Bangladesh

Growth accelerated in fiscal 2018 on higher public investment and stronger consumption demand with a revival in exports. Inflation remained moderate. The current account deficit widened with surging imports despite revived remittances. Growth is expected to be slightly higher in both fiscal 2019 and 2020 on slowing in major trading partners. The current account deficit is forecast to shrink, and inflation to stay in check. To sustain higher investment and growth, the banking system requires strengthening reform.

Economic performance

GDP growth accelerated to 7.9% in fiscal year 2018 (FY2018, ended 30 June 2018) from 7.3% in the previous year, as rising growth in total demand found support in higher consumption, investment, and exports (Figure 3.15.1). Continued political calm, improved power supply, and higher growth in private sector credit facilitated the fastest economic expansion in Bangladesh since 1974.

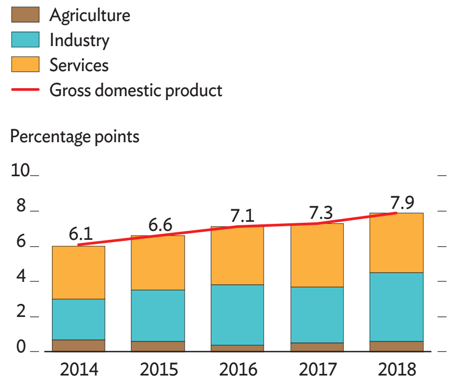
On the supply side, growth was lifted by improved expansion in industry and agriculture. Industry grew by 12.1% on strong production in large and medium-sized industries and higher investment. Agriculture grew by 4.2% as quick policy response to flood-induced crop losses in the summer facilitated a good winter harvest and buoyant horticulture output. Growth in services moderated to 6.4% as expansion slowed in transport, finance, education, and health care services.

On the demand side, strong private consumption that was buoyed by a recovery in remittances provided the main lift to growth. Public investment also contributed, reflecting substantial progress in implementing large infrastructure projects, notably the Padma Bridge and Dhaka Metro Rail. Investment increased from the equivalent of 30.5% of GDP in FY2017 to 31.2% in FY2018 as public investment rose from 7.4% of GDP to 8.0% and private investment increased slightly to 23.3%. A surge in imports made net exports a larger drag on growth than a year earlier despite the revival in exports.

Average inflation edged up from 5.4% in FY2017 to 5.8%. Headline inflation year on year decelerated from 5.9% in June 2017 to 5.5% as food inflation eased from 7.5% to 6.0%, benefiting from the good winter harvest and large rice imports (Figure 3.15.2). Nonfood inflation rose by just over 1 percentage

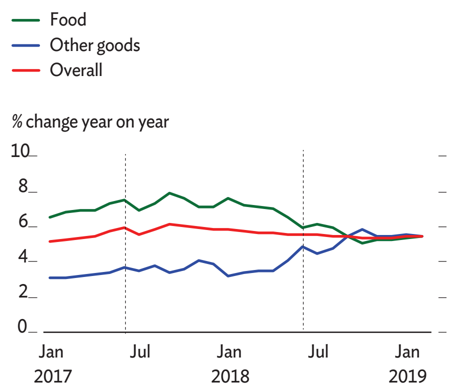
This chapter was written by Jyotsana Varma, Soon Chan Hong, Md. Golam Mortaza, and Barun K. Dey of the Bangladesh Resident Mission, ADB, Dhaka.

3.15.1 Supply-side contributions to growth



Note: Years are fiscal years ending on 30 June of that year.
Sources: Bangladesh Bureau of Statistics. http://www.bbs.gov.bd; ADB estimates.

3.15.2 Monthly inflation



Note: Dotted lines denote ends of fiscal years.
Source: Bangladesh Bank. 2019. *Monthly Economic Trends*. February. https://www.bb.org.bd.

point to 4.9% in June 2018 on higher global oil prices, upward adjustments in domestic administered gas and electricity prices, and depreciation of the Bangladesh taka against the US dollar.

Growth in broad money slowed to 9.2% in FY2018, well below the monetary program target of 13.3%, with a decline in net foreign assets (Figure 3.15.3). This was despite strong growth in private credit at 16.9%, notably for investment and import financing. Net bank credit to the government declined by 2.5% as sales of national savings certificates provided much of the domestic financing of the budget deficit.

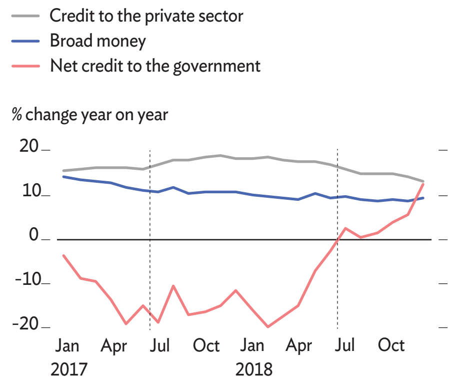
With declining net foreign assets pressuring bank liquidity, Bangladesh Bank, the central bank, reduced the required cash reserve ratio by 1.0 percentage point to 5.5% and lowered the repo rate by 75 basis points to 6.00% in April. This reduced pressure on the call money rate and forestalled any marked increase in bank lending rates, thereby supporting private sector growth. Banks' weighted average lending rate was nonetheless somewhat higher at 9.9% at the end of June 2018 than a year earlier, when it was 9.4%. The weighted average deposit rate also increased, from 4.7% to 5.5%, slightly narrowing banks' interest rate spread (Figure 3.15.4).

Budget revenue underperformed its target and declined from the equivalent of 10.2% of GDP in FY2017 to 9.6% with slower growth in value-added tax and supplementary duty collection at the import stage, while nontax revenue collection also underperformed. Government spending was lower than budgeted and declined marginally to the equivalent of 13.5% of GDP, curbing current spending from 8.3% of GDP in FY2017 to 7.8%. The annual development program and other capital spending strengthened from 5.3% of GDP to 5.7% with the implementation of the government's priority development projects. The fiscal deficit increased from 3.4% of GDP in FY2017 to 3.9% in FY2018, well within the budget target of 5% (Figure 3.15.5).

Export growth surged from 1.7% in FY2017 to 6.4% as garment exports, accounting for over 80% of the total exports, recovered from only 0.2% growth in FY2017 to 8.8% on stronger demand in the euro area. Other exports declined by 7.0% on lower demand for a number of other manufactured products. Import payments surged from 9.0% growth in FY2017 to 25.2%, reaching $58.9 billion. Imports of capital goods, food grains, and intermediate goods grew strongly. Remittances rebounded to grow by 17.3% to $15.0 billion, reflecting an increase in the number of workers going abroad in the past few years, a more favorable exchange rate, and measures to foster money transfer through official channels.

Despite larger remittances, the current account deficit grew abruptly from $1.3 billion in FY2017 to $9.8 billion, equal to 3.6% of GDP, as the surge in imports doubled the trade deficit, and deficits in services and primary income widened

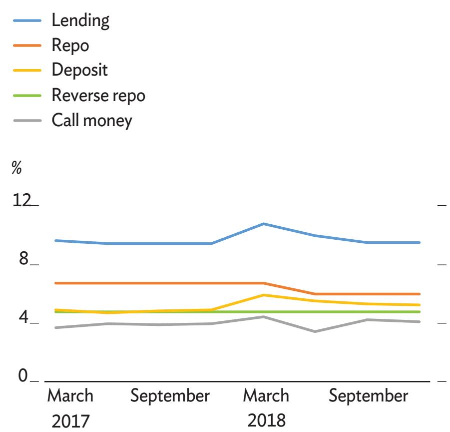
3.15.3 Growth of credit and money supply



Note: Dotted lines denote ends of fiscal years.

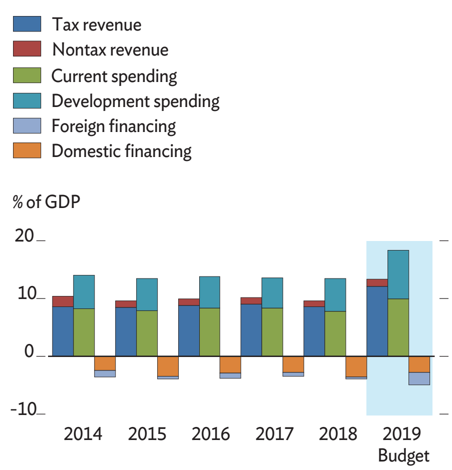
Source: Bangladesh Bank. 2019. *Major Economic Indicators: Monthly Update*. February. https://www.bb.org.bd.

3.15.4 Interest rates



Source: Bangladesh Bank. 2019. *Major Economic Indicators: Monthly Update*. January. https://www.bb.org.bd.

3.15.5 Fiscal indicators



Note: Years are fiscal years ending on 30 June of that year.

Source: Ministry of Finance. http://www.mof.gov.bd.

(Figure 3.15.6). While financing inflows nearly doubled to $9.4 billion, a financing gap of nearly $1 billion remained for the central bank to fill. Gross foreign exchange reserves at the end of June 2018 were still substantial at $32.9 billion, providing cover for nearly 6 months of estimated imports. The Bangladesh taka depreciated by 3.7% against the US dollar in FY2018, but it appreciated by 1.8% in real effective terms (Figure 3.15.7).

The ratio of government debt to GDP increased from 27.0% in FY2017 to 27.9% in FY2018. The government continues to prefer concessional external borrowing, especially to finance infrastructure projects, raising external debt from 11.3% of GDP to 12.1%. Domestic debt increased only marginally, from 15.7% of GDP to 15.8%, as the issuance of national savings certificates slowed.

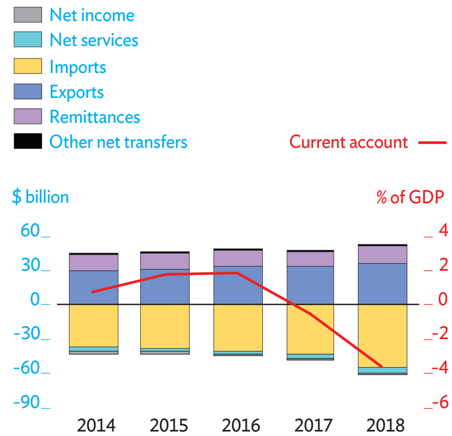
Economic prospects

GDP growth is expected to edge up to 8.0% in FY2019 on robust private consumption aided by continued recovery in remittances (Figure 3.15.8). Public investment will remain strong as the government continues to expedite the implementation of large infrastructure projects and other big projects receiving overseas support. Private investment is expected to rise, supported by measures to increase private sector credit, reform initiatives to improve the ease of doing business, and plans to make several hundred industrial plots available in special economic zones. Despite a weaker growth outlook in key exports markets, earnings from apparel exports are expected higher as new destinations strengthen. Tariff tensions between the People's Republic of China and the US make Bangladesh an attractive alternative source of manufactures. Consequently, the trade deficit will narrow as growth in exports outpaces imports. GDP growth in FY2020 is expected to remain solid at 8.0% as momentum from the previous year broadly continues.

On the supply side, further expansion in industry is expected to drive growth in FY2019 as export growth accelerates. Growth in agriculture is expected to moderate, considering the high base set last year. Growth in services is likely to remain unchanged, restrained in part by slower growth in agriculture. In FY2020, agriculture is projected to edge up as government policy support continues. However, with global growth continuing to slow, growth in industry is expected to moderate slightly, and expansion in services is likely to follow that trend.

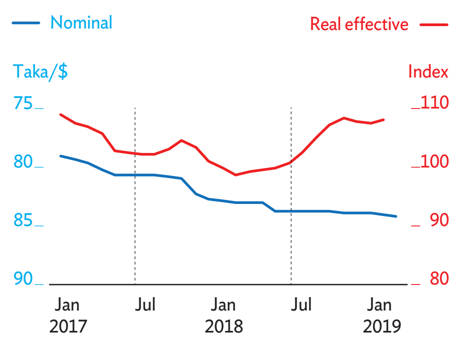
Inflation is expected to ease from 5.8% last year to a FY2019 average of 5.5%, contained by a good harvest and lower global food and oil prices (Figure 3.15.9). Inflation declined to 5.5% year on year in February 2019 from 5.7% a year before.

3.15.6 Current account components



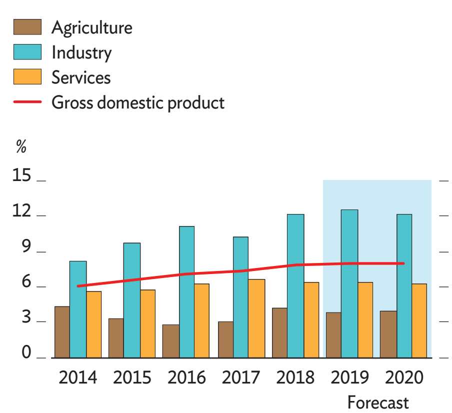
Note: Years are fiscal years ending on 30 June of that year.
Sources: Bangladesh Bank. *Annual Report 2017–2018.* http://www.bb.org.bd; ADB estimates.

3.15.7 Exchange rates



Note: Dotted lines denote ends of fiscal years.
Source: Bangladesh Bank. 2019. *Monthly Economic Trends.* February. http://www.bb.org.bd.

3.15.8 GDP growth by sector



Note: Years are fiscal years ending on 30 June of that year.
Sources: Bangladesh Bureau of Statistics. http://www.bbs.gov.bd; ADB estimates.

Inflation is projected to edge up to 5.8% in FY2020 on further upward adjustments likely for natural gas and electricity prices, as well as currency depreciation.

The monetary policy statement for the second half of FY2019 aims to balance inflation and output risks by providing an adequate supply of credit to productive economic sectors while implementing monetary and macroprudential policies to ensure domestic and external financial stability. The central bank kept the main policy rates unchanged: the repo at 6.00% and the reverse repo at 4.75%. It set target ceilings for broad money growth at 12.0% and domestic credit at 15.9%, which is expected to both accommodate the GDP growth target and contain inflation. Government borrowing appears on track while leaving adequate liquidity for private sector credit to grow within the target ceiling of 16.5%. The central bank will regularly monitor bank adherence to guidelines to better align their lending with deposit mobilization.

Exports increased by 13.4% in the first 7 months of FY2019, doubling 6.6% growth in the year-earlier period (Figure 3.15.10). Growth in readymade garment exports accelerated from 7.6% to 14.5%, benefiting from strong new orders from retailers that are partly attributable to global trade tension elsewhere. Given high demand for low-end products and acknowledged improvement in factory safety standards, exports are expected to increase by 14.0% in FY2019 and a further 15.0% in FY2020.

In the first 6 months of FY2019, import growth slowed steeply from the year-earlier rate of 25.2% to 5.7%. Although imports of intermediate and capital goods increased strongly in this period, imports of food grains and consumer goods markedly declined in the wake of high inventory building and food grain restocking in FY2018. On balance, imports are forecast to grow by 10.0% in FY2019 and 12.0% in FY2020.

Remittance growth moderated from 16.6% in the first 8 months of FY2018 to 10.0% in the same period this year after the large improvement in FY2018 set a high base (Figure 3.15.11). Government efforts have continued to reduce the cost of transferring remittances and to sideline unauthorized intermediaries. Remittances are expected to grow by 11.0% in FY2019 and by 10.0% in FY2020. With growth in exports and remittances expected to outpace growth in import demand, the current account deficit is expected to narrow to the equivalent of 2.3% of GDP in FY2019 and 2.5% in FY2020 (Figure 3.15.12).

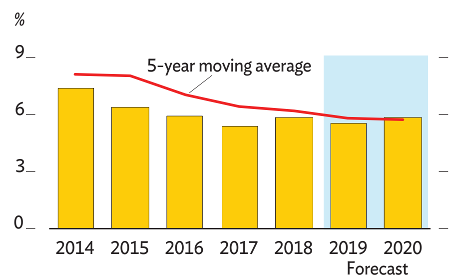
The taka depreciated by 1.4% against the US dollar in the 12 months to February 2019 and is expected to depreciate a bit more in the remaining months of FY2019 as imports rise somewhat higher. To avoid excessive volatility in the foreign exchange market, the central bank sold about $1.3 billion up to 27 January 2019 to meet demand for foreign exchange.

3.15.1 Selected economic indicators (%)

	2019	2020
GDP growth	8.0	8.0
Inflation	5.5	5.8
Current account balance (share of GDP)	–2.3	–2.5

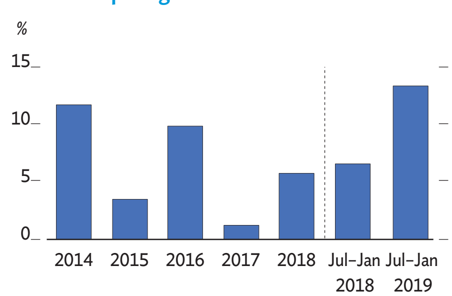
Note: Years are fiscal years ending on 30 June of that year.
Source: ADB estimates.

3.15.9 Inflation



Note: Years are fiscal years ending on 30 June of that year.
Sources: Bangladesh Bank. 2019. *Monthly Economic Trends.* February. http://www.bb.org.bd; ADB estimates.

3.15.10 Export growth



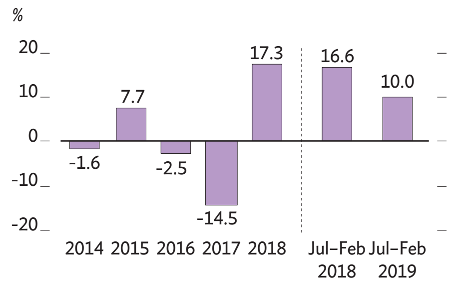
Note: Years are fiscal years ending on 30 June of that year.
Sources: Export Promotion Bureau, Bangladesh. *Export performance*, various issues.

The FY2019 budget targets 30.8% growth in revenue to bring the ratio of revenue to GDP to 13.4%. Total spending is set to grow by 25.1% to equal 18.3% of GDP, with current spending equal to 9.9% of GDP and the annual development program and other capital spending at 8.4%.

Attaining these high targets will be challenging in light of recent developments. In the first 6 months of FY2019, growth in revenue collection by the National Board of Revenue plunged from 20.4% in the year-earlier period to 6.1%. Import taxes and domestic indirect taxes have both been lower than expected with import demand weaker. Achieving the high investment spending planned in the budget will demand concerted effort, considering that only 27.4% of the annual development program was implemented in the first half of FY2019. However, as in the past, shortfalls on both sides of the ledger are likely to be managed to yield a fiscal deficit within the budget target, equal to 5.0% of GDP.

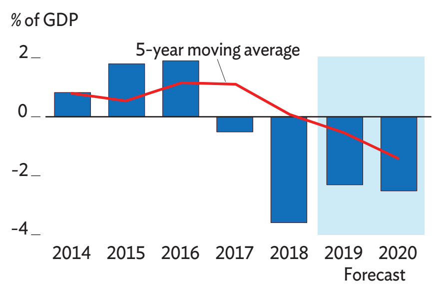
The outlook is subject to downside risks. Failure to boost revenue could crimp expenditure pledged for implementing priority projects. Global oil prices rising above expectations could stoke inflationary pressure. Failure to improve governance, the investment climate, and infrastructure could undermine other development achievements. Finally, adverse weather is a perennial risk.

3.15.11 Remittance growth



Note: Years are fiscal years ending on 30 June of that year.
Source: Bangladesh Bank. http://www.bb.org.bd.

3.15.12 Current account balance



Note: Years are fiscal years ending on 30 June of that year.
Sources: Bangladesh Bank. *Annual Report 2017–2018.* https://www.bb.org.bd; ADB estimates.

Policy challenge—promoting an efficient banking system

Banks play a key role in mobilizing and allocating resources for investment, especially as Bangladesh lacks a mature capital market. As of June 2018, the country had 57 commercial banks with 10,114 branches and combined assets of Tk13.9 trillion, equal to 62% of GDP. Loans and advances amount to about two-thirds of total assets.

Banks fall into four categories: 6 state-owned commercial banks (SCBs), 2 state-owned development financial institutions (DFIs), 40 domestic private commercial banks (PCBs), and 9 foreign commercial banks (FCBs). They operate under the regulation and supervision of the central bank. The SCBs once dominated the system with a large market share, but that share shrank over time as PCBs and FCBs gained market share, reflecting increased competition in banking. The asset share of SCBs declined from about 55% of the total in 1993 to 26.1% in June 2018, though the decline in deposit share was slightly smaller (Table 3.15.2).

SCBs and DFIs have small market shares, but they face major issues such as high nonperforming loans (NPLs), low profitability, weak governance, widening capital shortfalls, operational inefficiencies, scant automation, inadequate credit

3.15.2 Banking system structure, assets, and deposits, June 2018

Bank type	Number of banks	Number of branches	Share of industry assets (%)	Share of deposits (%)
SCB	6	3,741	26.1	27.4
DFI	2	1,411	2.4	2.8
PCB	40	4,888	67.0	65.8
FCB	9	74	4.6	4.0
Total	57	10,114	100.0	100.0

DFI = development financial institution, FCB = foreign commercial bank, PCB = domestic private commercial bank, SCB = state-owned commercial bank.
Source: Bangladesh Bank. 2018. *Annual Report 2017–2018.* http://www.bb.org.bd.

monitoring and internal risk management, and an ineffective legal framework.

NPLs have gone up for all classes of banks (Table 3.15.3). SCBs are burdened, however, with much higher NPLs than are PCBs or FCBs, which weak management allowed them to accumulate over time. The ratio of gross NPLs to total loans peaked at 41.1% at the end of 1999—the upshot of loans granted after only weak appraisal, directed lending programs during 1970s and 1980s, weak follow-up on repayment, and reluctance to write off long-standing bad loans because of the poor quality of underlying collateral and fear of possible legal complications. However, the ratio of NPLs steadily decreased to 6.1% at the end of 2011 with provisioning, write-offs, and a sharp reduction in new bad debt. NPLs rebounded, with some fluctuation, to 10.3% at the end of December 2018, partly reflecting a tightening of loan classification standards. The NPL ratio at SCBs then was about five times that of PCBs and FCBs.

Profitability at SCBs, measured as bank return on assets and return on equity, has been negative and below the industry average since 2014 because of higher provision requirements and operational inefficiency. The authorities were therefore required to inject capital into them on several occasions, still leaving the SCB capital adequacy ratio at only 2.0% as of June 2018 (Table 3.15.4). It will be a challenge for them to meet the Basel III requirement by 2019 of a capital adequacy ratio at 12.5% of risk-weighted assets. PCBs and FCBs, by contrast, have maintained stronger capital positions and enjoyed higher return on equity.

Better governance is required in the banking sector. Indications of weak governance are a high ratio of expenditure to income, high administrative and operating expenses, lending with scant appraisal, weak credit monitoring, a lack of integrity and compliance with applicable laws and regulations, and inefficient appointments in management.

To address banking sector issues, the authorities have taken a number of measures under past reform programs: enforcing stronger regulations, introducing a bankruptcy law, establishing money loan courts and a credit information bureau, corporatizing SCBs, applying a uniform guideline for writing off loans, changing loan classification and loan-loss provision, restructuring policy for large loans above Tk5 billion, the phased introduction of Basel III, and promoting a number of measures for good corporate governance. Although these initiatives have brought some improvements, they have not turned around weak performance in the sector.

The government is planning various measures to impose greater discipline on the financial sector through amendments to the Bank Company Act of 1991, Bankruptcy Act of 1997, and Money Loan Court Act of 2003. It is planning as well a special audit for banks to probe irregularities in the sector.

3.15.3 Gross nonperforming loans to total loans by type of bank (%)

Bank type	2011	2016	2017	2018
SCB	11.3	25.1	26.5	30.0
DFI	24.6	26.0	23.4	19.5
PCB	2.9	4.6	4.9	5.5
FCB	3.0	9.6	7.0	6.5
Total	6.1	9.2	9.3	10.3

DFI = development financial institution, FCB = foreign commercial bank, PCB = domestic private commercial bank, SCB = state-owned commercial bank.

Source: Bangladesh Bank. 2018. *Annual Report 2017–2018*. http://www.bb.org.bd.

3.15.4 Indicators of banking sector performance, FY2018 (%)

Bank type	SCB	DFI	PCB	FCB	Total
Share of assets	26.1	2.4	67.0	4.6	100.0
Gross nonperforming loan ratio	28.2	21.7	6.0	6.7	10.4
Provision adequacy	64.1	111.6	103.2	104.3	84.9
Ratio of capital to risk-weighted assets	2.0	–31.9	12.2	23.0	10.0
Return on assets	–0.7	–1.6	0.6	2.8	0.3
Return on equity	–12.3	–8.4	8.2	13.7	4.4
Net interest margin	2.1	0.9	3.5	4.6	3.2
Ratio of expenditure to income	83.9	149.9	78.4	44.3	80.3

DFI = development financial institution, FCB = foreign commercial bank, PCB = domestic private commercial bank, SCB = state-owned commercial bank.

Source: Bangladesh Bank. 2018. *Annual Report 2017–2018.* http://www.bb.org.bd.

Meanwhile, the central bank launched a new guideline on credit risk management, the Internal Credit Risk Rating System, effective on 1 July 2019. When revising the Bankruptcy Act, it is important to ensure that it sets time-bound procedures for Money Loan Courts to speed up the resolution of cases being settled.

Further, to improve governance, appointment to SCB boards of directors could be limited to competent professionals who possess operational knowledge of banking and finance, avoiding political appointments. Moreover, SCB management should be given full operational independence to conduct operations day to day, with both the board and management accountable to the central bank.

The authorities should ensure strict enforcement of existing bank rules and regulations. They might consider consolidation, merger, or divestment for SCBs, or even privatization to reduce their number. Alternatively, restructuring SCBs could be considered before divestment. The authorities could also consider establishing a national asset management company to take over NPLs from ailing banks. The government might decide to compensate SCBs in some efficient way or provide budgetary support for their mandated social services, such as providing financial services to underserved areas of the economy.