Executive Summary

Strengthening global recovery

Global economy is gradually recovering, particularly the advanced economies. Recovery in the US economy is now firmly grounded. While the central Europe is improving steadily, it is still weak in the periphery countries. In these economies, the need for consolidating fiscal expense is slowly waning as investors are less worried about debt sustainability, and regaining confidence on the economy. Banks and financial institutions are becoming more resilient improving the overall credit situation. The ongoing recovery in the advanced economies is likely to boost trade and capital flows in emerging and developing economies propelling higher global growth as well as higher output growth in those economies in the coming days.

Satisfactory GDP growth in the domestic front

The Bangladesh economy has been growing at more than 6 percent rate during the last five years. It recorded 6.0 percent growth in FY13. Manufacturing grew more than normal while agriculture and service sector performances were slightly lower. Public investment rose significantly with a minor increase in private investment. During the first half of FY14, frequent hartals and nation-wide blockades hindered economic activities seriously. Hence, imports, tax collections, and domestic credit growth slowed, though apparel manufacturing and exports stayed buoyant, so is the foreign exchange reserve. Food inflation also sneaked up due to supply disruptions.

Consumers as well as investors' confidence appear to have been restored subsequent to the national election. Moreover, government's policy support for private sector borrowers and exporters made a positive impact. In fact, credit growth, L/C opening and settlements of imports, and remittance inflows show signs of improvements since January 2014. General inflation including food inflation has also subsided. The improvement is likely to be wide-ranging as time goes by. With the improvements, industry and service sectors are expected to recover output loss suffered in the first half of the fiscal. Agricultural output is projected to achieve normal growth supported by favorable weather and policy support. The rebound in domestic economic activity together with global recovery is likely to help achieve a satisfactory level of real GDP growth in FY14.

Revenue collection improved considerably in recent years, which is attributable to strengthening revenue administration, reforms in tax law and improvement in compliance. Over the last five years, total revenue receipts grew at an average rate of 19 percent per year whereas NBR revenue rose 20 percent. For the same period, revenue-GDP ratio rose from 10.5 percent to 12.4 percent. The impetus of revenue collection was disrupted by the year-long unrest and hartals in 2013. The weak global recovery has also contributed to the reduction in import duty. However, the recent improvements in domestic economic activity and imports will revitalize revenue collection ahead. In the first nine months of the FY14, 63 percent of the revised revenue target has been realized. In particular, non-tax revenue recorded 68 percent collection against 62 percent NBR receipts.

Government's Annual Development Program (ADP) expenditure was scaled up 26 percent annually in the last five years against 12 percent yearly increase of current expenditure reflecting desired increase in the public investment for accelerating growth. The overall budget deficit also remained well anchored within 4.5 percent of GDP (excluding grants) indicating fiscal discipline throughout the period. Current and other expenses remained on track till March in FY14. On the other hand, the pace of ADP implementation has been slow in recent months. Indeed, 47.4 percent of the revised ADP budget has been implemented till March of FY14.

Positive outlook over the medium term

Over the medium term, there are plans to step up public investment with a view to reducing supply deficits in priority sectors. Government revenue is expected to grow by about 0.5 percent of GDP each year underpinned by the ongoing modernization of revenue management system and implementation of new tax laws. Moreover, the government has plans to rationalize corporate income tax while broadening its base. On the whole, the budget deficit is projected to stay within 5.0 percent of GDP. Bank borrowing will remain within a sustainable level whereas constant efforts will be there to attract grants and concessional loans. Non-concessional external loans will be borrowed only for critical sectors having high returns. In the monetary sector, money and domestic credit will grow in line with inflation and growth targets. Given positive outlook of the global economy, the external position will also stay reasonably strong with export resilience, rebound in remittances, and inflows of foreign resources. Exchange rate is anticipated to be flexible and competitive through effective demand management of the monetary authority and for resilience in the external account.

Despite challenges and risks, addressing critical issues will help preserve growth outlook

Raising investment at a desired level to move growth to a higher trajectory still remains an issue. Particularly, private sector investment has been lagging behind while public investment stepped up nearly at par with the planning documents. Besides, public and private partnership (PPP) for bridging investment gap in infrastructure is yet to be gain momentum. On the other hand, overall labour productivity is still at a low level. Therefore, it is indispensable to improve productivity of the growing labour force through skill development. This is essential for realizing benefits of the demographic dividend, which may sustain for another two decades. The need for investment in social infrastructure, particularly human resource development is enormous with a view to improving overall labour productivity. Effective measures for domestic resource mobilization and ensuring flow of external resources in the form of grants and concessional loans will be necessary to meet the investment need for building infrastructure. Besides, the pace of ADP implementation needs to be expedited to maximize the impact of public spending. In this respect, it will be required to enhance the capacity to design, procure, audit and manage the projects.

Given slow progress in the private investment, a number of effective policy measures are required. The removal of infrastructure deficits in areas of power, energy, and communication, strengthening governance and oversight in the financial sector leading to competitive interest rate structure, and the reforms in the capital market together are likely to accelerate private sector investment. Further, good governance, improvements in the business environment, and political stability will help augment private investment as well as ensure FDI inflows.

In addition, measures for modernizing revenue administration, expanding tax base, improving tax compliance, and implementing new tax laws will need to be expedited to mobilize sufficient resources for higher development expenditure. In the external front, export markets and products demand more diversification for mitigating the effects of potential shocks in major trading partners. The country will need to work further on improving labour rights and working conditions in the RMG sector. Further, diplomatic initiatives to expand and explore labour markets will be useful for maintaining sustained remittance inflows.

On the road to sustained growth, there are downside risks at both domestic and external fronts aside from these challenges. First, slower than expected growth in major trading partners may hold up domestic growth. Second, domestic political unrest (if any) may undermine confidence of economic agents, thereby depressing overall economic activity. Third, any geo-political tension, particularly in the gulf region could reduce remittance inflows and escalate food and energy prices; hence may adversely affect the external account.

A journey towards growth and prosperity

The Bangladesh economy has managed to grow over 6 percent in recent years accompanied by a significant fall in poverty rates indicating its inclusive nature of growth. It also has made commendable progress in achieving other Millennium Development Goals (MDGs). In this backdrop, the pace of economic growth is expected to accelerate over the medium term with stronger domestic economic activities and gradual recovery in major trading partners. The medium term revenue and expenditure stance is optimistic on grounds of persistent reforms in public revenue and expenditure management. Therefore, overall budget deficit will likely remain within a sustainable level. Further, the external position will stay strong due to export resilience, recovery in remittance inflows, and other external inflows. Challenges and risks are there to impair the positive outlook. However, planned strategies in reducing critical supply shortages, skill development, reforms in revenue measures, strengthening and supervision of the financial sector including capital market, advancement of digitization, measures for keeping external sector resilient, and broad structural reforms in areas of land use, management and critical public services will help Bangladesh move to higher growth trajectory and prosperity.