INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 08/126
FOR IMMEDIATE RELEASE
September 30, 2008

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2008 Article IV Consultation with Bangladesh

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

Background

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

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

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

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

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

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

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

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

Executive Board Assessment

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

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

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

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

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

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

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

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

Bangladesh: Selected Economic Indicators, FY2004–08 1/

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

Sources: Data provided by the Bangladesh authorities; and Fund staff estimates.
1/ Fiscal year begins July 1.
2/ Consists of other capital, net lending, food account balances, check float, and discrepancy.
3/ Includes assumption of BPC liabilities of 1.4 percent of GDP in FY08.