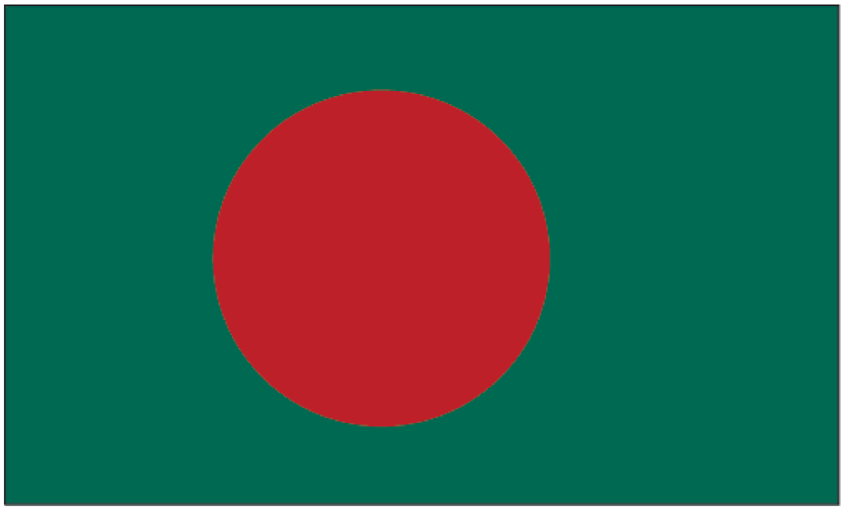
# Country report

# BANGLADESH



**Summary**

Bangladesh remains one of the poorest countries in the world despite robust growth rates. The economy of Bangladesh has proven resilient to the adverse effects of the global financial crisis as it is relatively isolated from the world economy. GDP is estimated to have grown 6% yoy in 2010 and 6% growth is also expected in 2011. Even so, economic development is hampered by flooding, power outages and a terrible infrastructure. Embedded and widespread corruption hinder the business environment. The political landscape is unstable as the ruling and the main opposition party share a historical animosity, severely obstructing any progress on the policy agenda. The fiscal position is weak and inflation targeting is complicated by conflicting central bank objectives. The social situation is tense and marked by violent mass protests. The external position did improve, as robust remittances inflows have significantly boosted the stock of FX-reserves.

**Things to watch:**

- Unstable political situation obstructing the policy agenda
- Impact of annual flooding on the agricultural sector
- Ability of the central bank to manage rising inflation

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## Bangladesh

| National facts | | |
|---|---|---|
| Type of government | Parliamentary Democracy | |
| Capital | Dhaka | |
| Surface area (thousand sq km) | 144 | |
| Population (millions) | 162.2 | |
| Main languages | Bangla | |
| | English | |
| Main religions | Muslim (83%) | |
| | Hindu (16%) | |
| | Other (1%) | |
| Head of State (president) | President Zillur Rahman | |
| Head of Government (prime-minister) | Sheikh Hasina | |
| Monetary unit | Taka (BDT) | |

| Economy | | 2010 |
|---|---|---|
| *Economic size* | *bn USD* | *% world total* |
| Nominal GDP | 100 | 0.16 |
| Nominal GDP at PPP | 244 | 0.33 |
| Export value of goods and services | 18 | 0.10 |
| IMF quotum (in mln SDR) | 533 | 0.25 |
| *Economic structure* | *2010* | *5-year av.* |
| Real GDP growth | 6.0 | 6.2 |
| Agriculture (% of GDP) | 18 | 19 |
| Industry (% of GDP) | 29 | 28 |
| Services (% of GDP) | 53 | 53 |
| *Standards of living* | *USD* | *% world av.* |
| Nominal GDP per head | 607 | 6 |
| Nominal GDP per head at PPP | 1483 | 13 |
| Real GDP per head | 495 | 6 |

| Social and governance indicators | rank / total |
|---|---|
| Human Development Index (rank) | 146 / 182 |
| Ease of doing business (rank) | 119 / 183 |
| Economic freedom index (rank) | 160 / 179 |
| Corruption perceptions index (rank) | 145 / 180 |
| Press freedom index (rank) | 121 / 175 |
| Gini index (income distribution) | 31.8 |
| Population below $1 per day (PPP) | 36% |

| Foreign trade | | | 2010 |
|---|---|---|---|
| *Main export partners (%)* | | *Main import partners (%)* | |
| US | 20 | India | 16 |
| Germany | 13 | China | 13 |
| UK | 9 | Kuwait | 8 |
| France | 6 | Singapore | 5 |
| *Main export products (%)* | | | |
| Readymade garments | | | 66 |
| Fish & prawns | | | 3 |
| Jute products | | | 4 |
| Leather & hides | | | 2 |
| *Main import products (%)* | | | |
| Capital goods | | | 19 |
| Textiles | | | 18 |
| Petroleum & petroleum products | | | 11 |
| Iron & steel | | | 6 |
| *Openness of the economy* | | | |
| Export value of G&S (% of GDP) | | | 18 |
| Import value of G&S (% of GDP) | | | 25 |
| Inward FDI (% of GDP) | | | 1.1 |

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

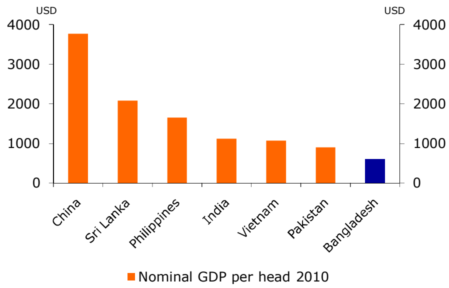
### Economic structure and growth

When the Europeans set up trading posts around the area of Bangladesh, the British dominated the region. As such, Bangladesh was part of British India until the region was split up into India and Pakistan in 1947. Pakistan was comprised of West Pakistan (current Pakistan) and East Bengal (current Bangladesh. This awkward arrangement of a two-part country with its territorial units 1,600 km apart left the Bengalis marginalized and dissatisfied. In 1971, East Bengal separated from Pakistan and was renamed Bangladesh. Ever since, economic development has been very slow, hampered by political turmoil. It is one of the poorest countries in the world with nominal GDP per head of only USD 1,483 and 36% of the population living below the poverty line of USD 1 per day. The low level of human development is also reflected in the UN's human development index, which ranks Bangladesh 146$^{th}$ out of 182 countries.

Economic development is also hampered by a high vulnerability to inundations. Each year, about a third of the country is flooded during the annual monsoon rains. This severely affects the agricultural sector, washing away crops. While the agricultural sector is not especially important in terms of economic size, since it accounts only for 18% of GDP, it employs 45% of the country's labor force. The industrial sector contributes 29% to GDP and within this sector the textiles and garment sector is a key growth driver. Unfortunately, the industrial sector is plagued by the terrible infrastructure and frequent power outages, which have become structural impediments to a higher level of economic growth. The large services sector, which contributes 52% to GDP, is not left unaffected by the power outages. Furthermore, the level of corruption is very high and widespread, affecting the overall business environment.

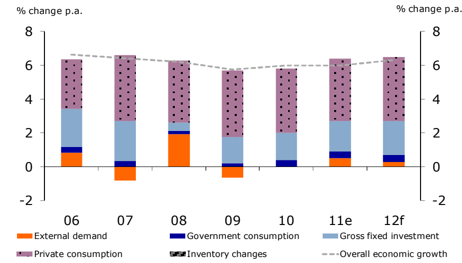
Even so, Bangladesh has been able to post surprisingly robust and stable rates of economic

**Chart 1: Income level**




Source: EIU

**Chart 2: Growth performance**




Source: EIU

expansion of the last couple of years. Real GDP growth averaged a decent 5.8% annually in the past ten years. Even during the global economic slowdown in 2008-09, the country's economy grew by 6.2% and 5.7% yoy respectively. This robustness can be attributed to Bangladesh' relatively low level of integration with the world economy. It does not have developed financial markets exposing it to international capital flows. Also, the banking system has not been exposed to US subprime loans or other western mortgage products. The banking sector is healthy according to the 2010 Financial System Stability Assessment of the IMF. It does note that state-owned banks remain in a financially weak condition, but the banking sector as a whole only poses a moderate contingent liability.

Another indicator pointing to low integration with the world economy is that the openness of the economy only amounts to 43%, which is relatively low. Exports are highly undiversified as textiles and garment products make up 80% of total exports. As Bangladesh' main export partners are the US and Western Europe, this makes export revenues highly susceptible to the economic cycle of developed countries. For its imports, Bangladesh mostly depends on India and China. It mainly imports capital goods, textiles, petroleum and metals.

The textiles and garment sector is a main driver of economic growth along with the agricultural sector and remittances inflows. Remittances from Bangladeshi workers overseas have proven to be very robust in 2008 and 2009, supporting household consumption. Remittances have grown from USD 1.8bn in 2001 to an estimated USD 11bn in 2010, equivalent to 11% of GDP.

Going forward, the outlook is positive as the economic recovery picks up in the west, albeit very slowly. Domestically, the agricultural sector is expected to grow on the back of supportive government policies, but devastating floods remain a high risk. Overall, the economy is forecasted to grow by 6% in 2011.

## Political and social situation

Since gaining independence in 1971, Bangladesh has developed a functioning parliamentary democracy amid episodes of military rule. The latest such event was between 2006 and 2008, when the country was ruled by a military sponsored caretaker government. While democracy returned with the general elections in January 2009, the political situation remains tense as the two main parties share a historical animosity. The Awami League (AL), led by Prime Minister Hasina, is the ruling party. The AL acquired 230 out of 300 seats in parliament, giving it a strong mandate as it has surpassed the two-thirds majority in parliament needed to amend the constitution unchallenged. This was a crushing blow to the main opposition party, the Bangladesh Nationalist Party (BNP). The hostility between these parties has resulted in distractions from economic policy, hampering of legislative efficiency and economic disruption through politically-motivated strikes and blockades by BNP supporters. The BNP and other leftist parties have strengthened recently, reflected by the BNP's victory in the municipal elections in the important port city of Chittagong in

June 2010. The victory gave the BNP a boost to step up anti-government protests. It started a month-long agitation program against the government in October 2010 with nationwide strikes, which crippled schools, businesses and crucial garment exports. The BNP will strengthen further if it gains more victories in the upcoming local government elections set in 1Q11, including the one for the capital Dhaka. We expect the political situation to remain unstable, as the BNP will continue to obstruct parliamentary proceedings and seize every opportunity to bring down the popularity of the AL.

The AL has lost popularity in the past year over a variety of issues, including the continued energy crisis. The social situation has become very tense as the population's discontent with government policies is vented via violent strikes and mass protests. The large energy deficiencies hindering the business environment have always been a source of unrest. This year, month-long violent labour protests broke out as garment workers were unsatisfied with the minimum wage hike. Garment factories owners also rioted as they demanded government subsidies to compensate for their loss of competitiveness as a result of the wage hikes.

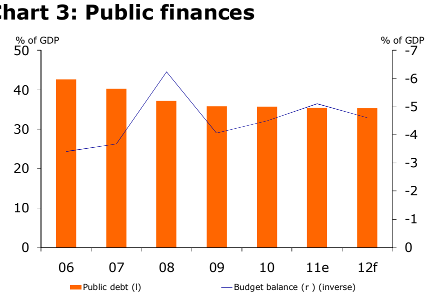
International relations have notably improved with India, as PM Hasina agreed to co-operate on a range of economic and security issues during a visit to India. Relations with China have cooled as it perceives Bangladesh is now firmly within India's sphere of influence. Tensions with Myanmar will remain until the border dispute concerning a gas-rich area in the Bay of Bengal is resolved.

**Economic policy**

The fiscal position is weak as it suffers from a narrow revenue base and rigid expenditures. The tax-to-GDP ratio stands at 8.5% of GDP and total revenue stands at 11.8% of GDP, which are both extremely low levels. The reasons behind such low revenues are a combination of low compliance levels and administrative weaknesses at the main revenue collection agency. Furthermore, the non-taxation of the entire agricultural sector and the multitude of tax holidays and exemptions further contribute to low revenue collection. While the government aims to increase the tax revenues to 13% of GDP by 2012, it is unlikely this target is met. The policy direction seems to focus on increasing revenue collection rather than an overhaul of the tax system. The announced measures are vaguely defined and aimed at ensuring transparency, accountability and efficiency. However, if the government would take some more fundamental measures concerning income tax, VAT or the number of tax holidays and exemptions, the tax revenue target would be more within reach.

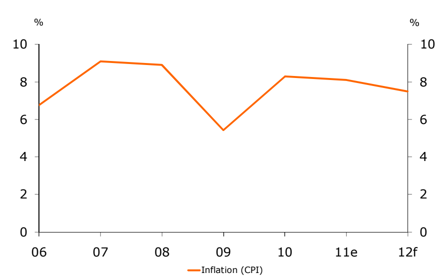
The rigid expenditures are another weakness, which make the fiscal position very inflexible. Subsidies for fuel, electricity, fertilizer, food and some exports amount to 1.5% of GDP. Existing subsidies are difficult to roll back and could even increase when the world price of inputs rises. For 2010, a budget deficit of 4.5% of GDP is expected. This is a moderate level when compared to

**Chart 3: Public finances**




Source: EIU

**Chart 4: Inflation**




Source: EIU

its regional peers, which run structurally higher deficits and sustain higher public debt levels. Public debt is estimated at 39% of GDP in 2010, which is a moderate level. A positive factor is that the portion of domestic debt in total debt has increased to 43% in 2010, up from 28% in 2000. These efforts to increase domestic financing in total borrowing will decrease the dependency on foreign investors. Another positive factor is the concessional nature and long maturity of most external public debt by international donors.

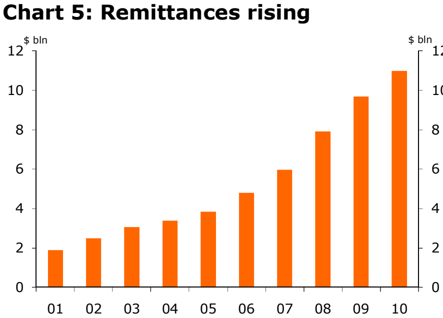
Containing inflation will be the most significant challenge for the central bank in 2011. Inflation is expected to average 8.1% yoy, which is too high. Inflationary pressures will remain significant as the rise in private sector credit will boost private demand and core inflation. Headline inflation is also subject to upward pressure as an adjustment in energy tariffs is expected and food prices are still high. Further complicating inflation management is the fact that the central bank is only semi-independent and has conflicting objectives. Other objectives include maintaining exchange rate stability and exchange rate competitiveness and to promote growth in agriculture and other priority sectors.

The exchange rate is a managed floating regime, but in practice it is a quasi peg to the USD. The government maintains this regime to ensure export competitiveness. In 2010, strong foreign exchange inflows have resulted in the central bank having to use unsterilized interventions in the foreign exchange market to ensure export competitiveness. This has led to excess liquidity, creating an inflationary environment for asset markets, complicating inflation management.

**Balance of Payments**

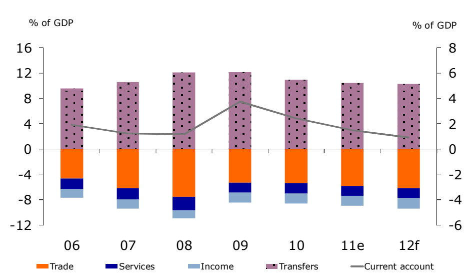
While the current account balance has posted modest surpluses in the past five years, it heavily relies on remittances inflows. These have proven to be very stable over the past decade and during the financial crisis. Remittances will contribute 11% of GDP to the current account balance in 2010. It is the only positive contributor and as such the backbone of the current account, which is expected to post a small surplus of 2.4% of GDP in 2010. The services and income balances will mark small deficits but the trade balance is the main drag. It will post a 5.4% of GDP deficit in 2010. As about 80% of the exports are made up of textiles and garment-related products and the US and Western Europe are the main export markets, exports have fallen in line with the economic cycle of the West but have been steadily recovering in the second half of 2010 . Exports are up 37% yoy in the period of July-Oct. 2010 but will remain susceptible to western demand. Imports have shown a similar trend as exports. This as a large part of the imports are raw materials needed for textile exports and the industrial sector as a whole. As such, this acts as an automatic stabilizer. Imports have grown by 34% yoy in the period of July-Oct. 2010. A risk mitigant is the fact that petroleum imports only account for 11% of total imports. The low oil dependency is due to the fact that Bangladesh has vast gas resources.

**Chart 5: Remittances rising**




Source: Bank of Bangladesh

**Chart 6: Current account**



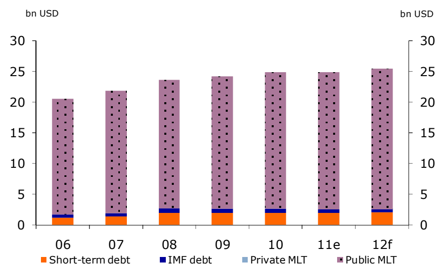

Source: EIU

As the current account balance has seen continuous surpluses in the past five years, no external financing was needed. These current account surpluses and central bank intervention in the currency markets by selling the domestic currency (Taka) have resulted in a substantial FX-reserves accumulation. FX-reserves are estimated to stand at USD 10.6bn at end-2010, up from USD 3.8bn in 2006. The capital account is closed as heavy restrictions on short-term external commercial borrowing exist.

## External position

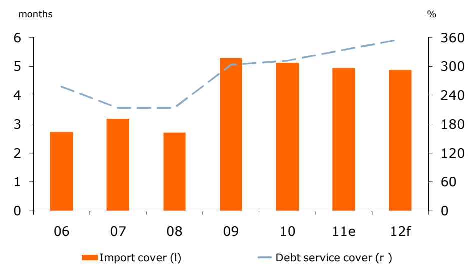
The external position has improved markedly over the past couple of years and is actually sound. Total external debt stands at USD 24bn, equivalent to 25% of GDP, which is rather low. A positive characteristic of external debt is that the portion of short-term debt is low with 8% (USD 2bn). Almost the entire external debt stock is owed by the public sector to official creditors with long maturities. A positive aspect is the fact that this debt is on concessional terms making the debt service easily manageable. The stock of FX-reserves has increased markedly in recent years resulting in an improvement of the external liquidity ratios. FX-reserves cover debt service by 300%, a sound level and imports are covered by over five months.

**Chart 7: External debt**




Source: EIU

**Chart 8: Covers offered by FX reserves**




Source: EIU

## Bangladesh

| Selection of economic indicators | 2006 | 2007 | 2008 | 2009 | 2010e | 2011f | 2012f |
|---|---|---|---|---|---|---|---|
| *Key country risk indicators* | | | | | | | |
| GDP (% real change pa) | 6.6 | 6.4 | 6.2 | 5.7 | 6.0 | 6.0 | 6.1 |
| Consumer prices (average % change pa) | 6.8 | 9.1 | 8.9 | 5.4 | 8.1 | 7.4 | 6.3 |
| Current account balance (% of GDP) | 1.9 | 1.3 | 1.2 | 3.7 | 2.4 | 1.5 | 0.9 |
| Total foreign exchange reserves (mln USD) | 3806 | 5183 | 5689 | 10219 | 10653 | 11290 | 12790 |
| *Economic growth* | | | | | | | |
| GDP (% real change pa) | 6.6 | 6.4 | 6.2 | 5.7 | 6.0 | 6.0 | 6.1 |
| Gross fixed investment (% real change pa) | 8.3 | 8.5 | 1.8 | 5.7 | 6.0 | 6.5 | 7.2 |
| Private consumption (real % change pa) | 4.3 | 5.9 | 5.5 | 6.0 | 5.7 | 5.6 | 5.7 |
| Government consumption (% real change pa) | 6.0 | 6.4 | 3.6 | 4.0 | 8.0 | 8.0 | 6.5 |
| Exports of G&S (% real change pa) | 25.8 | 13.0 | 7.0 | 12.2 | 5.6 | 8.6 | 9.0 |
| Imports of G&S (% real change pa) | 18.2 | 16.0 | -2.1 | 15.2 | 5.4 | 6.3 | 8.2 |
| *Economic policy* | | | | | | | |
| Budget balance (% of GDP) | -3.4 | -3.7 | -6.2 | -4.1 | -4.5 | -5.2 | -4.7 |
| Public debt (% of GDP) | 43 | 40 | 40 | 40 | 39 | 37 | 37 |
| Money market interest rate (%) | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.5 |
| M2 growth (% change pa) | 22 | 15 | 18 | 21 | 21 | 18 | 17 |
| Consumer prices (average % change pa) | 6.8 | 9.1 | 8.9 | 5.4 | 8.1 | 7.4 | 6.3 |
| Exchange rate LCU to USD (average) | 68.9 | 68.9 | 68.6 | 69.0 | 69.5 | 70.5 | 71.6 |
| Recorded unemployment (%) | 4.2 | 4.2 | 4.2 | 5.1 | 5.1 | 5.0 | 5.0 |
| *Balance of payments (mln USD)* | | | | | | | |
| Current account balance | 1196 | 857 | 926 | 3345 | 2404 | 1650 | 1110 |
| Trade balance | -2890 | -4195 | -6004 | -4693 | -5369 | -6410 | -7550 |
| Export value of goods | 11554 | 12474 | 15502 | 15067 | 15971 | 17090 | 18370 |
| Import value of goods | 14443 | 16669 | 21506 | 19760 | 21341 | 23500 | 25920 |
| Services balance | -1007 | -1268 | -1669 | -1462 | -1631 | -1760 | -1900 |
| Income balance | -841 | -968 | -1019 | -1376 | -1575 | -1790 | -2040 |
| Transfer balance | 5933 | 7288 | 9618 | 10875 | 10980 | 11600 | 12600 |
| Net direct investment flows | 697 | 653 | 1010 | 674 | 1102 | 1310 | 1410 |
| Net portfolio investment flows | 28 | 141 | -38 | -41 | 100 | 100 | 60 |
| Net debt flows | 1142 | 583 | 2007 | 264 | 311 | 420 | 580 |
| Other capital flows (negative is flight) | -2012 | -832 | -3393 | 313 | -3467 | -2840 | -1670 |
| Change in international reserves | 1052 | 1401 | 511 | 4555 | 450 | 640 | 1490 |
| *External position (mln USD)* | | | | | | | |
| Total foreign debt | 20535 | 21859 | 23644 | 24224 | 24463 | 24450 | 25140 |
| Short-term debt | 1178 | 1379 | 1986 | 1967 | 1969 | 1980 | 2010 |
| Total debt service due, incl. short-term debt | 1475 | 2428 | 2666 | 3375 | 3422 | 3370 | 3430 |
| Total foreign exchange reserves | 3806 | 5183 | 5689 | 10219 | 10653 | 11290 | 12790 |
| International investment position | -20691 | -20398 | -21931 | -19489 | n.a. | n.a. | n.a. |
| Total assets | 5027 | 7159 | 7731 | 12406 | n.a. | n.a. | n.a. |
| Total liabilities | 25718 | 27558 | 29662 | 31895 | n.a. | n.a. | n.a. |
| *Key ratios for balance of payments, external solvency and external liquidity* | | | | | | | |
| Trade balance (% of GDP) | -4.7 | -6.1 | -7.5 | -5.3 | -5.4 | -5.7 | -6.1 |
| Current account balance (% of GDP) | 1.9 | 1.3 | 1.2 | 3.7 | 2.4 | 1.5 | 0.9 |
| Inward FDI (% of GDP) | 1.1 | 1.0 | 1.3 | 0.8 | 1.1 | 1.2 | 1.1 |
| Foreign debt (% of GDP) | 33 | 32 | 30 | 27 | 25 | 22 | 20 |
| Foreign debt (% of XGSIT) | 108 | 101 | 86 | 86 | 84 | 79 | 75 |
| International investment position (% of GDP) | -33.4 | -29.8 | -27.6 | -21.8 | n.a. | n.a. | n.a. |
| Debt service ratio (% of XGSIT) | 8 | 11 | 10 | 12 | 12 | 11 | 10 |
| Interest service ratio incl. arrears (% of XGSIT) | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| FX-reserves import cover (months) | 2.7 | 3.2 | 2.7 | 5.3 | 5.1 | 4.9 | 5.1 |
| FX-reserves debt service cover (%) | 258 | 213 | 213 | 303 | 311 | 335 | 373 |
| Liquidity ratio | 126 | 122 | 119 | 142 | 139 | 135 | 135 |

Source: EIU