COUNTRY REPORT

Bangladesh

At a glance: 2000-01

OVERVIEW

Bangladesh's poor political situation will continue until the general election is held, probably in late 2000 or early 2001. The campaign of strike action by the opposition prevents any significant structural reforms being introduced, and hinders the development of the gas sector. The economy is underwritten by donors. After the election, the political situation will improve, at least temporarily, and GDP growth will increase.

Key changes from last month

Political forecast

- The political situation is likely to deteriorate as the general election approaches. The outcome of the election will depend on whether popular resentment towards the opposition's campaign of general strikes overshadows disappointment with the current government's achievements.

Economic policy outlook

- The government will remain reliant on multilateral funding, and continued high levels of domestic borrowing raise the risk of inflationary pressures increasing if economic sentiment improved and demand for private-sector credit increased.

Economic forecast

- The EIU has increased its GDP growth estimate for fiscal year 1999/2000 (July-June) to 5.3%, and to 5.2% in 2000/01, when manufacturing and export performance should improve. Poorer than expected export performances so far in 2000 have led to the current-account deficit being increased to 1.4% of GDP in 2000, falling back to 0.9% in 2001.

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The Economist Intelligence Unit

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"n/a" means not available; "–" means not applicable

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Outlook for 2000-01

Political forecast

Domestic politics

Political tensions have increased as the next general election approaches. The election must take place by September 2001 and, under the constitution, the ruling party must hand over power to a caretaker government three months prior to the election. The caretaker government will have the constitutional responsibility to hold the polls in a free and fair manner. The election may well take place at the end of 2000 or in early 2001. The prime minister, Sheikh Hasina Wajed, has hinted at an early election, stressing that this would not be a concession to opposition demands for an early poll, but to prevent the poll from being disrupted during the monsoon season.

The proximity of the election has led to a further deterioration in the political environment. The opposition Bangladesh National Party (BNP) held a two-day strike in May in protest at the appointment of a new chief election commissioner, Mohammad Abu Syed, because it said it had not been consulted by the government. The BNP's leader, Begum Khaleda Zia, had earlier turned down Sheikh Hasina's offer for talks to choose the new commissioner. In June the opposition held a strike in protest at a provision within the government's budget to raise Tk35bn (US$69) from commercial borrowing. This polarisation will increase as the campaign season starts in earnest. Although the opposition returned to parliament in late June for around one hour, this was a move to prevent opposition MPs having their parliamentary membership scrapped for not attending parliament for more than 90 days.

The election result will hinge on whether popular opinion turns against the ruling Awami League (AL), for failing to deliver on its election pledges, or blames the government's shortcomings on the BNP's relentless campaign of unpopular general strikes. Any decision by the BNP to escalate its strike campaign in the run-up to the election may lose it popular support. The AL is unlikely to form an electoral alliance, although it enjoys the support of 11 small left-oriented parties. The BNP-led opposition alliance has not yet indicated whether it will share seats between the opposition parties, or campaign separately. Several sensitive issues, such as the death sentence currently hanging over the killers of Sheikh Mujib, the father of the prime minister, Sheikh Hasina, relations with India, and the alleged misuse of the recently enacted and controversial Public Safety Act (PSA), may ignite the political situation further. The political situation will stabilise after the election.

International relations

Bangladesh's relations with its neighbours and bilateral donors will remain uncomfortable. The government remains wary of India's regional influence, and friction continues over accusations by Bangladesh that Indian security forces have killed Bangladeshi nationals. Moves to increase regional co-operation, such as the meeting in early July of the Bay of Bengal group (which comprises India, Thailand, Myanmar, Bangladesh and Sri Lanka), are unlikely to bring any substantial economic benefits in the forecast period. Bangladesh's bilateral and multilateral lenders have criticised the BNP and the AL for their failure to end the politics of confrontation.

Economic policy outlook

Policy trends

Both the major parties—the AL and the BNP—are officially committed to free-market policies. Although a segment of the AL leadership is still wedded to the socialistic principles that the party espoused in the early 1970s, and pro-state-control forces, such as trade unions and left-wing politicians, are more at ease with the AL, it will continue in its attempts to liberalise the economy. The BNP is more demonstratively business-friendly and market-oriented. Bangladesh currently has a highly liberalised trade regime, which was introduced by the BNP while it was in power during 1991-96. Both the parties welcome foreign investment, but it is likely that the pace of reforms would be increased if the BNP were to return to power.

The fiscal situation has deteriorated in recent years. The government continues to subsidise or provide public guarantees to loss-making state-owned enterprises (SOEs) and nationalised commercial banks (NCBs) with high levels of non-performing loans. In addition, the government's tax collection has been below target, mainly because of weak growth of non-food imports, resulting from continued stagnation in the manufacturing sector and problems with the recently introduced preshipment (PSI) measures. It is also expected that budget targets for current expenditure will overshoot in the run-up to the election owing to higher than expected interest payments on domestic debt and expenditure such as the implementation of the new national wage commission. The situation is likely to deteriorate further if the government introduces the new wage scale for industrial enterprises. The government's development spending is funded largely by borrowing and by multilateral donors. Judging the effectiveness of government policy is made more difficult by the tardiness and unreliability of official data.

Fiscal policy

Privatisation efforts will stall, as the prospect of a general election in less than a year prevents the ruling party from selling state assets. Despite a decline in losses at SOEs in recent years—they fell from Tk14.1bn (US$276.5m) in fiscal year 1996/97 (July-June) to Tk8.3bn in 1998/99—they remain a severe drain on the government budget. The bulk of these losses are financed through borrowings from NCBs. A failure to reduce expenditure or increase revenue by broadening the tax base or through privatisation will maintain pressure on the fiscal position. The fiscal deficit in 2000 is estimated to be more than 6% of GDP. This will prevent Bangladesh from moving out of its cycle of high non-productive expenditure, which has come at the expense of development.

Monetary policy

The government has been pursuing an expansionary monetary policy, criticised by the IMF in late June as threatening Bangladesh's macroeconomic stability. The broad money supply in 1995 expanded at an annual rate of more than 15% but, during the first half of the 1999/2000 government borrowing from commercial banks—to finance the fiscal deficit—increased by 39%. Meanwhile, private credit growth has remained weak. Excess liquidity in the banking system increased to Tk51.3bn (US$1bn) at end-December 1999 compared with Tk37bn at end-December 1998. According to the World Bank, however, this is mainly owing to increased caution being exercised by the banks in their choice of new loans and higher new lending rates, rather than crowding-out caused by excessive government borrowing. The authorities will continue with their attempts to maintain a loose monetary policy throughout the forecast period. The effectiveness of this will be restrained as banks will shy away from offering fresh loans, and the government will continue borrowing from domestic sources to finance politically motivated policies and projects in the run-up to the forthcoming general election.

Economic forecast

Forecast summary

(% unless otherwise indicated)

	1998[a]	1999[b]	2000[c]	2001[c]
Real GDP growth[d]	5.7	5.2[a]	5.3	5.2
Industrial production growth	4.0	3.6	4.2	5.8
Agricultural production growth	2.9	5.0[a]	4.9	4.3
Gross fixed investment growth[d]	10.0[b]	12.7	8.9	9.9
Unemployment rate (av)	2.4[b]	2.4	2.4	2.5
Consumer price inflation				
Average	8.3	6.3	5.8	6.2
Short–term interbank rate	14.0	14.1[a]	13.5	13.5
Government balance				
(% of GDP)	–5.4[b]	–6.6	–6.3	–5.3
Exports of goods fob (US$ bn)	5.1	5.5	5.8	6.6
Imports of goods fob (US$ bn)	–6.7	–7.4	–7.8	–8.2
Current–account balance (US$ bn)	0.0	–0.3	–0.5	–0.4
% of GDP	–0.1	–0.8	–1.4	–0.9
Total foreign debt				
(year–end; US$ bn)	16.4	17.1	17.2	18.0
Exchange rates (av)				
Tk:US$	46.91	49.09	51.79	54.46
Tk:¥100	35.83	43.09	48.17	52.24
Tk:€ [e]	52.53	52.29	50.19	56.63

[a] Actual. [b] EIU estimates. [c] EIU forecasts. [d] Fiscal years. [d] Ecu before 1999.

International assumptions

World growth will continue to recover in 2000-01, although it will remain below trend. Real GDP growth in the US—Bangladesh’s main export market—is expected to strengthen to 5% in 2000, from 4.2% in 1999, before decreasing to 2.9% in 2001. This will help to maintain export growth, although a failure to raise production and competition will prevent Bangladesh from taking full advantage of this. Export growth will also be strengthened by an expected recovery in Bangladesh’s other leading markets—the EU and Japan. The expected rise in international food prices will be limited by ample domestic supplies following a good rice harvest, but the import bill will face pressure from rising industrial raw material and international commodity prices.

International assumptions summary

(% unless otherwise indicated)

	1998	1999	2000	2001
GDP growth				
US	4.3	4.2	5.0	2.9
OECD	2.4	2.9	3.7	2.9
EU	2.6	2.2	3.1	2.8
Exchange rates (av)				
US$ effective (1995=100)	119.3	116.4	117.5	112.9
¥:US$	130.9	113.9	107.5	104.3
US$:€[a]	1.12	1.07	0.97	1.04
Financial indicators				
US$ 3–month commercial paper rate	5.34	5.18	6.52	6.55
¥ 2–month private bill rate	0.72	0.27	0.05	0.64
Commodity prices				
Oil (Brent; US$/b)	12.8	17.9	24.5	20.0
Gold (US$/troy oz)	294.1	278.8	285.7	290.0
Food, feedstuffs & beverages (% change in US$ terms)	–13.9	–18.6	–2.8	5.3
Industrial raw materials (% change in US$ terms)	–19.6	–4.3	16.8	8.8

[a] Ecu before 1999.

Economic growth

The economy has largely recovered from the floods in 1998. Three successive bumper harvests, in fiscal years 1998/99-1999/2000, have led to a revival of the agricultural sector, but manufacturing sector growth has remained weak. Industrial growth will increase, but will remain below the rates of the early 1990s, hindered by the deteriorating political situation and the slowdown in economic reform. The banking sector will remain in the doldrums, state-owned enterprises will remain loss-making and corruption and excessive bureaucracy will continue to drag down the economy. External balances and foreign-exchange reserves will remain fragile.

The government has estimated GDP growth at 5.5% in fiscal year 1999/2000 (year ending June 30th), from an earlier projection of 6.4%. The government's forecast that GDP growth for 2000/01 will be 6.2% is also likely to be revised downwards as the fiscal year progresses. The EIU forecasts GDP growth of only 5.2% in 2000/01. Following a number of good harvests, we forecast agricultural growth of just over 4%. Despite its problems, some rebound in the industrial sector is probable and we forecast an expansion of 6.4%, and in exports of 10% in 2000/01. The sector has largely restocked after the floods of 1998, and industrial growth should return towards its previous trend-rate. Poor infrastructure and inefficient resource allocation will continue to act as major obstacles to increasing the rate of growth.

Inflation

Two successive bumper harvests and inflows of food aid lowered the inflation rate to just under 2.5% year on year in February 2000. This trend is likely to continue as food prices will remain weak—food expenditure constitutes over 60% of the consumption basket. Weak capital markets and weak private-sector credit demand, owing to poor investor confidence caused by political volatility, will further ease pressure on prices. These factors, together with lacklustre GDP growth, will prevent inflation from rising to historical levels during the forecast period. However, increased government borrowing from the domestic market and a continued recovery in non-oil and oil commodity prices may ignite import- and demand-induced inflationary pressures later in the forecast period. Nevertheless, the recent strength in domestic food output will result in the annual average inflation rate falling to 5.8% in 2000, before increasing to 6.2% in 2001 as industrial demand increases and high commodity prices filter into the index.

Exchange rates

The taka was devalued by 4.4% in calendar year 1999, as the government attempted to improve the country's export performance, following pressure from leading export bodies in the country, as well as the World Bank and the IMF. The currency will remain under pressure, as high import payments and other outward remittances, in the form of higher debt-servicing costs, together with a loss of export competitiveness, particularly given the recent depreciation of the Indian rupee against the US dollar, will increase the need for further devaluations in 2000. However, low levels of inflation and an improvement in export performance will reduce pressure on the taka towards the end of 2000 and in 2001. We thus expect the annual average rate of depreciation to remain low, at 5.2% and 4.9% in 2000 and 2001 respectively.

External sector

Exports will continue to recover over the forecast period. Merchandise export growth hit a recent all-time low of 2.9% (national accounts basis) in 1998/99, because of floods in 1998, but subsequently recovered to 7.2% year on year by December 1999. This recovery is likely to continue, with export growth (in US dollar terms) of 7% during 2000 and more than 12% in 2001 as the economic situation improves after the election. Export competitiveness will suffer in the early part of the forecast period because the taka still remains overvalued vis-à-vis the currencies of the South-east Asian countries, and because of the deepening energy crisis, narrow export base and the increasingly unstable political environment.

In addition to these concerns, export growth will be hindered by a failure to raise production, and by the poor quality and reliability of goods in the key readymade garments industry (RMG). However, subdued import growth, owing to a weakness in import-intensive manufacturing activities during the rest of 2000, and a lower food import requirement, will prevent a further deterioration in the trade deficit in 2000. The trade deficit will narrow in 2001 as exports strengthen, helping to offset part of the increase in the import bill resulting from stronger domestic demand and commodity prices.

An increase in interest payments on the external debt will cause a deterioration in the income balance over the forecast period and exert further pressure on the current account. We expect inward workers' remittances, which helped to keep the current-account deficit at around 2% of GDP (national accounts basis) in the last fiscal year, to rise in 2000/01, assuming a sustained recovery in oil prices and in South-east Asian economies. However, remittances will not totally cover the trade deficit and Bangladesh will still need bilateral and multilateral loans to meet its financing requirement. As a result of these factors, we expect the current-account deficit to be around 1.4% of GDP in 2000 and 0.9% in 2001.

The foreign-exchange reserves position is currently weak, with import cover of barely two months. According to the Bangladesh Bank (the central bank), foreign-exchange reserves (excluding gold) stood at US$1.6bn at the end of June. Despite weak import pressures and weak domestic demand, relatively poor export growth in 2000 will prevent any strong improvement in the reserves position. Foreign direct investment (FDI) fell in 1999, as a result of political instability, and although it is forecast to rise in 2000 and 2001, it will fail to raise reserves, as it is concentrated in the gas sector where imports of capital equipment have resulted in a subsequent outflow of US dollars in profit and dividends.

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