of GDP) 1/	-4.8	-4.9	-3.7	-4.1	-4.1	-3.7
Debt (% of GDP)	28.5	31.7	32.1	32.8	33.2	33.1
Primary Balance (% of GDP) 1/	-3.1	-3.0	-1.6	-2.1	-1.9	-1.4

Source: Bangladesh Bureau of Statistics; Ministry of Finance; Staff Estimates
1/ including grants

Inflation is projected to remain above the BB's 5.3 percent target. The inflation outlook has worsened due to the war in Ukraine and associated sanctions that resulted in higher global commodity prices. Though domestic crop production is expected to remain resilient, food prices may increase further if the government increases domestic energy and fertilizer prices. Non-food prices are likely to remain elevated as well, driven by an increase in transportation costs and the knock-on effects on other products. Global price increases in imported consumer products and freight costs, together with exchange rate depreciation, are likely to keep prices of imported items elevated.

Monetary policy is likely to remain accommodative, subject to inflation dynamics. BB kept the prior reductions in policy rates and reserve requirements unchanged despite the economic recovery. A further rise in inflation could prompt the BB to tighten monetary policy. However, monetary policy transmission through policy rates remains a challenge given the continued use of non-market NSC instruments for government borrowing and the cap on bank lending rates. With a decline in net foreign assets, BB lowered the broad money growth target to 10.0 percent for June 2022. Meanwhile, it raised the private sector credit growth target to 14.8 percent assuming a gradual recovery in the economy and return of investor confidence. However, continuation of the cap on lending rates and the inflation-based floor on the term deposit rate may squeeze the spread of the commercial banks and distort their lending decisions.

External stability will be subject to rising global commodity prices and increased uncertainty following the war in Ukraine. The current account deficit is projected to increase to 4.0 percent of GDP in FY22, driven by surging import payments and a decline in official remittance inflows as the use of informal transmission channels normalizes. The forecast is clouded by uncertainties in global trade and commodity prices stemming from the war in Ukraine. A slowdown in the growth in major export markets, particularly the European Union, could hamper export growth. Import payments of many goods (i.e., petroleum products, cotton, yarn, fertilizer, cooking oil, wheat) may rise further. Remittances are likely to pick up in the medium term with the increase in the outflow of migrant workers. Foreign currency reserves are expected to decline in the near and medium-term.

The fiscal deficit is expected to reach 4.1 percent of GDP in FY22 and moderate over the medium term. The volatility and uncertainty in the price of oil and LNG in the international market have created uncertainty regarding the required subsidy payments in FY22 and subsequent years. The government is also likely to move away from some of the austerity measures announced at the beginning of the pandemic, increasing government consumption. As a result of the war in Ukraine, implementation of US$ 12.7 billion Rooppur Nuclear Power Plant could be affected by sanctions. External support for the host community in Cox's Bazar and the displaced Rohingya population is expected to buffer the impact of the crisis on government expenditure. Revenue collection is expected to grow, but without major structural changes in the medium term, the revenue to GDP ratio for Bangladesh is likely to remain one of the lowest in the world at below 10 percent of GDP. Reliance on NSCs for deficit financing is likely to decline in the medium term, raising the pressure on bank borrowing. Close monitoring of the liquidity of the banking system will be required to prevent any crowding out of private investment. Despite the rise in deficit, the debt to GDP ratio is expected to remain at a sustainable level.

Risks and Reform Priorities

Risks remain tilted to the downside. Inflation may increase further due to both demand-pull and cost-push factors, disproportionately affecting the poor. High commodity prices for an extended period could impact the external balance more than expected. Weaker global demand for Bangladeshi exports could derail export growth. A further increase of subsidy payments to the energy, power, and the agriculture sectors would widen the fiscal deficit. New virulent waves of COVID-19 could necessitate additional movement restrictions, hampering domestic economic activities. The pandemic has deepened longstanding financial sector vulnerabilities. Contingent liabilities from non-performing loans combined with weak capital buffers could necessitate recapitalizations, resulting in higher domestic debt of the government and depressing credit growth. Upside risks include higher than expected export growth driven by diversion of export orders if supply chain diversification intensifies.

Containing inflation and managing the potential negative impacts of the war in Ukraine are immediate priorities. While growth has remained resilient, rising inflation is contributing to headwinds. Implementing existing stimulus programs for smaller firms and scaling up direct cash and food support programs to help the low-income households could underpin more balanced and sustainable growth. While some steps to roll out targeted fiscal stimulus have already been taken, fiscal space is sufficient to support expanded social protection programs.[11] Vigilance will be required to monitor inflation and adjust monetary policy to contain inflation, which will require close coordination with fiscal policies on commodity price subsidies. Prudent exchange rate management will be critical to keep the external balance at a desirable level and maintain adequate foreign exchange reserves.

Addressing longstanding structural reforms would support the recovery and strengthen resilience to future shocks. Bangladesh's expected graduation from the UN's Least Developed Country (LDC) status in coming years will present opportunities but also challenges, including the eventual loss of preferential access to advanced economy markets and more rigorous environmental and labor standards. Priority reforms are highlighted below. [12]

- **Strengthening trade competitiveness.** A trade competitiveness strategy is needed to sustain and increase export competitiveness in the post-LDC graduation environment. A national tariff policy complemented by revenue performance improvements could reduce overall nominal protection by rationalizing import tariffs and para-tariffs (regulatory and supplemental duties) and contribute to export diversification. A modern trade policy agenda that includes trade facilitation and services

[11] Steps include an announcement to provide special cards to 10 million people to buy daily essential commodities at a subsidized rate, and new stimulus programs targeting returning migrant workers, unemployed youth and rural entrepreneurs.

[12] Adopted from "Bangladesh Systematic Country Diagnostic 2021 Update." World Bank, November 2021.

reforms could further strengthen trade competitiveness and help companies in all sectors adapt to the rapidly evolving technological disruptions. The Bangladesh National Single Window and the Customs Modernization Strategic Action Plan (2019–2022) should be implemented

- **Improving the business climate to attract investment.** Bangladesh lags competitor countries in attracting FDI and private sector investments. Full operationalization of the new economic zones will be critical in achieving envisioned investment growth. Rationalizing regulations, reducing costs of starting and operating a business, and trade policy reforms will help the private sector to become competitive to drive growth and job creation.
- **Climate change adaptation and mitigation.** Climate vulnerabilities pose serious risks to sustainable growth and poverty reduction. Adaptation will be critical to protect vulnerable sectors, and a clear roadmap of decarbonization could help reduce the carbon footprint. Addressing institutional constraints is one of the highest priorities for successful implementation of Bangladesh Delta Plan projects across all subsectors.
- **Improving the governance framework, including budget reliability.** Institutional capacity and regulatory quality are needed to create contestable markets. The country's public financial management (PFM), particularly public investment management (PIM), needs to be strengthened to support investment plans. Improving the reliability of the budget and strengthening the capacity to produce credible statistics will be important for efficient macroeconomic management.
- **Addressing financial sector vulnerabilities.** Continued regulatory forbearance in financial sector delays the recognition of growing challenges (e.g., non-performing loans). Financial sector systemwide and institution-specific exit plans are needed to help avoid building further vulnerabilities. In parallel, relatively weak capital positions in the banking sector will need to be rebuilt. As credit demand is growing, timely recognition and resolution of non-performing loans in bank balance sheets is critical for addressing the supply side constraints in the credit market.