BANGLADESH ECONOMIC OUTLOOK

Bangladesh economy is in that critical phase where it requires a 'push' to break out of the 6% trap. Winning back investors' confidence now solely remains in the hands of the policymakers, whose timely decision-making will be the key driver of the economy in FY16.

- In the absence of any major political setback, GDP growth is expected to pick up to 6.7% in FY16 from 6.5% in FY15.
- We might need to wait a bit longer than usual to see the desired reflection of falling lending rate on credit growth and Investments. Problem-ridden financial sector, abundance of foreign loans for quality borrowers and an overall subdued investment sentiment due to infrastructural deficiency will mute the effect of low interest rate on credit growth and investments.
- As domestic consumption increases riding on a favorable demographic transition, growth outlook for Industrial and Service sector remains on the positive side.
- Export is expected to pick up substantially in FY16 driven by restored confidence of buyers and stable political environment in the country.
- Stuttered by slowdown in Middle East, remittance is expected to remain flat this fiscal. However, driven by solid growth in manpower exports, remittance might bounce back in near future.
- Unless private investments pick up in remaining months of FY16, we see a slim chance of growth in imports in FY16 from the current level.
- Major risks for the economy in near-term are: Poor health of the financial sector, slow pace of government's investment activities and lack of skilled human resources.

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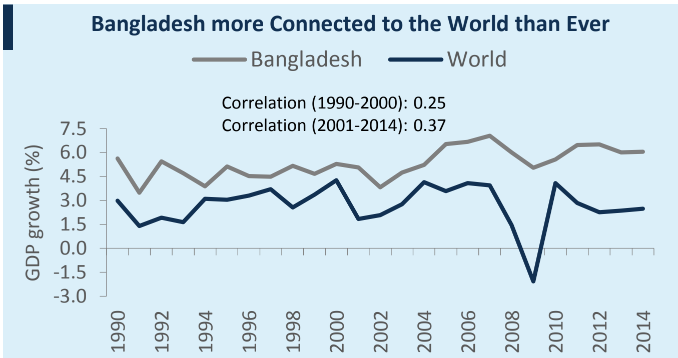
CONTEXT

Bangladesh economy exhibited yet another round of resilient 6.5% GDP growth amid global glum economic scenario in 2015. Calm political environment, five-year low lending rate and a comfortable inflation rate-all these are signals of the current macroeconomic stability. Unfortunately, reflection of this stability is still not visible in investments.

Without doubt, Bangladesh is a resilient economy. But the economy is now more connected to the world than ever and a faltering global economy does not bode well for it especially since it still does not have an independent growth engine of its own. Against the backdrop, 2016 comes as a crucial period especially since this is the first year of the ambitious 7th Five Year Plan. **Can Bangladesh economy grow amidst the global slowdown? Can the country leverage its current macroeconomic stability to attract investors? These are the crucial answers we will be looking forward to in 2016.**



Source: World Bank

Growth Outlook

Based on the relatively calm political scenario of 2015, the macroeconomic outlook for 2016 has been upgraded by World Bank, IMF and ADB. Other factors that are being considered the growth drivers in 2016 are **strong consumption supported by the hefty rise in public sector wage, increased public expenditure and a healthy growth in exports.** These projections estimate a **6.7%-6.8% GDP growth in 2016.** The range is significantly higher than the 6.2%-6.5% projection made in April'15. Government projection, as usual, remains overly optimistic. As per the Government projection, the economy is expected to register 7% growth in the current fiscal and an even higher growth in subsequent years.

While we certainly agree that the country has the potential to reach its vision, we believe the 'Push' factor required to attain higher growth rate from a moderately large base is still not there. As seen from 2015, investments did not pick up even though political situation calmed down after March. Lack of material improvement in certain areas such as: infrastructure, governance and skill base of manpower can be cited as one of the major reasons behind the dearth of investors' enthusiasm. At the same time, the economy needs to cope up with the fact that, single digit growth in Export and remittance is here to stay unless global economy picks up. Without a dramatic shift in either of these factors, only a one-time pay rise might not lead towards sustainable economic growth. **Based on a slightly improved growth prospects in three broad sectors in the absence of any major debacle in FY16, we expect the economy to grow at 6.7% this year.**

Economic Statistics

(USD Million)	2015-16	2014-15	Growth
GDP (at current market price)	219,070	194,051	**6.70%***
Export (July-Jan)	16,084	14,914	**7.84%**
Import (July-Dec)	20,525	19,189	**6.96%**
Remittances (July-Jan)	8,639	8,730	**-1.05%**
Tax Revenue (NBR) (July-Oct)	5,429	4,872	**11.43%**
Total Domestic Credit (July-Dec)	94,954	86,376	**9.93%**
Credit to the Private Sector (July-Dec)	79,552	69,668	**14.19%**
Broad Money M2 (July-Dec)	107,451	95,032	**13.07%**
Foreign Exchange Reserve (Jan)	27,139	25,020	**8.47%**
Taka-Dollar Exchange Rate (Jan)	78.5	77.8004	**0.90%**
Current Account Balance (July-Dec)	2,100	1646	**27.58%**
Budget Size (FY16)	37,931	30,806	**23.13%**

*Real growth rate, Source: Bangladesh Bank

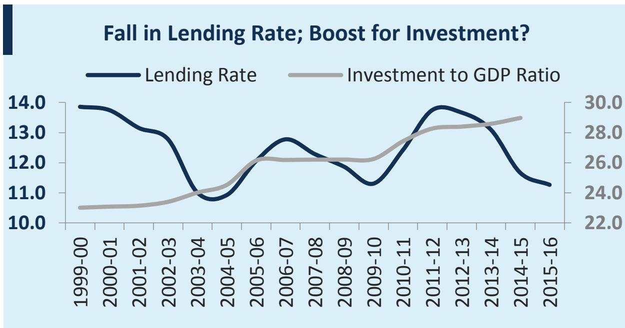
Growth Rates

Indicator	FY12	FY13	FY14	FY15	FY16E*
Export	17.7%	12.4%	8.6%	3.3%	8%-9%
Import	16.6%	-4.4%	19.2%	11.3%	7%-8%
Remittance	10.2%	12.6%	-1.6%	7.7%	0%-1%
Inflation	8.6%	8.1%	7.0%	6.3%	6.2%
Agriculture	3.0%	2.5%	4.4%	3.0%	3%-3.2%
Service	6.6%	5.5%	5.6%	5.8%	6%-6.2%
Industrial	9.4%	9.6%	8.2%	9.6%	9.8%
GDP	6.5%	6.0%	6.1%	6.5%	6.7%

*Expected, Source: BBS, Bangladesh Bank, EPB

INVESTMENTS SHOULD GET A BOOST BUT....

Lending rate has been decelerating for the past few years and if we turn back a few pages of the history, this is nothing new to the economy. By observing the downward spirals of lending rate in 2004-05 or 2009-10, we can see a common trend: cut in lending rate has always been followed by a spike in investments.



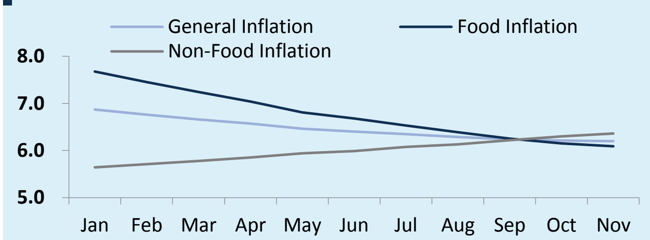
Source: Bangladesh Bank

Based on past lessons, it is fair to expect that investments will pick up from its current stagnant level within this year. To what extent investments will grow, however, remains dependent on a few factors.

Infrastructural deficiency in Bangladesh has reached an extremely uncomfortable level for the investors. To alleviate the pain, required magnitude of Government effort is not being seen. Currently, the government spends only **a third** of what is required to drive the economy forward. While on paper the budget and revenue target size have been ballooning, little impact is being visible to the investors. In current fiscal as well, the government implemented only 24% of ADP in the first half while collected only 6% of the targeted revenue in first three months. Such pace of government investments does not send a positive vibe to the investors.

Government also could not reap any major benefit out of falling oil price. While correction at retail level could have widened the margin of local businesses and increased the purchase power of consumers, it was only BPC that took advantage of such a huge windfall. Though inflation has been moderate in last fiscal, it was low food inflation that drove down the overall inflation while non-food inflation was on the rise.

Inflation* Dragged Down by Food Inflation



*12-Month Average Inflation, Source: Bangladesh Bank

If we compare the inflation to deposit rate, it translates into a meager 0.26% real return on savings. Falling rate on almost all savings instruments has already minimized the perks of holding cash. Incentives for parking money with Central Bank has also been cut for the banks. Recent cut in policy rates by 50 basis points and in 364 Days T-bill rate by 270 basis points are clear signals that the local banks should start expanding their loan portfolio.

However, growing the loan portfolio amid such a subdued environment is quite challenging for the banks. To top that off, quality borrowers are increasingly being lured away by foreign banks which can provide much cheaper loan. Since no major currency depreciation is on the cards, large borrowers are finding it more attractive to borrow from foreign sources which already captured about 10% of domestic loan portfolio.

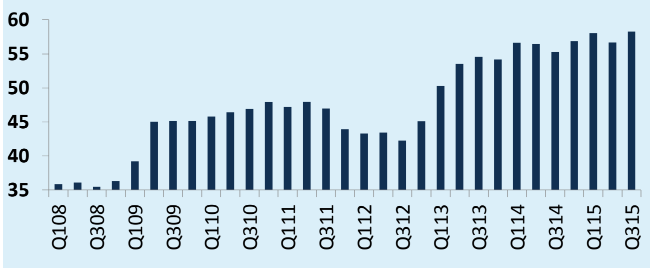
Currency	1 Yr	6-M	3-M	1-M
Euro	1.5%	-2.3%	-2.6%	-3.8%
INR	9.4%	6.2%	2.9%	1.8%
Yen	0.2%	-5.8%	-3.6%	-1.3%
CNY	5.3%	5.9%	3.6%	0.8%
VND	4.1%	2.2%	-0.3%	-0.9%
BDT	-0.7%	-0.7%	-2.6%	-1.5%

*Calculated against USD, Positive return denotes Depreciation against USD, Source: Investing.com

Domestic banks on the other hand, are flooded with excess liquidity of USD 16 billion. Moreover, commission income from LC and LG is down because of the down commodity market narrowing the second highest source of earnings as well.

Apart from the challenges put by lack of demand, the banking sector is burdened with poor asset which is a threat for the entire economy. Currently 58% of loans in banking system are secured against real estate, which has undergone massive price correction in recent years. In many cases the value of the collateral has fallen below the value of the loan signaling a potential disaster.

% of Loans Secured by Real Estate



Source: Bangladesh Bank

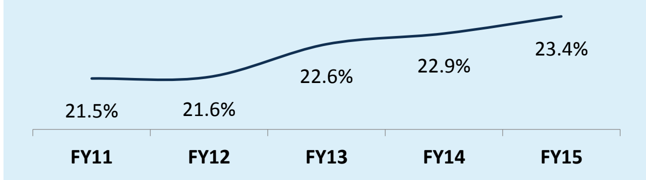
Taking all these factors into consideration, we believe impact of falling lending rate will be largely muted by the persisting inefficiencies in the system. Nevertheless, at least a modest reflection of current macroeconomic fundamentals on investments and credit growth can be expected to be seen in FY16. At the same time, the investors will be observing how the policymakers address the problems of poor infrastructure, ailing financial system and weak business environment of the country. Thus, it solely remains in the hands of policymakers to take bold steps to reform Bangladesh to an attractive investors' destination.

SECTOR OUTLOOK

Industry

Manufacturing industry, driven by strong domestic demand is expected to be the growth catalyst of Industrial sector in FY16. The growing impact of domestic consumption on industrial sector is visible from the rising industrial output to Domestic consumption ratio. Since we do not expect any disruption in production activities in FY16 as experienced in FY15, we believe **Industrial sector will grow at an approximate 9.8% in this fiscal year.**

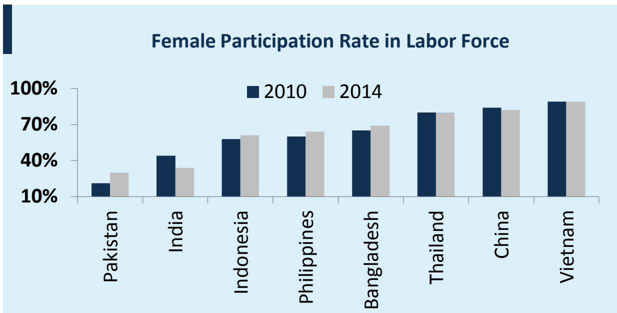
Industrial Output to Private Consumption Ratio



Source: BBS

Factors that will facilitate domestic consumption in near future are:

- **Demographic Transition:** Bangladesh has one of the youngest and trainable population base in the world with 53.4 million people waiting to enter the workforce within next 15 years. Evidences from Korea, Thailand and India suggest such a demographic transition propped by sound policymaking resulted in exceptional economic growth and demand boost in the economies. Given, these people are provided with suitable employment opportunity, purchase power of the consumers is expected to increase.
- **Female Participation in Labor force:** Female participation in labor force has increased from 65% to 69% in the last 10 years. As seen from the graph below, female participation has further room for growth. And with increased economic power of women, domestic consumption is expected to get a boost.



Source: World Bank

Service

Driven by new wage policy and relatively better political climate than that of FY15, we believe, service sector will register 6%-6.2% growth in FY16.

Trade, Personal and Community Service (Plumber, Electrician, and Barber etc.) and transport sectors have been the major contributors to service sector growth in the past. Low investment involvement and easy skill requirement have spurred the growth of these sectors. Although government plans to raise the share of ICT, Tourism and Aviation service to GDP in future, in short run, trade and personal service are expected to be major growth drivers of the sector.

Structure of Service Sector (% of GDP)

	FY74	FY80	FY90	FY00	FY10	FY14
Trade	9.3	12.9	11.9	12.3	14.0	13.4
Transport	4.2	10.5	9.3	7.6	9.0	9.1
Telecom	0.2	0.2	0.4	0.7	1.6	1.5
Financial Services	1.3	1.4	1.3	1.5	3.1	3.9
Real Estate	5.6	6.0	8.3	8.9	7.2	7.1
Public Admin	2.2	2.3	2.3	2.6	3.3	3.4
Education	1.6	1.9	1.9	2.3	2.4	2.6
Health	1.2	2.0	2.2	2.3	2.0	2.1
Restaurants	0.3	0.4	0.6	0.6	0.9	1.0
Personal Services	4.2	10.1	10.1	10.6	12.6	12.1
Total Services	**30.1**	**47.7**	**48.3**	**49.4**	**56.1**	**56.2**

Source: BBS

Trading activities will directly benefit from the growth in manufacturing industry while personal service sector will grow from the increased purchasing power of the people and lack of employment opportunities in formal sector. Among other major sectors, Telecom sector is expected to grow at a steady pace driven by increasing data usage. As for the financial sector, future hinges upon the establishment of discipline into the sector. Once the investors' confidence is restored and banking sector gets rid of its toxic assets, the sector will thrive taking the entire economy ahead.

Agriculture

2015 saw several positive policy developments targeted towards agricultural sector. To ensure fair price for paddy farmers, the GoB has imposed a 10% CD in addition to the existing 10% RD in December and May of this year, respectively. Bangladesh Bank has given ambitious targets of farm loan disbursements to the banks. BB has also taken BDT 200 crore dairy farm refinancing scheme by which the farmers will get loan at 5% rate. **Driven by sound policymaking and a favorable climate, the sector is expected to register 3%-3.2% growth in FY16.**

EXTERNAL SECTOR

Export

In July-Jan of current fiscal, the country exported goods worth USD 19.3 billion, posting over 8% YoY growth. Woven garments outperformed overall export basked by registering 12.3% YoY growth. In recent times, stable political environment and ongoing reforms in RMG factories have revived the buyers' confidence to a great extent. Moreover, buyers have shifted their focus from China due to higher production cost and Bangladesh remains their next preferred sourcing spot (*Bangladesh recently recorded the highest in HSBC Trade Confidence Score)*. **Based on recent momentum and upbeat buyers' confidence, we believe, export earnings will register 8%-9% growth in FY16.**

Remittance

Remittance declined 1.05% in the first seven months of the current fiscal. Total remittance inflow in July-Jan period stood at USD 8.64 billion against USD 8.73 billion in the corresponding period of last fiscal.

Remittance from major Middle Eastern destinations (45% of total remittance) and Singapore (3% of total remittance) declined 4% while that from USA (17% of Remittance) grew 8.2% YoY in July-Nov of FY16. In the next half, the outlook for oil price remains depressed posing an ominous sign for Middle East economies. **Under the circumstance, remittance is expected to remain flat in FY16.** On a positive note, Manpower exports grew 53% YoY in the first seven months of FY16 signaling possibilities of future improvement in remittance inflow.

Import

Import payments stood at USD 20.5 billion in the first half of the current fiscal, 6.96% higher than that of the corresponding period of previous fiscal. After remaining in the negative territory for first four months, imports surged in November and December. Higher import payments for edible oil and Petroleum products caused the growth in imports.

Item (USD Mn) (July-Dec)	FY15	FY16	Change
Food Grains	687	506	-26%
Consumer goods	1,019	1,458	43%
Intermediate Goods	11,313	12,009	6%
Petroleum products	777	1,124	45%
Chemicals	846	909	8%
Pharmaceutical products	77	115	48%
Textile and articles thereof	2,781	3,019	9%
Iron, steel & other base metals	1,420	1,566	10%
Capital Goods	4,816	4,412	-8%
Others	1,354	2,139	58%
Grand Total	19,189	20,525	7%

Source: Bangladesh Bank

Recent figures of imports raise two red flags. First, despite the steep fall in oil price, import payments for Petroleum products rose 45% YoY. Second, reflection of soft commodity market is not visible in the import payments for intermediate goods. Whether these figures are mere anomalies or a regular scenario caused by government's inefficiency remains a question.

Besides, 8% decline in imports of capital machinery despite stable political environment is a matter of concern. However, 29% growth in LC opening for capital machinery in the same period provides a little relief in this regard. **If business confidence revives, we believe import will grow at 7%-8% in FY16. Direction of import payments might deviate significantly from our prediction in case the above-mentioned anomalies prevail in the next half of FY16.**

AREAS REQUIRING IMMEDIATE FOCUS

Facilitation of New Investments

Despite a cut in lending rate, we have not seen any significant investments in the country. It is only the slow government projects that have gained some traction in recent years. Although the economy is ripe for investments, these small glitches are hindering quality capital investments in the country. Such a lack of investment opportunities within the country has led towards illicit outflow of money from the country. Unless the government take steps to improve the business environment of the country, investments is unlikely to pick up to an optimum level.

Diversification of Exports

Currently, EU account for 50% and US accounts for 21% of our total exports. Rising popularity of Vietnamese products in US market remains a concern for Bangladesh. According to a latest CPD study, average price of Vietnam's top ten knit items is 71% higher than that of Bangladeshi products and price of Vietnam's top ten woven products is 25% higher than that of Bangladeshi products. In the context of approval of the TPP agreement, Vietnam has emerged as a key competitor of Bangladesh. To stay competitive in such market environment, it is high time we focused on moving up the value chain in RMG exports. Besides, the policymakers should formulate timely policies to develop high potential sectors such as: Footwear, Pharmaceuticals, Electronic goods and jute goods.

Bringing discipline into the financial sector

Historically the financial sector has been suffering from poor corporate governance and deteriorating asset quality. In addition to that, management efficiency in terms of managing risks and asset-liability was not up to the international standard. No doubt that entire system has to go through a reform program focusing on recapitalization, risk management and efficiency of banking professionals. Previously, initiatives taken by Bangladesh Bank were quite successful in terms of achieving a strong capital base, reducing non-performing loans, restricting financial institutions to take large exposure in capital market for better risk management and discouraging fund flow to unproductive sectors**. We believe, in future, continuation of such strict measures by Bangladesh Bank will enhance the performance of the sector.**

CONCLUSION

Despite many odds, the Bangladesh economy has been growing resiliently at an average 6% for the last one decade. It is high time to break out of the 6% club and grow as per our true potential. With a sound financial sector and proper channeling of funds to productive sectors, Bangladesh can boost its investment to an optimized level. We are highly optimistic that the economy will be able to achieve 7%+ growth rate within the next five years given our politicians work coherently to eliminate the unwanted glitches hindering our economy.