

**FOR
INFORMATION**

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From: The Secretary

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Bangladesh—Assessment Letter for the World Bank and the Asian Infrastructure Investment Bank

April 29, 2020

This note provides the IMF staff's current assessment of Bangladesh's macroeconomic conditions, prospects, and policies. The assessment has been requested in relation to a proposed budget support loan to Bangladesh to be considered by the Asian Development Bank in April 2020.

I. RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

The COVID-19 pandemic is expected to significantly slow down the economic growth of Bangladesh. As of 10 April, 424 cases have been confirmed. Before the pandemic, growth was projected to remain strong at above 7 percent, supported by robust private consumption with stronger remittance inflows. However, in the April 2020 *World Economic Outlook*, growth is projected to decline to 3.8 percent in FY20 (July 2019-June 2020). The ready-made garments (RMG) industry, which accounts for more than eighty percent of the country's exports, has already been hit hard by the pandemic. Major retailers in importing countries have cancelled or postponed their orders, which will lower export receipts by several billions USD. Remittance inflows, which represent about 5 percent of GDP, have started to decline in March, falling by 11 percent relative to March 2019. Domestic economic activities will be affected by the national shutdown that started on March 26. The current account deficit is projected to increase to around 3½ percent from 1.7 percent in FY19, and foreign exchange reserves are expected to decline. A gradual recovery is expected in FY21 (7.8 percent growth), supported by a rebound in the global economy and fewer domestic impacts from COVID-19. However, the recovery is subject to considerable uncertainty with risks firmly tilted downward.

Risks to the outlook are clearly tilted downward. External risks include a prolonged COVID-19 outbreak which would lead to delayed and slower recovery in exports and remittance inflows. Oversupply in the oil market could continue to slow down economic activity in Middle East countries, which are the most important source of remittances for Bangladesh. Domestically, a larger outbreak of COVID-19 might require longer containment measures by the authorities, which could increase social discontent, further weaken domestic demand, and disrupt the lives of Bangladeshi people, particularly those who are vulnerable. The already-weak banking sector could face further pressures in maintaining its asset quality and providing necessary support for the private sector.

II. POLICY FRAMEWORK AND SETTINGS

Fiscal Policy

The government has introduced a series of fiscal measures to contain and mitigate the impact of the COVID-19 outbreak. Total announced measures amount to about 2.6 percent of GDP though it includes banking sector loans, including to support working capital of the business sector. At end-March, the Ministry of Finance issued a revised budget for FY20, which includes additional resources to fund the COVID-19 Preparedness and Response Plan and to expand existing transfer programs that benefit the poor. Increased allocation has been also made to support food distribution, housing, and increased allowances to vulnerable populations. In addition, a Tk.50 billion stimulus package for exporting industries has been announced to finance salaries for about 4 million workers for three months. The Ministry of Finance will also subsidize interest payments on up to Tk. 500 billion in working capital loans by banks to businesses. The National Board of Revenue has suspended duties and taxes on imports of medical supplies, including protective equipment and test kits.

These measures, combined with lower revenue, will increase fiscal deficits in FY2020. The government has approached international financial institutions seeking budget support, and similar requests have been addressed to bilateral development partners. Close donor coordination will be required to maximize the efficiency and effectiveness of financial assistance. The government's priority remains to mobilize external funds on concessional terms, and Bangladesh's sustainable debt dynamics allow the authorities to increase external borrowing in response to the pandemic. Bangladesh remains at a low risk of debt distress as assessed in the 2019 Article IV.

Monetary Policy

Bangladesh Bank has eased monetary policy and taken other steps to contain the negative fallout from the COVID-19 outbreak. Bangladesh Bank (BB) reduced in two steps the repo rate by 75 basis points (bps) to 5.25 percent and reduced the cash reserve requirement (CRR) by 150 bps to 3.5 percent. Furthermore, BB announced that it will buy treasury bonds and bills from the banks to ensure countrywide access to financial services. BB has also relaxed foreign exchange regulations for trade and some specific non-trade transactions and provided liquidity in foreign exchange markets by selling USD.

The scope for BB's support to the banking sector and the economy could be constrained by large government borrowing. Even before the COVID-19 outbreak, the increasing fiscal deficit and sharp reduction in non-bank deficit financing through National Saving Certificates (NCS) led to a sharp increase in banks' lending to government and deceleration of private-sector credit growth.

Financial Sector Policy

The banking sector is expected to play an important role in channeling assistance to the economy. A substantial portion of the recently unveiled stimulus package will be provided via bank loans. However, the capacity of commercial banks to support private-sector credit could be constrained, with a higher share of credits to government due to COVID-19. BB has also taken measures to delay non-performing loan (NPL) classification, extend tenures of trade instruments, and ensure access to financial services. The delay in NPL classification goes against past Fund staff advice.

Given the already high level of NPLs, it is vital for BB to monitor closely the banking sector conditions. Effective supervision by BB needs to continue while strengthening corporate governance of commercial banks. Loans under the stimulus package should be effectively targeted and carefully monitored to preserve banking soundness while providing support where most needed.

Macrostructural issues

To sustain robust economic performance in the medium term, the authorities will need to step up their reform efforts, while upgrading the country's economic policy framework. Improvements in infrastructure and governance will be necessary to enhance the business environment and attract FDI. This will also promote further diversification of the economy. Addressing climate change risks through continuous efforts in mitigation and adaptation will be required to enhance resilience and sustainability of economic growth.

IMF Relations

Bangladesh is on a standard 12-month Article IV consultation cycle. The 2019 Article IV consultation was concluded by the IMF's Executive Board on September 9, 2019. The Bangladeshi government also requested balance of payments support from the IMF under the Rapid Credit Facility on March 29, 2020.

Table 1. Bangladesh: Selected Economic Indicators, FY2016-22 1/

I. Social and Demographic Indicators							
Population (2017, millions; estimate)	165	Infant mortality (2016, per thousand live births)	28.0				
GDP per capita (2017, U.S. dollars)	1517	Life expectancy at birth (2016, years)	71.6				
Labor force participation rate (2017, percent; national measure)	58	Adult literacy (2016, percent of people)	73.0				
Poverty headcount ratio (2016, national measure, percent)	24	Population dependency ratio (2017, percent)	50.0				
Gini index (2016, World Bank estimate)	32	Population growth (FY16, y/y, percent; estimate)	1.1				
II. Macroeconomic Indicators							
	FY16	FY17	FY18	FY19	FY20	FY21	FY22
				Est.		Proj.	
Output							
Real GDP growth (%)	7.1	7.3	7.9	8.2	3.8	7.8	7.3
Prices							
Inflation, CPI annual average (%)	5.9	5.4	5.8	5.5	5.7	5.6	5.5
Central Government Operations							
Fiscal balance (% of GDP)	-3.4	-3.3	-4.6	-5.2	-6.9	-6.5	-5.8
Balance of Payments							
Current account (% of GDP)	1.9	-0.5	-3.5	-1.7	-3.4	-2.3	-1.4

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

1/ Fiscal year begins July 1.