April 2021

Bangladesh Development Update

Moving Forward: Connectivity and Logistics to Strengthen Competitiveness

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BANGLADESH DEVELOPMENT UPDATE

Moving Forward:
Connectivity and Logistics to Strengthen Competitiveness

April 2021

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Table of Contents

List of Boxes

List of Figures

List of Tables

Preface

This report provides an assessment of the state of the economy in Bangladesh, discussing the outlook, risks, and key reform challenges. It covers: real sector developments, focusing on growth and its components; inflation; monetary and financial sector developments; external sector trends, focusing on the balance of payments, foreign exchange reserves and the exchange rate; and fiscal outcomes, focusing on revenue mobilization, public expenditures, and deficit financing. The special focus section of this update discusses how improved connectivity and logistics can help the Bangladeshi economy recover from the COVID-19 pandemic and build resilience to future shocks. It is largely based on the report "Moving Forward: Connectivity and Logistics to Sustain Bangladesh's Success." (Herrera Dappe et al 2020). The cutoff date for data used in this report is March 15, 2021.

Acknowledgements

This report was prepared by a team comprised of Bernard Haven (Senior Economist), Robert Carl Michael Beyer (Senior Economist), Nora Carina Dihel (Senior Economist), Nazmus Sadat Khan (Economist), Selvia Arshad (Consultant), and Shegufta Shahriar (Team Associate). Anzhela Prygozhyna (Senior Financial Sector Specialist) and Sadia Afrin (Consultant) contributed to the analysis of the Financial Sector. Ayago Esmubancha Wambile (Senior Economist), Maria Eugenia Genoni (Senior Economist), Nandini Krishnan (Senior Economist) and Nishtha Kochhar (Consultant) contributed to the analysis of poverty trends. Muneeza Mehmood Alam (Economist), Matias Herrera Dappe (Senior Economist), Erik Nora (Senior Operations Officer), and Aurelien Kruse (Lead Country Economist) provided useful comments. Yutaka Yoshino (Lead Country Economist) and Manuela Francisco (Practice Manager) gave overall guidance under the leadership of Mercy Miyang Tembon (Country Director, Bangladesh and Bhutan) and Zoubida Allaoua (Regional Director, EFI).

Abbreviations

ADP	Annual Development Program
ADR	Advance-Deposit Ratio
AQR	Asset Quality Review
BAB	Bangladesh Association of Bankers
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BDT	Bangladeshi Taka
BOP	Balance of Payments
BPDB	Bangladesh Power Development Board
CETP	Central Effluent Treatment Plant
CFT	Countering Financing of Terrorism
COVID-19	Coronavirus Disease 2019
CPI	Consumer Price Inflation
CRAR	Capital to Risk Weighted Asset Ratio
DSEX	Dhaka Stock Exchange
EMDE	Emerging Market and Developing Economies
EPZ	Export Processing Zone
FCB	Foreign Commercial Banks
FDI	Foreign Direct Investment
FY	Fiscal Year
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
GNI	Gross National Income
IMF	International Monetary Fund
LC	Letter of Credit
LNG	Liquefied Natural Gas
M2	Broad Money
MLT	Medium and Long Term
MOE	Ministry of Education
MPS	Monetary Policy Statement
NBR	National Board of Revenue
NDA	Net Domestic Assets
NFA	Net Foreign Assets
NPL	Non-Performing Loan
NSC	National Savings Certificate
NTRCA	Nongovernment Teachers' Registration and Certification Authority
NTSC	Nongovernment Teachers Selection Commission
OECD	Organization for Economic Co-operation and Development
OSS	One-Stop Shop
PCB	Private Commercial Banks
REER	Real Effective Exchange Rate
RMG	Ready-made garments
SCB	State-Owned Commercial Bank
SOB	State-Owned Bank
SSB	State Specialized Banks

Executive Summary

Bangladesh has been severely affected by the COVID-19 pandemic. A first wave of infections started in April with an initial peak in early July 2020. While new infections subsequently declined, the risk of a resurgence remained at the time this report was written. A national COVID-19 vaccination campaign began in February 2021, and it is expected to accelerate as Bangladesh receives doses under the COVAX Initiative. However, achieving mass vaccination and herd immunity will take significant time.

A national shutdown implemented from March to May 2020 to contain domestic transmission resulted in severe supply-side disruptions in all sectors of the economy. GDP growth decelerated sharply, down to an estimated 2.4 percent in FY20. Industrial growth slowed, with a sharp decline in readymade garment (RMG) manufacturing output. Service sector growth also decelerated due to disruptions in transport, retail, hotels, and restaurants. Early signs of recovery emerged in the first half of FY21, after movement restrictions were progressively lifted.

Inflation remained moderate in FY20, but food price volatility rose due to supply chain disruptions and temporary surges in consumer demand. Despite a contraction in exports, the current account surplus rose as imports also fell and official remittance inflows surged. Thus, the balance of payments surplus rose in FY20 and the first half of FY21. The exchange rate remained stable, and foreign exchange reserves remained at adequate levels.

The pandemic has reversed the country's steady trend of poverty reduction over the past two decades, at least temporarily. Widespread losses in employment and labor earnings caused a significant increase in poverty. Early evidence points to large effects on food security. Recent survey data from poor areas in Dhaka and Chittagong suggest that there was a gradual recovery of livelihoods in those areas. In Chittagong, the percentage of adults working seems to have returned to pre-COVID levels in February 2021.

The Government of Bangladesh (GoB) responded to the economic shock from the pandemic proactively. It announced a COVID-19 response program of US$ 14.6 billion (4.5 percent of estimated FY20 GDP). However, implementation challenges remain, particularly in bringing resources to small businesses and poor households. To support the GoB's program, Bangladesh Bank eased monetary policy and introduced refinancing facilities. While liquidity rose, private sector credit growth remained muted amid heightened uncertainty. The COVID-19 crisis has compounded longstanding financial sector vulnerabilities, including weak capital buffers and undercapitalization of banks.

While public expenditure declined, due to slow implementation of development projects, revenues fell even more, due to low trade and weak economic activity, so that the fiscal deficit widened to an estimated 6.0 percent of GDP in FY20. Preliminary data from the first four months of FY21 show further reductions in expenditure and modest revenue growth.

The economy is expected to continue to recover gradually. Over the first half of FY21, mobility returned to pre-pandemic levels, factories reopened, and exports rebounded. Consequently, GDP growth is projected to reach 3.6 percent in FY21, led by (i) a recovery in manufacturing on the back of strong export demand, (ii) a rebound in construction supported by accelerating public investment, and (iii) robust services growth, thanks to progress in the vaccination campaign. On the demand side, private consumption is expected to continue to recover gradually while export demand expands strongly. Inflation is projected to remain close to Bangladesh Bank's 5.5 percent target despite expansionary monetary and fiscal policies, and monetary accommodation is likely to continue. The fiscal deficit is projected to remain at 6.0 percent of GDP in FY21 before moderating in the medium term. External stability is likely to be sustained, supported by export growth and resilient remittance inflows.

The outlook is subject to significant downside risks, particularly from the financial sector. Financial stability risks stemming from high levels of non-performing loans (NPLs), weak capital buffers, and poor bank governance and risk management pre-date COVID-19, but the pandemic has exacerbated them. Reduced profitability, weaker asset quality, and lower credit growth can have large second-round repercussions on the real economy. The fragile outlook for the global economic recovery adds external risks, if it impacts demand for RMG products and employment of Bangladesh's overseas workforce.

Moving Forward: Connectivity and Logistics to Strengthen Competitiveness

As the COVID-19 pandemic reshapes trade and supply chains, the logistics sector can play an important role to support the recovery in Bangladesh and drive improvements in its competitiveness. Currently, Bangladesh lags its competitors in terms of logistics performance, which constrains its exports. The COVID-19 pandemic has exposed vulnerabilities, including the absence of electronic processing systems that has impeded the facilitation of cargo movement at ports and border stations. In the near-term, reforms should focus on ensuring business continuity and on building resilience. In the longer term, improving logistics performance would help Bangladesh maintain its position as a major player in RMG manufacturing while diversifying its export basket.

Achieving efficient logistics requires a system-wide approach. It should be guided by a logistics strategy focused on both infrastructure and service delivery. The overarching goal can be broken down into four interlinked objectives:

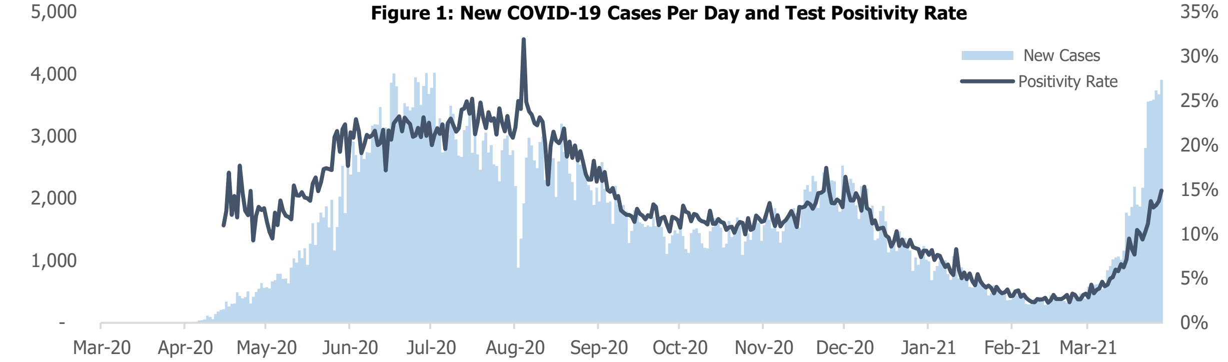
1. **Developing a system-wide strategy aimed at increasing logistics efficiency;**
2. **Improving the quality, capacity, and management of infrastructure;**
3. **Improving the quality and integration of logistics services; and**
4. **Achieving seamless integration of regional logistics services.**

Recent Economic Developments

Context

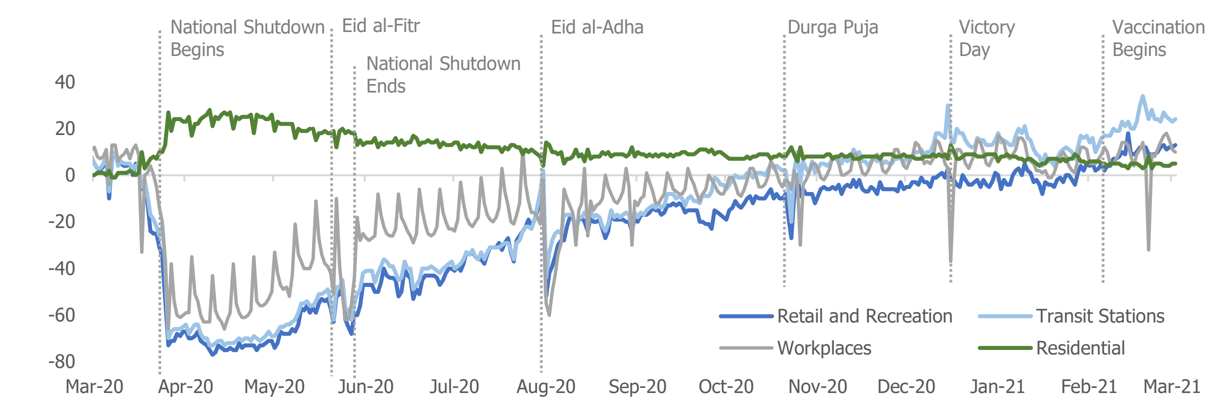
Bangladesh has been severely affected by the COVID-19 pandemic. The domestic epidemic unfolded in March 2020 and officially recorded cases rose to a peak in July 2020 (Figure 1). To slow the spread of the virus, a national shutdown was imposed from March to May 2020 resulting in widespread economic disruptions (Figure 2). Movement restrictions were progressively lifted from June 2020 onward and mobility returned to pre-pandemic levels by October 2020. Incidence and transmission rates have declined since August 2020, although the persistence of new infections suggests that transmission of the virus remains an ongoing challenge. A national COVID-19 vaccination campaign began in February 2021, when Bangladesh received an initial shipment of vaccines from India.[1] At the time of this report, 30 million doses have been procured from India, and Bangladesh will receive further doses under the COVAX initiative.[2]

Figure 1: New COVID-19 Cases Per Day and Test Positivity Rate



Source: Institute of Epidemiology Disease Control And Research

Figure 2: Mobility Trends - Percent Change from Baseline



Source: Google COVID-19 Community Mobility Reports

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[1] Bangladesh received 2 million COVID-19 vaccine doses as a gift from India in January 2021, followed by shipments of 7 million doses purchased from the Serum Institute of India as of March 23, 2021.

[2] This information was updated as of 1:00pm EDT April 12, 2021 in the report.

Real Sector

Following a sharp growth deceleration in FY20, early signs of recovery emerged in the first half of FY21. On the demand side, consumption was partially supported by resilient remittance inflows, which helped offset the impact of lost labor income. On the supply side, industrial growth slowed with a sharp decline in readymade garment (RMG) manufacturing, while service sector growth was weighed down by disruptions in transport, retail, hotels, and restaurants. In the agricultural sector, following a good rice harvest in FY20, there were prolonged floods in FY21 damaged crops. Poverty is estimated to have risen in FY20, as a result of lower employment and earnings.

Table 1: Contributions to Growth

	FY14	FY15	FY16	FY17	FY18	FY19	FY20e
GDP Growth	6.1	6.6	7.1	7.3	7.9	8.2	2.4
	Contribution of Production Sectors (%)						
Agriculture	0.7	0.5	0.4	0.4	0.6	0.5	0.4
Industry	2.3	2.7	3.2	3.1	3.8	4.1	0.4
Services	2.9	3.0	3.2	3.4	3.2	3.4	1.7
Net tax	0.2	0.3	0.2	0.3	0.3	0.1	0.0
	Contribution of Expenditure Components (%)						
Consumption	3.1	4.3	2.4	5.1	7.8	3.1	1.6
Private consumption	2.7	3.8	2.0	4.7	7.0	2.6	1.6
Government consumption	0.4	0.4	0.4	0.4	0.8	0.5	0.0
Investment	3.0	2.2	2.8	3.3	3.5	2.8	1.4
Private Investment	2.2	1.5	2.5	2.0	2.2	2.1	1.2
Government Investment	0.8	0.8	0.3	1.3	1.3	0.7	0.2
Trade Balance	0.4	-1.3	1.9	-0.9	-3.6	2.1	-0.3
Exports, goods & services	0.6	-0.5	0.4	-0.4	1.2	1.7	-2.6
Imports, goods & services	-0.3	-0.7	1.5	-0.5	-4.8	0.4	2.3
Statistical discrepancy	-0.4	1.3	0.0	-0.1	0.2	0.2	-0.4

Source: BBS, Growth in constant terms, National Accounts 2005-06 base

Growth

The COVID-19 pandemic caused an unprecedented global recession.[3] Emerging market and developing economies (EMDEs) output shrank by an estimated 2.6 percent in 2020—the worst performance since at least 1960 (the first year for which aggregate GDP data for EMDEs is available). This was despite substantial macroeconomic support that helped soften the decline in economic activity. The fall in investment was partly mitigated by policy rate cuts and macroprudential support measures, which provided liquidity and promoted lending, as well as by sizable fiscal packages. The decline in private consumption was partly offset by expanded social safety nets and employment programs, while resilient remittances in some countries also helped to cushion the shock to households.

In Bangladesh, the COVID-19 pandemic disrupted domestic economic activity while depressing external demand for its key exports in FY20. On the demand side, exports declined as external demand plummeted, while a decline in imports of capital goods pointed to a concomitant deceleration in private investment. Consumption was partially supported by

[3] This paragraph adapted from World Bank (2021)

resilient remittance inflows, which buffered losses in labor income. Real GDP growth is estimated to have reached 2.4 percent in FY20. High-frequency data for the first six months of FY21 (July to December 2020) point clearly to a recovery. For instance, electricity consumption rose by 2.8 percent in the first quarter of FY21 (y-o-y) and 7.6 percent in the second quarter (y-o-y), while mobility indicators returned to pre-pandemic levels.

Industrial sector output declined sharply in FY20 and recovered in FY21. Apparel production fell by 16.8 percent in FY20 (y-o-y) as international orders were suspended.[4] The leather sector experienced significant production disruptions stemming from a collapse in rawhide prices and the failure to operationalize effluent treatment facilities for tanneries. There was some respite, however, thanks to increased production of textiles (3.7 percent) and pharmaceuticals (10.7 percent). During the first half of FY20, the expansion of the construction sector stalled, as the COVID-19 crisis unfolded, and the growth of bank advances to the sector fell 2.1 percent in FY20 (from 15.8 percent in FY19). In the first half of FY21, manufacturing production recovered as RMG export orders were being reinstated and construction activity rose as the implementation of infrastructure megaprojects resumed and the housing and real estate industry rebounded.

Service sector growth was severely affected by the pandemic. Movement control measures in the fourth quarter of FY20 brought major segments of the sector to a stop, including transport and communication, hotels and restaurants, and wholesale and retail, which collectively accounted for half of service sector output in FY19. Services rebounded in the first half of FY21 as movement restrictions were lifted, and resilient remittance inflows sustained private consumption (which supported wholesale and retail trade activity). At the same time, a modest increase in government expenditure supported the expansion of health and education services.

Agricultural output was boosted by a robust rice harvest in FY20 but was dampened by losses from flooding in FY21. Food grain production increased by 2.6 percent in FY20, thanks to a bumper harvest of *aman* rice and a productive *boro* harvest, despite cyclone Amphan and COVID-19 related disruptions. The production and marketing of perishable products such as eggs, poultry, meat, and dairy were more severely affected by logistical disruptions. In FY21, rice production was hampered by prolonged floods and consequent waterlogging. The government was unable to meet its rice procurement target and food stocks declined. To limit the impact on prices, rice imports were authorized, resulting in a 50.4 percent (y-o-y) spike in food imports in the first half of FY21.

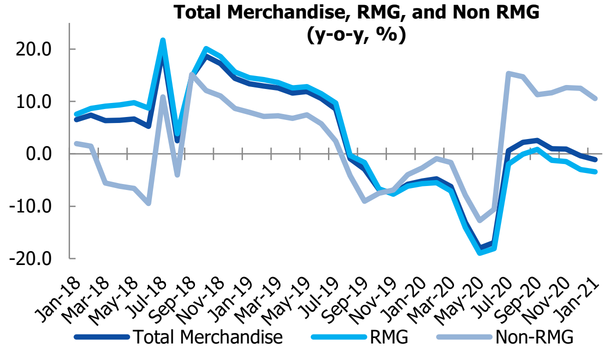
Consumption remained subdued, although resilient remittance inflows softened somewhat the impact of lost labor income. Rapid household surveys suggest that poor households faced income losses of 35 to 45 percent at the peak of the pandemic (PPRC and BIGD, 2020), with substantial job losses in the RMG sector (CPD, 2021). However, income losses associated with job losses were partially offset by remittance inflows. In the first half of FY21, the wage index has grown by 6.1 percent, which is likely to have supported private consumption growth. Imports of consumer goods also rose (by 11.1 percent, y-o-y) although this is partially attributable to clearing the port backlog from FY20. Government consumption growth remained subdued, as higher

[4] Based on Quantum Index of Industrial Production (QIIP) data

spending on social programs was offset by reductions in recurrent expenditure on vehicles and allowances related to foreign trips, meetings, and training of civil servants.

Investment growth slowed given heightened uncertainty. In FY20, growth of credit to the private sector declined to 8.6 percent from 11.3 percent the year before (and it has declined further in FY21 to 8.3 percent (y-o-y) as of January 2021). Private investment was likely affected by deteriorating financial sector conditions and significant overall uncertainty about. Net foreign direct investment (FDI) growth plummeted, declining by 31.4 percent (y-o-y) in FY20. Public investment growth also slowed: in FY20 it was constrained by limited access to foreign expertise, which is needed for some infrastructure projects, and in the first half of FY21, it was dampened by efforts to delay non-essential projects, as the fiscal deficit rose, although implementation of infrastructure megaprojects resumed.

Figure 3: Export Growth
Total Merchandise, RMG, and Non RMG
(y-o-y, %)



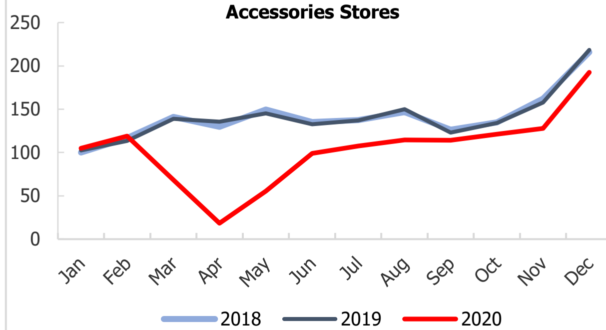
Source: Export Promotion Bureau

Trade volumes declined sharply in FY20 and recovered only gradually in FY21. Exports fell by 16.8 percent in FY20 due to supply-chain disruptions and depressed external demand for RMG (which still made up 83 percent of the country's merchandise exports in FY20). Imports also declined by 12.1 percent. Lower industrial activity limited the demand for intermediate goods. A depressed business outlook and low investment growth weighed on capital goods and machinery imports which declined by 33.8 percent in FY20. As a result, the trade deficit widened by 7.7 percent in FY20. In the first 8 months of FY21 (July 2020 to February 2021), merchandise exports began to recover, albeit gradually: total merchandise exports were still 1.1 percent below what they were over the same period of FY20. Likewise, the recovery in imports has also been slow, with total imports declining by 6.8 percent (y-o-y) in the first seven months of FY21 (July to January). Retail sales data from key export markets suggest that the apparel sector continues to struggle, with ongoing movement restrictions, particularly in Europe (Figures 4 and 5). Improving connectivity and logistics could help accelerate export growth, a topic which is addressed in the focus section at the end of this report.

Figure 4: EU-27 Retail Sales - Clothing, Footwear, Leather Goods in Specialized Stores

Source: Eurostat, indexed to January 2018.

Figure 5: US Retail Sales - Clothing and Clothing Accessories Stores

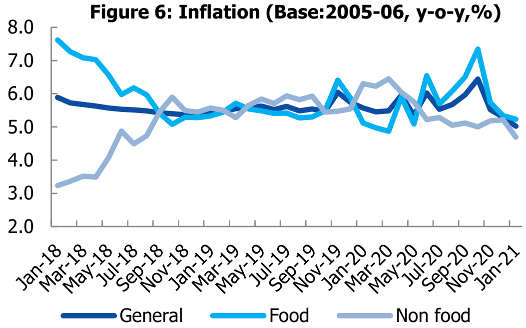


Source: US Census Bureau, indexed to January 2018.

Inflation

Inflation remained moderate in FY20, but food price volatility rose. Consumer price inflation (CPI) rose from 5.5 percent in FY19 to 5.7 percent in FY20, marginally exceeding Bangladesh Bank's 5.5 percent target. Food prices increased due to supply chain disruptions and temporary surges in consumer demand. In the first quarter of FY21 food prices came under pressure from large-scale flooding that adversely affected the rice harvests and restrictions on onion exports by India. However, food and non-food prices moderated in the second quarter of FY21, and inflation fell to 5.0 percent (y-o-y) by January 2021.

Figure 6: Inflation (Base:2005-06, y-o-y,%)



Source: Bangladesh Bureau of Statistics

Poverty and Welfare

The substantial gains in household incomes and poverty reduction achieved over the past two decades have been put at risk by the COVID-19 pandemic. The pandemic has severely impacted jobs and earnings and caused poverty to rise in FY20. A microsimulation exercise that considers the impacts of slower GDP growth, income losses of informal workers in impacted sectors, as well as temporary reductions in international remittances (see Box 1), estimated that the upper poverty rate, based on the national poverty line, reached 30 percent of the population (7 percentage points above a non-COVID counterfactual scenario).[5]

A nationwide phone-based survey (September to November 2020) documented substantial labor market impacts of the pandemic, including widespread losses in labor earnings.[6] At the time of the survey, almost one in five economically active individuals experienced either a job loss (5 percent) or a prolonged absence from work (14 percent) since the onset of the COVID-19 crisis.[7] Among the latter, the average duration of unemployment was 3 months. Among those employed at the time of the survey, 51 percent reported a loss in earnings or wages. Among those who did not own their dwelling, 56 percent reported being unable to pay their rent in full in the month preceding the interview. Food insecurity, as measured by self-assessments by the respondents, was also substantial, with 54 percent of respondents expressing concerns that they would run out of food, 41 percent having to reduce their consumption of preferred food, and 32 percent having run out of food or money in the week preceding the interview.

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[5] World Bank Macro-Poverty Outlook (April 2021).

[6] As part of a regional survey to track the welfare impacts of COVID-19 in South Asia, the World Bank implemented a nationwide phone survey between September and November 2020, identifying respondents through random digit dialing (RDD), using an algorithm to generate random phone numbers to identify respondents, and interviewing those who consented. The final sample of 7,690 individuals was roughly representative of the mobile phone-owning population in Bangladesh.

[7] The economically active population in 2020 is defined as those individuals of working age who were participating in the labor force (either employed or not employed and actively seeking work) in the 7 days prior to the interview, or individuals who worked at any point in 2020.

However, subsequent surveys pointed to a gradual labor market recovery in major urban centres by February 2021.[8] The percentage of adults working the week preceding the interview increased from 50 to 66 percent between June 2020 and February 2021. In Chittagong, it reached 62 percent in February 2021, on par with pre-COVID levels, and in Dhaka, it increased from 51 to 69 percent, still below pre-COVID levels (74 percent). Women are also regaining employment, but at a slower pace than men. The percentage of males working increased by 18 percentage points between June 2020 and February 2021 (to 92 percent – very close to the pre-COVID rate or 93 percent). The share of women working rose by 12 percentage points between June 2020 and February 2021, increasing to 33 percent (below the pre-COVID employment rate of 38 percent).

Households in poor and slum areas of Dhaka and Chittagong self-reported that their food security has improved substantially. In June/July 2020, 50 percent of households reported that at least one member had eaten smaller or fewer meals in the preceding two weeks. In September/October 2020, this share fell to 23 percent. The results also show improvements in households' ability to pay rent and expectations to be able to obtain cash to fund an emergency.

Monetary and Financial Sector Developments

Bangladesh Bank eased monetary policy in response to the COVID-19 crisis and introduced refinancing facilities to support the GoB's response program. Broad money and bank liquidity rose, but the growth of credit to the private sector remained muted, amid heightened uncertainty. The pandemic has exacerbated longstanding financial sector vulnerabilities, including weak capital buffers and undercapitalization of banks, poor banking sector governance, and high levels of non-performing loans (NPLs), especially among state-owned banks (SOBs). A cap on interest rates for loans and deposits distorts risk pricing, reduces financial returns for lenders and hampers lending growth.

Table 2: Monetary Program Performance

Y-o-Y Growth in Percentage

	FY18		FY19		FY20		FY21		
	Target	Actual	Target	Actual	Target	Actual	Target (Dec-20)	Target (Jun-21)	Actual (Dec-20)
Net Foreign Assets	0.1	-0.8	-1.6	2.9	4.2	9.2	12.5	5.8	30.2
Net Domestic Assets	17.9	12.8	16.2	12.1	16.0	13.6	14.4	18.3	9.9
Domestic credit	15.8	14.7	15.9	12.3	17.4	14.0	15	17.4	9.9
Public Sector credit	8.3	-0.5	8.5	19.8	37.7	59.9	35.7	31.7	18.6
Private Sector credit	16.8	16.9	16.8	11.3	14.8	8.6	11.5	14.8	8.4
Broad Money	13.3	9.2	12.0	9.9	13.0	12.6	14	15.0	14.2
Reserve Money	12.0	4.0	7.0	5.3	12.0	15.6	15.5	13.5	21.2
Inflation (end of period)	5.5	5.8	5.6	5.5	5.5	5.7	5.5	5.5	5.3
GDP Growth	7.4	7.7	7.8	8.1	8.2	5.2	8.2	8.2	

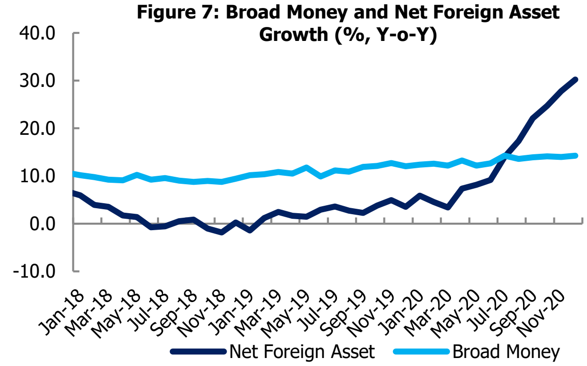
Source: Bangladesh Bank and Bangladesh Bureau of Statistics.

[8] Based on three rounds of phone-based surveys by the World Bank on a representative sample of households living in poor and slum areas of Dhaka and Chittagong City Corporations (CCs), conducted between June 2020 and February 2021

Monetary

Monetary policy has been eased in response to the COVID-19 crisis. Bangladesh Bank took several measures in 2020, which included: (i) reducing the cash reserve ratio to 4 percent (from 5.5 percent) and the repo rate to 4.75 percent (from 6 percent); (ii) purchasing of government securities from commercial banks at market rates; (iii) increasing the advance-deposit ratio (ADR) to 87 percent (from 85 percent); (iv) raising the target for broad money growth to 15.6 percent, an increase of 2.6 percentage points; and (v) establishing refinancing facilities of US$ 4.5 billion under the GoB's COVID-19 response program.

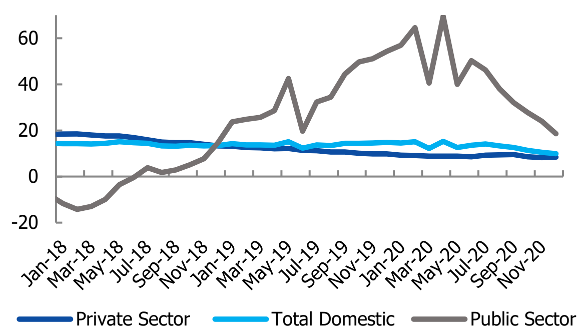
Figure 7: Broad Money and Net Foreign Asset Growth (%, Y-o-Y)



Source: Bangladesh Bank

Reserve and broad money growth accelerated as a result of accommodative policy and remittance inflows. The rate of reserve money growth rose from 5.3 percent at the end of FY19 to 15.6 percent at the end of FY20. It continued to rise in FY21 to 20.7 percent (y-o-y) in November 2020 on a monthly basis, exceeding the 15.5 percent annual target set by Bangladesh Bank for December 2020. This was led by robust growth in net foreign assets and net claims of Bangladesh Bank on deposit money banks (DMBs). Net foreign assets grew by 30.2 percent in the first half of FY21 (y-o-y), reflecting a surge in official remittance inflows, a reduction in imports, and disbursements of international loans. Currency held outside banks surged with the COVID-19 pandemic, rising by an estimated 37.4 percent in the second half of FY20 before declining again in the first half of FY21 as the situation normalized. The broad money (M2) growth rate gradually increased to 14.2 percent in the first half of FY21, marginally exceeding Bangladesh Bank's target of 14.0 percent.

Figure 8: Credit Growth (%, y-o-y)



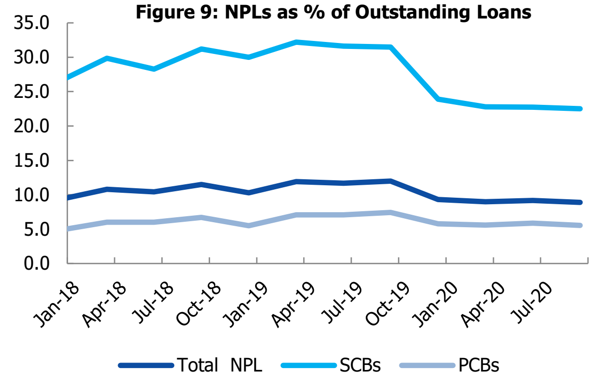
Source: Bangladesh Bank

Despite monetary easing, the **growth of credit to the private sector decelerated.** The growth rate of credit to the private sector fell from 11.3 percent at the end of FY19 to 8.4 percent in December 2020, substantially below Bangladesh Bank's 11.5 percent target. Demand for credit was weak due to slower economic growth and lower investments, given heightened uncertainty. On the supply side, commercial banks remained risk-averse due to growing credit risks, high levels of NPLs and the uncertain outlook. Thus, the overall advance-to-deposit ratio (ADR) remained well below the allowed regulatory limit of 87 percent, standing at 77.8 percent in March 2020, and even declined further to 74.0 percent in September 2020. The highest ADR was among private commercial banks (80.5 percent) followed by state-owned development banks (SODBs, 77.0), state-owned commercial banks (SCBs, 59.1), and foreign commercial banks (53.9).

Financial sector

The COVID-19 pandemic exacerbated longstanding financial sector vulnerabilities. Even before the pandemic, weak regulatory enforcement and deviations from international classification standards impeded the recognition of NPLs. In addition, a moratorium on debt repayment and asset foreclosures was introduced from March to December 2020, masking the financial challenges of lenders and borrowers. Although this moratorium was lifted, Bangladesh Bank subsequently allowed lenders to restructure loans for previously non-defaulted borrowers. This will ease the burden on borrowers and will reduce loan loss provisioning requirements for banks, but it will defer to a later date the recognition of NPLs and losses as well as adequate provisioning.

Figure 9: NPLs as % of Outstanding Loans



Source: Bangladesh Bank

As a result of regulatory forbearance measures, Financial Soundness Indicators (FSI) did not fully reflect deteriorating financial sector conditions. The aggregate level of NPLs as a share of banking sector credit and advances reportedly declined from 9.3 percent in December 2019 to 8.8 percent in September 2020. As a result, the aggregate banking sector capital to risk-weighted assets ratio (CRAR) increased from 11.4 percent in March 2020 to 11.9 percent in September 2020. As of June 2020, at least nine of Bangladesh's 60 scheduled banks did not comply with CRAR, and 21 banks did not meet capital conservation buffer requirements. In a stress test performed by Bangladesh Bank in June 2020, only 24 banks would comply with CRAR if their top three borrowers defaulted. To strengthen capitalization, Bangladesh Bank restricted the distribution of bank dividends in February 2021.

Systemic risks are rising, led by SOB undercapitalization. SOBs have a high ratio of NPLs and their financial performance is poor due to low returns. All nine SOBs (including six SCBs and three state specialized banks (SSBs)) did not comply with the minimum 10 percent capital adequacy requirement. The CRAR of SCBs stood at 8.3 percent in September 2020, while the CRAR of SSBs stood at negative 33.7 percent. SOBs collectively accounted for more than 50 percent of total NPLs in Bangladesh in September 2020.[9]

A cap on lending rates may have impaired risk pricing in domestic banks, depressing private credit growth and exacerbating banking sector risks. Monetary easing and a surge in official remittance inflows contributed to a 23.4 percent increase in bank liquidity in the first half of FY21. As a result, the average weighted interest rates for loans and deposits declined to 7.6 percent and 4.5 percent, respectively. Average weighted interest rates are currently below the rate caps

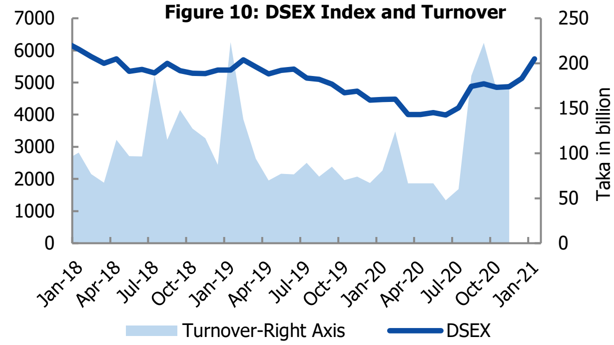
[9] Reported SCB NPLs reached 22.5 percent of loans and SSB NPLs reached 15.9 percent of loans. The return on assets (ROA) of SCBs and SSBs dropped to 0 percent and –5.1 percent in September 2020, compared to 0.6 percent for private commercial banks and 2.2 percent for foreign banks. Overall banking sector net interest margin (NIM) in CY19 was 2.1 percent, down from 2.2 percent in CY18 and is much lower than South Asian peer countries. SSBs reported negative financial results and NIM.

introduced by Bangladesh Bank in April 2020 (9 percent on loans and 6 percent on deposits). However, these caps remain binding on higher risk loans, particularly for lending to Cottage, Micro, Small and Medium Enterprises (CMSMEs). Bank lending to CMSMEs increased by only 2.1 percent in the first nine months of 2020. SCB lending to CMSMEs rose by 20 percent while SSB lending contracted by 57.1 percent and private commercial bank lending fell by 1.5 percent. Agricultural lending grew by 8.1 percent, while lending to households contracted by 18.1 percent during the same period.

Macro-Financial

The domestic capital market was negatively impacted by COVID-19, although equities recovered in late 2020. The Bangladesh Securities and Exchange Commission (BSEC) introduced floor prices to slow price declines in FY20, resulting in a substantial downward trend in trading volume. The Dhaka Stock Exchange (DSE) Broad Index declined by 10.0 percent from January to March 2020. Due to the national shutdown from late March to May 2020, trades were suspended, and the market capitalization of the listed companies dropped by 9.4 percent over January-June 2020. Trading resumed from June 1, 2020 and the benchmark index of the DSE increased by 36 percent by February 2021. Market capitalization increased by 21.9 percent since the end of 2019 (to BDT 3,467.7 billion).

Figure 10: DSEX Index and Turnover



Source: Dhaka Stock Exchange

External Sector

The balance of payments surplus rose in FY20 and the first half of FY21, reaching US$ 6.1 billion. A contraction in exports was offset by a decline in imports and a surge in official remittance inflows. As a result, the current account surplus rose. The financial account reached a surplus of US$ 2.2 billion in the first half of FY21, as rising foreign loan disbursements offset a sharp contraction in FDI. The exchange rate remained stable, and foreign exchange reserves remained adequate.

Table 3: Balance of Payments
USD millions

	FY17	FY18	FY19	FY20	FY21 (Jul-Dec)
Overall Balance	**3,169**	**-857**	**179**	**2,925**	**6,155**
Current account balance	**-1,331**	**-9,567**	**-4,490**	**-4,723**	**4,322**
Trade balance	-9,472	-18,178	-15,835	-17,858	-6,465
Merchandise exports f.o.b. (inc. EPZ)	34,019	36,285	39,604	32,832	18,761
Merchandise imports f.o.b. (inc. EPZ)	-43,491	-54,463	-55,439	-50,690	-25,226
Services	-3,288	-4,201	-3,176	-2,541	-845
Income	-1,870	-2,641	-2,382	-3,106	-1,629
Current transfers	13,299	15,453	16,903	18,782	13,261
Official	59	51	41	19	19
Private	13,240	15,402	16,862	18,763	13,242
o/w Remittances	12,769	14,982	16,420	18,205	12,945

Capital account	**400**	**331**	**239**	**256**	**87**
Financial account	**4,247**	**9,011**	**5,130**	**7,537**	**2,201**
Foreign direct investment (net)	1,653	1,778	2,628	1,271	455
Portfolio investment (net)	457	349	171	44	-157
MLT loans (excludes supplier credit)	3,218	5,987	6,263	6,222	2,885
MLT amortization payments	-895	-1,113	-1,202	-1,257	-680
Other long-term loans (net)	-153	141	302	438	393
Other short-term loans (net)	1,030	1,508	272	931	162
Trade Credit (net)	-1,185	-1,270	-3493	-616	251
Commercial banks	122	1,631	189	-270	-1,108
Errors and omissions	**-147**	**-632**	**-700**	**-145**	**-455**

Source: Bangladesh Bank

Current Account Balance

The current account deficit widened in FY20, due to weak exports, before moving into surplus in the first half of FY21, supported by a surge in official remittance inflows. The current account deficit widened from US$ 4.5 billion in FY19 to US$ 4.7 billion in FY20 as exports fells more than imports. Although official remittance inflows increased by 10.8 percent in FY20, this was not enough to cover the trade deficit. However, official remittance inflows surged in FY21 (see Box 1), resulting in the first half year current account surplus in four years: it reached US$ 4.3 billion in the first half of FY21 (July-December) compared to a deficit of US$ 1.7 billion over the same period of the previous year.

Box 1: Remittance Inflows in the Context of COVID-19

In the two years prior to FY20, official remittance inflows rose substantially (Figure 11), supported by favorable oil prices, a higher minimum wage in Saudi Arabia, and the introduction of a 2 percent GoB subsidy on remittances sent through official channels. They remained geographically concentrated, with 57 percent coming from the Gulf Cooperation Council countries in FY20 (Figure 12).

During the initial months of the COVID-19 pandemic, from March to May 2020, official remittances declined as lockdown measures were implemented and flights from Bangladesh to Saudi Arabia, Qatar, Bahrain, Kuwait, Oman, and the UAE were suspended. However, a surge in official inflows began in June 2020, likely reflecting a temporary switch from informal to formal remittance payment channels (given disruptions in international travel), additional transfers to support families following the floods in July, and transfers of accumulated savings by returning overseas workers. Data from Oman (where greater data on overseas workers is available) reflect a temporary surge in official remittances per Bangladeshi worker (Figure 13).

Official remittance inflows began to taper-off in FY21 as the net outflow of migrant workers likely slowed substantially. While records of returning migrants are incomplete, the Ministry of Expatriates' Welfare and Overseas Employment reported that 376,000 workers returned to Bangladesh from April 1 to December 17, 2020. In Saudi Arabia, Bangladesh's largest overseas labor market, new worker visa issuances fell by 92 percent (y-o-y) in the second quarter of 2020 (Figure 14).

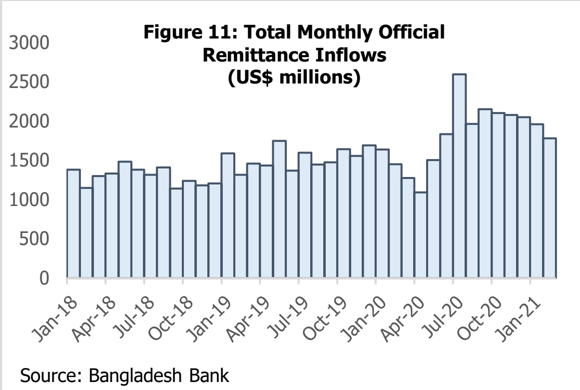


Figure 11: Total Monthly Official Remittance Inflows (US$ millions)

Source: Bangladesh Bank

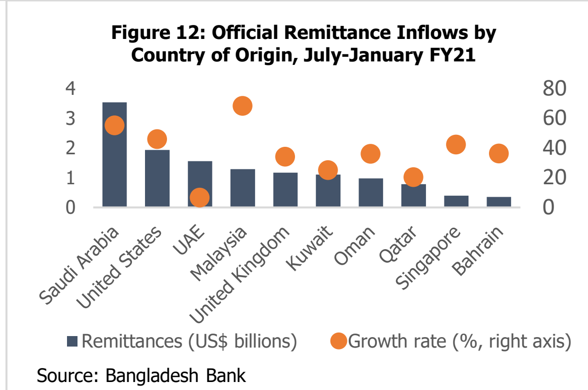


Figure 12: Official Remittance Inflows by Country of Origin, July-January FY21

Source: Bangladesh Bank

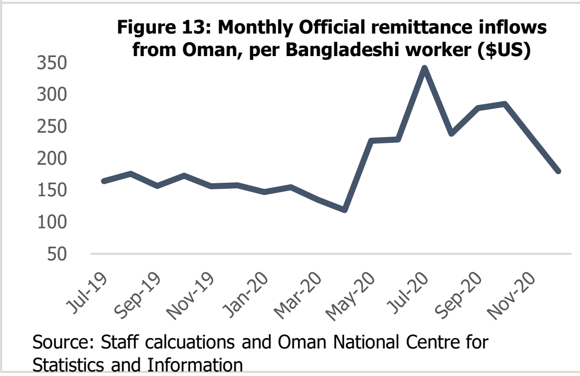


Figure 13: Monthly Official remittance inflows from Oman, per Bangladeshi worker ($US)

Source: Staff calcuations and Oman National Centre for Statistics and Information

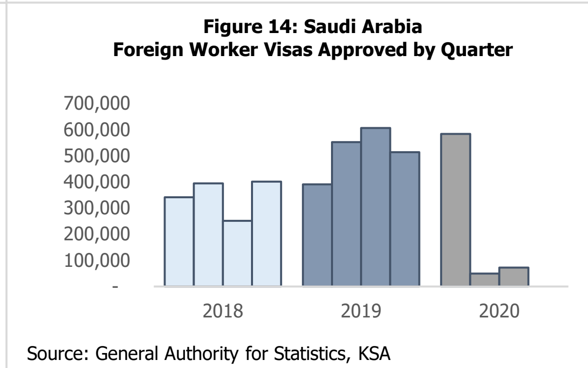


Figure 14: Saudi Arabia Foreign Worker Visas Approved by Quarter

Source: General Authority for Statistics, KSA

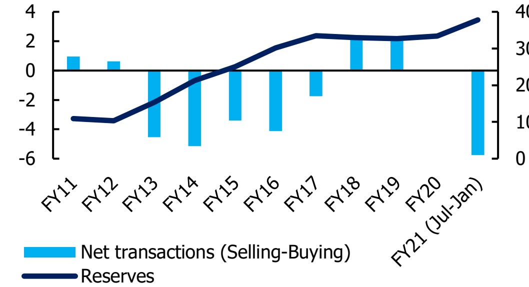
Capital and Financial Accounts

The financial account surplus rose with higher net external financing, while the capital account surplus rose modestly. Net nominal FDI inflows declined by 31 percent from FY19 to FY20, contracting sharply in the second half of the year, due to the pandemic. However, the decline in FDI was offset by higher foreign loan disbursements and lower trade credit outflows. The capital account surplus rose by US$ 17 million from a low base.

The overall balance of payments surplus rose in FY20 and the first half of FY21. The financial account surplus more than offset the current account deficit in FY20, resulting in a surplus on the overall balance of payments. These dynamics continued into the first half of FY21. The current account moved into surplus, supported by a narrower trade deficit and a surge in official remittance inflows compared to the same period of FY20. The overall balance of payments surplus stood at US$ 6.1 billion in the first half of FY21, compared to US$ 27 million over the same period of FY20.

Gross reserves remained adequate. In the first half of FY20, foreign exchange reserves were supported by robust remittance inflows. A sharp decline in remittances in the last quarter of FY20 was offset by rising foreign assistance and a narrower trade deficit. Foreign reserves grew to US$ 33.4 billion at the end of FY20 and continued to rise in FY21, reaching US$ 43.2 billion at the end of January 2021, supported by a continued surge in official remittance inflows and depressed imports. Reserves were equivalent to 8.9 months of goods and non-factor service imports by the end of January 2021.

Figure 15: Reserves and Foreign Currency Transactions

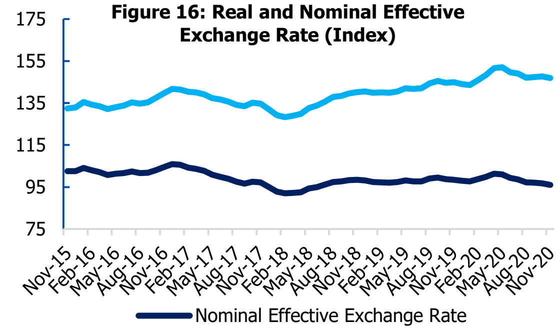


Source: Bangladesh Bank

Exchange Rate

The nominal BDT/US$ exchange rate remained stable. The Bangladeshi taka (BDT) depreciated marginally against the US dollar during FY20 from 84.5 BDT/US$ at the end of FY19 to 84.9 BDT/US$ at the end of FY20. The BDT/US$ exchange rate remained stable around 84.8 in the first seven months of FY21, as Bangladesh Bank purchased US$5.8 billion over this period to offset appreciation pressure on the local currency (reversing the direction of its previous foreign exchange interventions).[10] The real effective exchange rate depreciated by 2.9 percent in the first half of FY21, after appreciating for two years. The gap between the interbank exchange rate and the unofficial rate shrank to BDT 0.95 in the first half of FY21 compared BDT 2.35 during the same period of the previous year, as opportunities to send remittances through informal channels were constrained during the pandemic.

Figure 16: Real and Nominal Effective Exchange Rate (Index)



Source: IMF

[10] Bangladesh operates a de jure floating exchange rate regime with a de facto crawl-like stabilized arrangement (IMF, "Annual Report on Exchange Rate and Exchange Restrictions 2018").

Fiscal Trends and Debt Sustainability

The fiscal deficit is estimated to have widened to 6.0 percent of GDP in FY20. Expenditure moderated due to slow implementation of development projects, but revenue collection plunged as international trade contracted and domestic economic activity slowed. The government announced a package of COVID-19 economic response programs during the last quarter of FY20, with an estimated value of US$ 14.6 billion (4.5 percent of estimated FY20 GDP). However, preliminary data for the first four months of FY21 show further reductions in recurrent and development expenditure, and modest revenue growth.

Table 4: Fiscal Outcomes

	FY16	FY17	FY18	FY19	FY20
Taka in Billion					
Total Revenue	1,729.5	2,012.1	2,165.6	2,518.8	2,662.0
o/w Tax Revenue	1,518.9	1,780.8	1,943.3	2,259.6	2,217.6
Total Expenditure	2,384.3	2,695.0	3,218.6	3,916.9	4,173.2
o/w Current Expenditure	1,444.3	1,644.9	1,788.8	2,178.1	2,400.1
o/w ADP	812.9	868.5	1,245.7	1,526.6	1,613.7
Deficit	-654.8	-682.9	-1,053.1	-1,398.1	-1,515.4
Net External Financing	147.4	123.0	264.9	329.7	459.7
Net Domestic Financing	507.3	559.9	788.2	1,068.5	1,055.7
General Government Debt Stock	5,455.2	6,083.2	7,185.8	8,419.1	10,334.5
External	2,058.9	2,346.7	2,751.3	3,081.0	3,673.2
Domestic	3,396.3	3,736.5	4,434.5	5,338.1	6,661.3
% of GDP					
Total Revenue	10.0	10.2	9.6	9.9	9.6
o/w Tax Revenue	8.8	9.0	8.6	8.9	8.1
Total Expenditure	13.8	13.6	14.3	15.4	15.2
o/w Current Expenditure	8.3	8.3	7.9	8.6	8.7
o/w ADP	4.7	4.4	5.5	6.0	5.9
Deficit	-3.8	-3.5	-4.7	-5.5	-5.5
Net External Financing	0.9	0.6	1.2	1.3	1.7
Net Domestic Financing	2.9	2.8	3.5	4.2	3.8
General Government Debt Stock	31.5	30.8	31.9	33.7	37.6
External	11.9	11.9	12.2	11.7	13.4
Domestic	19.6	18.9	19.7	21.0	24.3

Source: Ministry of Finance, Monthly Report on Fiscal Position for September 2019.

Revenue

Revenues declined in FY20 before recovering modestly in early FY21. As in previous years, the revenue target for FY20 was an aspirational 45.4 percent nominal increase over FY19 collections. However, year-over-year revenue growth decelerated in the first half of FY20 as trade slowed, and collections fell precipitously after domestic movement restrictions were implemented in the second half of the fiscal year. Trade-related taxes fell by 24.5 percent in the last quarter of FY20, y-o-y. Corporate and personal income taxes were similarly affected. The National Board of Revenue (NBR) extended payment and filing deferrals to mitigate the impact of the pandemic although taxes were not altogether waived. To reduce the FY20 deficit, the NBR focused on collecting direct tax and non-tax payments from large taxpayers. Overall, tax revenue collected by the NBR is estimated to have declined (for the first time in over two decades) by 2.5 percent in nominal terms in FY20 (see Table 5). Total government revenues (including non-tax revenues) declined by 1.9 percent y-o-y, to an estimated 9.6 percent of GDP in FY20. Though economic activity started to normalize in the early part of FY21, nominal tax revenue growth was only 3.9 percent in the first half of the fiscal year. Despite the growing gap between revenue targets and actual collections in recent years, the revenue target for FY21 was set 43.7 percent higher than estimated FY20 collections.

Table 5: Nominal Growth in NBR Tax Collections

	FY16	FY17	FY18	FY19	FY20	FY21 (July-Dec)
Indirect taxes – trade	17.9	20.2	12.7	3.5	-4.5	6.8
Indirect taxes – domestic	14.4	19.3	17.7	11.3	-3.2	1.2
Direct taxes	12.2	17.6	-2.3	17.0	0.1	4.8
Total	14.6	19.0	9.3	10.7	-2.5	3.9

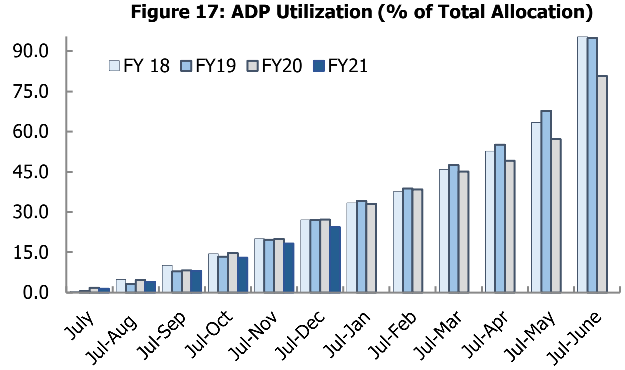
Source: National Board of Revenue (NBR)

Administrative reforms to automate VAT and income tax remain largely incomplete. The government initiated the VAT Online Project in 2013 to implement the VAT and Supplementary Duty Act 2012 and do away with the manual system in VAT collection. However, only five out of 16 modules were ready -albeit not fully functional- by the completion deadline of December 31, 2020. The automation of income tax returns faced similar implementation bottlenecks. Coordination challenges between authorities and suppliers resulted in only partial implementation of the Bangladesh Integrated Tax Administration System (BITAX) project. The NBR subsequently initiated the development of an online tax return filing system using its own internal resources. After numerous delays, the use of Electronic Fiscal Devices (EFDs) for VAT collection started on a pilot basis from August 2020 onward. The NBR plans to install 100,000 EFDs by June 2021.

Expenditure

Public expenditure growth slowed in FY20 as COVID-19 disrupted government infrastructure spending. Total nominal expenditure for rose by 6.1 percent (y-o-y), well below the average growth rate of the previous ten years (16.5 percent) and 20.6 percent below the budget target. Development expenditure (the Annual Development Program (ADP)) contracted in the fourth quarter, as major infrastructure projects were delayed by movement and travel restrictions. Current expenditures, including subsidies and transfer payments, faced targeting and execution challenges over the same period[11] and as a result they grew by 5.5 percent.

Figure 17: ADP Utilization (% of Total Allocation)



Source: IMED ERD

[11] As of January 2021, a cash transfer program that targeted transfers of BDT 2,500 to 5 million families affected by COVID-19 could not be completed due to ongoing targeting challenges.

Total expenditure declined by 12.8 percent (y-o-y) in the first four months of FY21 (July-October 2020). Despite execution challenges in FY20, the GoB adopted an ambitious budget for FY21, targeting a 13.3 percent increase in nominal expenditure over the revised FY20 budget. The pace of spending in the first half of FY21 has been slow. ADP expenditure declined by 34.5 percent over the first half of FY21 (y-o-y), as authorities limited funding allocation to a prioritized list of investment projects. ADP expenditure declined by BDT 400 billion (equivalent to 19.5 percent of the total FY21 ADP) and the ADP implementation rate declined to an eleven-year low (Figure 17), although implementation of mega projects within ADP accelerated towards the end of CY20. Current expenditure declined marginally, as the government continued a policy to reduce expenditure deemed to be unnecessary.[12] However, spending on subsidies and current transfers increased by 9.4 percent y-o-y, from July to October, to reach 36 percent of current expenditure

The GoB announced a package of COVID-19 economic response programs in the last quarter of FY20 with an estimated value of US$ 14.6 billion (4.5 percent of estimated FY20 GDP). The package includes support to workers in export-oriented sectors (in the form of subsidized loans to employers), working capital loans to businesses, insurance and incentives for doctors, and additional programs for the poor and small businesses (see Table 6). Bank lending to firms accounts for 77 percent of the program, [13] with interest rate subsidies borne by the government. Direct government expenditure accounts for 23 percent of the program. Out of a total of 9 packages that were announced, two have been fully implemented (1 and 9), while others, that were announced towards the end of 2020 and in early 2021 have not yet started.

Table 6: COVID-19 Response Program and Disbursement Rate (as of January 2021)

Name of the package		*BDT (billions)*	*US$ (millions)*	*Disbursement rate*
1	Salaries and allowances for workers in export industries	50	588	100%
2	Working capital for industries and service sector	400	4,706	62.8%
3	Working capital for cottage, micro, small and medium enterprises (CMSME)	200	2,353	31.7%
4	Bangladesh Bank Export Development Fund (EDF)	128	1,500	72.5%
5	Pre-shipment credit refinance scheme	50	588	2.4%
6	Special honorarium for doctors, nurses, medical workers	1.0	1.12	0%
7	Health insurance and life insurance	7.5	88.2	3.4%
8	Free Food Distribution	25	294.1	42.7%
9	Open Market Sales at 10 BDT/kg	7.7	90.6	100%
10	Cash transfer to targeted poor people	12.5	147.1	69.9%
11	Expansion of allowance programs	8.2	96.5	2.9%
12	Construction of home for homeless people	21.3	250.5	57%
13	Additional procurement of paddy/rice (2.0 lac ton)	8.6	101.2	59.2%
14	Support for farm mechanization	32.2	378.8	84.1%
15	Agricultural lending program	50	588	67.1%

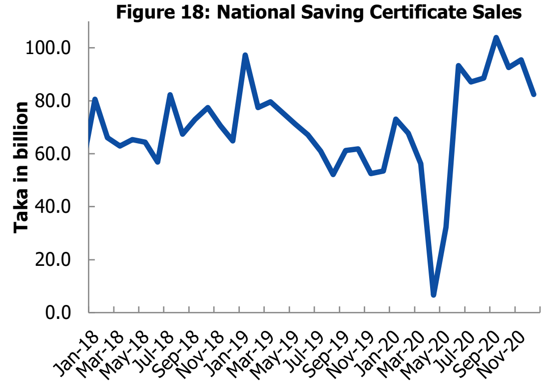
[12] Including allowances related to foreign trips, meetings, and trainings of civil servants and the purchase of new vehicles.

[13] Including government specialized banks and microcredit institutions.

16	Agriculture subsidy program	95	1,059	75.6%
17	Refinance scheme for lower income professionals, farmers and small businesses	30	352.9	37.9%
18	Lending through four specialized banks to create employment among the poor	32	376.5	21.4%
19	Interest subsidy to commercial banks (banks received application for BDT 13.9 billion interest waiver)	20	235.3	0%
20	Credit guarantee scheme for the SME sector	20	235.3	0%
21	Support to the laid off workers in the RMG and leather industry	15	235.3	0.1%
22	Credit support to the CMSME sector (recent scheme)	15	176.5	0%
23	Support for the elderly people, widows and female divorcees (recent scheme)	12	141.2	0%
	Total	**1,241**	**14,583.1**	**52.4%**

Deficit and financing

Figure 18: National Saving Certificate Sales



Source: Bangladesh Bank

The fiscal deficit reached 5.5 percent of estimated GDP in FY20, according to preliminary fiscal data. The decline in revenue growth was offset by lower public expenditure growth, and the deficit grew in line with GDP. To finance the rising deficit, the government has increasingly resorted to domestic borrowing from banks and non-bank institutions. Sales of high-yielding National Savings Certificates (NSCs) declined sharply in early FY20, as the authorities implemented new control measures to prevent individuals from exceeding NSC purchase limits.[14] As NSC sales declined, borrowing from the banking sector rose substantially, growing by 136.2 percent in FY20 in nominal terms, compared to FY19. However, this trend was reversed in FY21. Following the introduction of six percent cap on deposit rates, over the first four months of FY21 (July-October), net NSC sales nearly tripled y-o-y, while borrowing from the banking sector declined by 58.2 percent. NSCs offer significantly higher interest rates than other types of bank deposits, distorting capital markets and increasing government debt servicing costs. External financing rose in the last quarter of FY20 as development partners expanded their support in response to the COVID-19 crisis. More than US$ 1.7 billion in budget support was disbursed by development partners (IMF, World Bank, ADB, and AIIB). JICA also disbursed $300 million in budget support in early FY21.

[14] These include i) online monitoring ii) mandatory use of taxpayer identification numbers iii) mandatory use of bank accounts and iv) prohibiting the use of cash to buy NSCs, v) increasing the income tax withholding on interest from 5 percent to 10 percent for holdings over BDT 0.5 million vi) fixing a maximum limit for a combination of three types of NSC holding for an individual.

Debt levels and dynamics

Bangladesh remains at low risk of debt distress, but public debt is rising. Public debt was estimated at 39.2 percent of GDP in FY20, comprised primarily of domestic debt. External debt amounted to 13.4 percent of GDP (or just over a third of the total debt stock), comprised of long-term loans from multilateral and bilateral lenders at concessional or semi-concessional rates with generous grace periods. The average maturity of new debt commitments is close to 34 years, with an average interest rate of 1 percent. The latest joint World Bank-IMF Debt Sustainability Analysis (May 2020) concluded that Bangladesh remained at a low risk of external and public debt distress, even when the economic shock caused by COVID-19 is factored-in. At the same time, corporate debt risk, measured by Bloomberg, remains high as companies continue to rely on short-term funding in the absence of developed capital markets.

Fiscal policy remained sustainable, despite the COVID-19 shock, but there are underlying vulnerabilities. Domestic resource mobilization remains exceptionally low compared to other countries at a similar level of income, as a result of tax policy gaps and weak administration. Non-concessional external borrowing has increased and may push up the debt path in the future. The ratio of public debt service-to-revenue rose with the use of high-cost NSCs (which yield double digit interest rates). SOEs remain a source of fiscal burden, particularly those in the energy and financial sectors. Subsidies to SOEs rose by 10.8 percent (y-o-y) in FY20 in addition to which the GoB provides guarantees and counter guarantees against loans incurred by SOEs. As of May 2020, the face value of these guarantees stood at BDT 606.5 billion (approximately US$ 7.1 billion) in FY21.

The implementation of key reforms has been lagging. A Medium-Term Revenue Strategy (MTRS) is being prepared to guide future reforms, and the 8th Five-Year Plan sets out clear targets to increase government revenues. However, in recent years, reforms in tax policy and administration have moved slowly, and ambitious plans to broaden the tax base and automate core administrative functions remain incomplete. Spending plans to support households and firms affected by COVID-19 also faced implementation challenges. Although large export-oriented industries were able to benefit from the government's stimulus program, small and micro firms struggled to access loans from the banking sector, as reflected in the slow disbursement rate of the relevant programs (see package 3, 17, and 18 in Table 6), and the deferrals of completion dates for several of them.

Outlook and Risks

The economy is expected to continue to recover gradually, particularly if the government's COVID-19 recovery programs are implemented swiftly. Downside risks include new waves of COVID-19 infections that would dampen external demand for exports and Bangladesh's labor force overseas. With growth firming up, poverty is projected to decline marginally in FY21. Addressing structural challenges through policy reform could accelerate the post-COVID-19 recovery, while supporting longer term development objectives.

Medium-Term Outlook

Context

While global economic activity is projected to recover, it is expected to be 4.4 percent below pre-pandemic projections in CY22.[15] The pandemic is expected to inflict lasting scars, maintaining activity and incomes well below their pre-pandemic trend for a prolonged period. Specifically, lingering risk aversion on the demand side, and the effects of diminished physical and human capital accumulation on labor productivity are projected to depress output growth. The World Bank's baseline forecast (January 2021) projects that global GDP growth will reach 4 percent in 2021 and moderate to 3.8 percent in 2022. The recovery is expected to be supported by widespread vaccination, while sustained monetary policy accommodation is expected to more than offset the partial unwinding of fiscal responses to the COVID-19 economic shock.

In EMDEs, the initial bounce back will be supported by accommodative monetary policy in the near term, although a full recovery will likely take time. Inflationary pressures should remain subdued, providing room for monetary accommodation, especially as advanced economies continue to adopt expansionary monetary policy stances. However, in more than a quarter of EMDEs, the pandemic is expected to erase at least 10 years of per capita income gains. The deterioration in overall business confidence has dampened investment, and losses in learning-adjusted school years and prolonged spells of unemployment have eroded earlier gains in human capital. In South Asia, regional growth is projected to reach 3.3 percent in 2021, substantially lower than the average in the decade leading up to the pandemic. Underlying these weak prospects are expectations that incomes and employment will recover slowly, especially in the services sector, the supply of credit to the private sector will remain constrained by financial sector vulnerabilities and rising credit risks, and fiscal policy support will be muted on account of large imbalances.

Table 7: Selected Macroeconomic Indicators
(annual percentage change, unless indicated otherwise)

	FY19	FY20e	FY21f	FY22f	FY23f
Real GDP growth, constant market prices	8.2	2.4	3.6	5.1	6.2
Private Consumption	3.9	2.6	3.2	4.5	5.3
Government Consumption	9.5	-0.9	4.3	5.4	6.5
Gross Fixed Capital Investment	8.4	4.3	3.6	7.4	8.6
Exports, Goods and Services	11.6	-16.8	8.4	8.6	8.9

[15] The global outlook is adapted from World Bank (2021).

Imports, Goods and Services	-0.2	-12.1	6.0	10.5	9.4
Real GDP growth, constant factor prices	8.4	2.6	3.6	5.0	6.1
Agriculture	3.9	3.0	2.2	3.3	3.1
Industry	12.7	1.3	4.5	6.1	7.4
Services	6.8	3.4	3.3	4.8	6.0
Inflation (Consumer Price Index)	5.5	5.6	5.7	5.7	5.8
Current Account Balance (% of GDP)	-1.5	-1.5	-0.5	-2.1	-2.4
Net FDI (% of GDP)	0.9	0.4	0.3	0.5	0.6
Fiscal Balance (% of GDP) 1/	-5.4	-5.5	-6.0	-6.0	-5.9
Debt (% of GDP)	33.7	37.6	41.7	44.9	47.2
Primary Balance (% of GDP) 1/	-3.4	-3.2	-3.6	-3.4	-3.0

Source: World Bank staff estimation; Bangladesh Bureau of Statistics; Bangladesh Bank, Ministry of Finance.
1/Including grants. f=forecast; e=estimated

Real Sector

Bangladesh's economy is expected to recover gradually, while remaining vulnerable to shocks. Given the significant uncertainty pertaining to both epidemiological and policy developments, real GDP growth for FY21 could range from 2.6 to 5.6 percent depending on the pace of the ongoing vaccination campaign, whether new restrictions to mobility are required and how quickly the world economy recovers.[16] In the industrial sector, manufacturing is expected to rebound (thanks to strong export demand), while construction activity should benefit from accelerating public investment and a gradual recovery in private investment, as uncertainty wanes. As vaccination campaigns progress and normal patterns of activity resume, services sector growth should also accelerate. However, extensive flooding in the first months of FY21 is expected to dampen agricultural growth in the near term, following bumper crops over the previous two years, while livestock, dairy, and poultry production is expected to recover only gradually (given that production capacity was lost in these activities during the lockdown period).

Growth is expected to accelerate in FY22 and FY23. It is projected to reach at 5.1 percent in FY22. as exports and consumption continue to recover, and 6.2 percent in FY23 as investment rises, led by externally financed public infrastructure investments under the recently adopted 8th Five-Year Plan. These dynamics will support job creation, and labor income is expected to rise as pandemic-related disruptions wane in the second half of FY21. Private consumption is expected to continue a gradual recovery. Although official remittances are expected to taper from record highs, inflows will continue to support household consumption. Strengthening competitiveness through improved logistics and competitivenesss performance could help accelerate the COVID-19 recovery over the medium-term (see the special section at the end of this report).

[16] This forecast assumes that the domestic recovery will be sustained despite ongoing social distancing and targeted lockdown measures in advanced economies. The World Bank's forecast was produced independently and differs from a Ministry of Finance estimate of 5.2 percent growth in FY20 and a projection of 8.2 percent GDP growth in FY21. This forecast assumes that the domestic recovery will be sustained despite ongoing social distancing and targeted lockdown measures in advanced economies.

Inflation

Inflation is projected to remain close to Bangladesh Bank's 5.5 percent target, despite expansionary monetary and fiscal policies. Food inflation is expected to remain moderate, as domestic crop production recovers from flooding earlier in the year, and rice imports from India, Thailand, and Vietnam are allowed under recently granted waivers. Non-food inflation is expected to be moderate as well, with domestic demand recovering only gradually and commodity prices expected to rise moderately. In its FY21 monetary policy, Bangladesh Bank targets containing CPI inflation at 5.5 percent: on one hand, policy rates have been lowered substantially in response to the COVID-19 pandemic, but on the other hand growth is expected to remain below pre-COVID-19 projections in the medium-term, which should offset the impact on inflation.

Monetary and Financial Sector

Monetary accommodation is likely to continue. At a meeting of the Monetary Policy Committee in January 2021, Bangladesh Bank maintained its expansionary policy stance for the second half of FY21. Prior reductions in policy rates and reserve requirements have been maintained. The original broad money (M2) growth target of 15.6 percent for FY21 was lowered modestly to 15.0 percent, for the second half of FY21. The target was revised after broad money growth accelerated to 14.2 percent (y-o-y) from July to December 2020 (with rising net foreign assets and purchases of domestic securities by Bangladesh Bank). The targeted growth of credit to the private sector was maintained at 14.8 percent for FY21, although it is unlikely to be met given weak financial sector conditions and declining financial intermediation.[17]

The transition from a quantity-based policy regime towards inflation targeting has been postponed. As indicated in its FY21 monetary policy, Bangladesh Bank remains committed to moving towards inflation targeting over the longer term, but the reform has been deferred during the COVID-19 response period. The adoption of inflation targeting will place greater emphasis on price stability as the primary objective of monetary policy. This would allow greater exchange rate flexibility, further development of financial markets, and strengthened forecasting of banking and government liquidity. Greater clarity around the purpose, amount, and timing of foreign exchange interventions, and gradually enhancing exchange rate flexibility would help buffer the economy against external shocks and increase monetary policy autonomy.

In the financial sector, regulatory forbearance measures will result in delaying the recognition of growing challenges until late FY21 and FY22. While a moratorium on debt payments ended in December 2020, Bangladesh Bank has allowed banks to restructure term loans. These measures are likely to raise credit risks and add to pressures on profitability and capital adequacy in the banking sector. However, the observed impact in bank financial statements will likely take place later in FY21 and in FY22 as loans mature and borrowers begin servicing outstanding loans.

[17] Private sector credit growth for December 2020 was 8.4 percent.

External Sector

External stability will be supported by a declining current account deficit. The current account deficit is expected to decline in FY21 thanks to the recent surge in official remittance inflows, and the recovery of exports. The rebound in exports, as observed in the first six months of FY21, is expected to continue in the second half of the year. However, the surge of official remittance inflows began to moderate in the second quarter of FY21 and is unlikely to be sustained as restrictions on passenger movements are lifted (see Box 1). The net outflow of migrant workers is expected to slow in FY21 and FY22 as new worker visa issuance in the Middle East declined during the pandemic and some workers have returned. Over the longer term, overseas migration is expected to continue to expand as demand recovers in the Middle East and as Bangladesh accesses new overseas labor markets in Asia. International reserves are projected to remain adequate at 5.4 months of goods and service imports in FY23.

Fiscal Trends

The fiscal deficit is projected to reach 6.0 percent of GDP in FY21 and to moderate in the medium term. Total expenditures are expected to increase modestly to about 16 percent of GDP over the next three fiscal years. On-budget expenditure on relief and recovery measures (social safety net, job retention, agriculture, and health sector activities) will rise, although about 70 percent of resources for the stimulus are anticipated to be channeled through the banking sector as credit. Expenditure on operations and maintenance of public infrastructure is also expected to gradually rise over the medium term, as public investment projects are completed. Over the near term, revenues are expected to remain depressed. Trade tax revenues and VAT collections are expected to rise gradually as imports recover, while direct tax revenues should grow as firm revenues and profitability recover. Over the medium-term, ongoing tax administration and policy reforms and expenditure prioritization efforts should support fiscal consolidation. As a result, the deficit is projected to narrow to 5.9 percent of GDP by FY23.

Although the impact of the COVID-19 shock on public finances was significant, Bangladesh remains at low risk of debt distress. According to the latest Bank-Fund Debt Sustainability Analysis (May 2020), the risk of both external and overall debt distress continues to be low. Nonetheless, the relatively high ratio of total public debt service to revenue underscores the need to boost revenues over the longer term. As Bangladesh prepares for LDC graduation, prudent fiscal management and a strategy for external financing of major infrastructure programs will become increasingly important.

Risks and Priorities

Global downside risks remain elevated, with persistent uncertainty stemming from the COVID-19 pandemic. Risks to the global outlook include additional waves and new variants of COVID-19 infections and delays in the rollout of vaccination campaigns that could dampen or reverse the global recovery. Additional stress on already weakened corporate balance sheets could result in a higher rate of bankruptcies and increased unemployment as temporary shutdowns could become permanent Higher corporate debt levels coupled with rising default rates could result in a rapid deterioration of market sentiment. Capital flows could be disrupted by shifting expectations of monetary policy in EMDEs, which also face currency depreciation risks. Sovereign exposure to the financial sector has also risen, particularly in EMDEs. Conversely, accelerated adoption of digital services and technologies could improve productivity, contributing to a faster than expected global recovery.

In Bangladesh, the outlook is also subject to significant downside risks. Movement restrictions could again be required if COVID-19 infections accelerate, disrupting economic activity. Fiscal risks include a shortfall in international support for COVID-19 vaccination programs, cost overruns on major infrastructure projects, and delays in tax reforms. In the event that external financing for the Rohingya response declines, additional public expenditure may be required. In turn, higher borrowing from domestic banks could constrain the availability of credit to the private sector. Challenges in the implementation of credit and social protection programs, under the government's economic stimulus program, could also undermine the recovery. External risks, stemming from the fragile global economic recovery, include weak demand for RMG products and reduced employment of Bangladesh's overseas workforce. Low public debt levels and a low risk of public debt distress provide some buffer, although risks remain tilted to the downside.

The COVID-19 pandemic has exacerbated financial sector risks. Financial stability risks pre-date COVID-19, including high levels of NPLs, weak capital buffers, poor bank governance, and risk management. Reduced profitability and weaker asset quality in the banking sector are likely to have second-round repercussions for the real economy by limiting the availability of credit. Although Bangladesh was already not fully aligned to international standards prior to COVID-19, Bangladesh Bank has further relaxed loan classification requirements and allowed banks to freeze loan classifications as per their pre-COVID-19 status. Such extraordinary measures can have positive effects in the short term (by alleviating stress on banks temporarily) but harmful consequences over the medium and long term, unless they are carefully implemented and closely monitored. Moreover, the expected positive developmental impact of accommodative monetary policy and the COVID-19 stimulus package could be undermined by interest rate caps and delayed recognition of NPLs persist, as these measures will ultimately hamper credit growth.

The realization of financial sector risks can put pressure on fiscal and external balances, and vice versa. Contingent liabilities from high NPLs and insufficient capital in banks could result in higher public domestic debt. A recent initiative to set up a public asset management company (AMC) could potentially have high fiscal costs and create moral hazard. Conversely, increased deficit financing from domestic banks may put upward pressure on interest rates and may further constrain credit to the private sector.

Structural Challenges and Recommendations

Protecting households affected by the negative effects of COVID-19 remains an urgent priority. In a nationwide monitoring survey -carried out in February 2021, a fifth of the respondents reported having no sources of help to turn to if faced with a future emergency expenditure, and another 7 percent said they would have to mortgage or sell assets (a high-risk strategy). Only 14.3 percent and 32.5 percent of respondents said they could rely on own savings and borrowing from friends or relatives, respectively. According to the same survey access to formal assistance has expanded but remained low. Only 16 percent of households reported having received any formal assistance (from the government or NGOs) after March 1st (of which only 4 percent had received assistance previously).

Building a data infrastructure to track the impact of future shocks on households and firms can help inform the policy response to future crises, strengthening resilience. At the onset of the pandemic the statistics system of Bangladesh did not have the data infrastructure required to assess and monitor the impacts of the crisis on households and firms on a real time basis. Efforts to make data collection more agile and rapid within the National Statistic System should be prioritized. This would entail institutionalizing rapid data collection systems at the Bangladesh Bureau of Statistics, including building capacity to manage and maintain updated recontact records.

Resolving longer term structural challenges could accelerate the post-COVID-19 recovery. Structural reform priorities include building institutional capacity, increasing government revenues, diversifying exports, resolving financial sector vulnerabilities, rebalancing urbanization, and improving the business environment. Bangladesh's expected graduation from the UN's Least Developed Country (LDC) status in coming years will present opportunities but also challenges, including the eventual loss of preferential access to advanced economy markets and more rigorous environmental and labor standards. Several opportunities for reforms that would support the COVID-19 recovery are highlighted below.

Business climate reforms and changes to the insolvency framework could help firms recover more quickly. Bangladesh rose by eight places (to 168) in the 2020 Doing Business index, as reform momentum accelerated. However, Bangladesh still lags comparator countries in the following dimensions: enforcing contracts, trading across borders, paying taxes, and protecting minority investors. Strengthening the insolvency framework could also support a timely resolution of distressed debts. According to the most recent Doing Business report, it takes 4 years on average to seize collateral of distressed debtors, with a recovery rate of just 20 cents on the dollar. While an insolvency framework has been proposed, progress has been limited. An enhanced Bankruptcy Act would facilitate debt restructuring and resolution, especially for CSMEs, while streamlining loss recovery for lenders and enhancing credit market infrastructure to secure the rights of creditors and reduce lending risks.

Addressing banking sector vulnerabilities would support financial sector growth and increase access to credit. As a first step, a roadmap could be developed with a clear timetable to resolve NPLs, make additional loan loss provisions and capitalize banks. Reform priorities include a comprehensive review of banking sector assets, enforcement of loan classification standards, and recognition and loss provisioning for NPLs in line with international standards (including IFRS 9). Development of a strategy to enhance SOB governance could enhance their financial soundness and developmental impact, enabling countercyclical responses to market downturns. Bangladesh Bank has initiated amendments to the Banking Companies Act, and this legislation could include revised provisions on disclosure, governance of banks and SOBs, and the recovery and resolution framework. Strengthening the autonomy, regulatory framework, enforcement powers and supervisory capacity of Bangladesh Bank would further enhance governance of the sector. Finally, ending the interest rate ceiling would strengthen the banking sector and expand access to credit. The interest rate cap is likely to result in a decline in the supply and quality of credit, and profit margins in the banking sector may be eroded. This would in turn impact the banks' capital position with further negative spillovers on credit for trade and commerce. If spreads between deposit and lending rates remain constant, deposit rates will fall below inflation, which may also hamper deposit growth.

Bangladesh remains far from the productivity frontier and can achieve rapid productivity growth through global integration. Improved connectivity and logistics would strengthen resilience against shocks, while supporting integration into the global economy. The following special focus section identifies challenges and inefficiencies in these areas and the actions needed to overcome them.

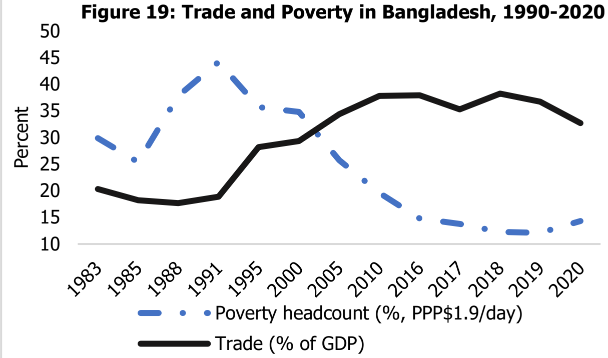
Moving Forward: Connectivity and Logistics to Strengthen Competitiveness[18]

The logistics sector can play an essential role in the recovery from the COVID-19 pandemic and and in building resilience against future shocks by improving Bangladesh's competitiveness. Efficient logistics reduce costs and delays for domestic transportation and exports, expediting imports of consumer goods and foreign inputs used in domestic production. Superior logistics performance offers a competitive advantage, increases production sharing across countries, and shortens product lifecycles. Despite some progress in improving its logistics performance, Bangladesh still lags its competitors, and many exporters report inefficient logistics as one of the key constraints to servicing the orders they receive (Lopez-Acevedo and Robertson, 2016). In the short-term, logistics reforms should focus on ensuring business continuity and building resilience in the aftermath of the pandemic. In the longer term, improving logistics performance would help Bangladesh maintain its position as a major player in ready-made garment (RMG) manufacturing as well as with diversification of its export basket. Efficient logistics and improved connectivity would help achieve a better allocation of production inputs across sectors, firms, and districts.

A. Setting the Stage: Trade and Logistics in Bangladesh

Trade is vital to Bangladesh's economic development. Although logistics has both a domestic and an international dimension, this section focuses on the role of logistics for external linkages given the importance of trade in Bangladesh's development. Over the last two decades, trade has registered a robust average growth rate of about 11 percent. Led by the RMG sector, exports have contributed to the country's remarkable growth by creating jobs and reducing poverty. Based on the international poverty line of $1.90 per person per day, poverty declined from 44.2 percent in 1991 to 12 percent in 2019 (Figure 19). As a result, Bangladesh reached the World Bank's threshold for lower-middle-income country status in 2015 and is on course to graduate from least developed country (LDC) status in 2026.

Figure 19: Trade and Poverty in Bangladesh, 1990-2020

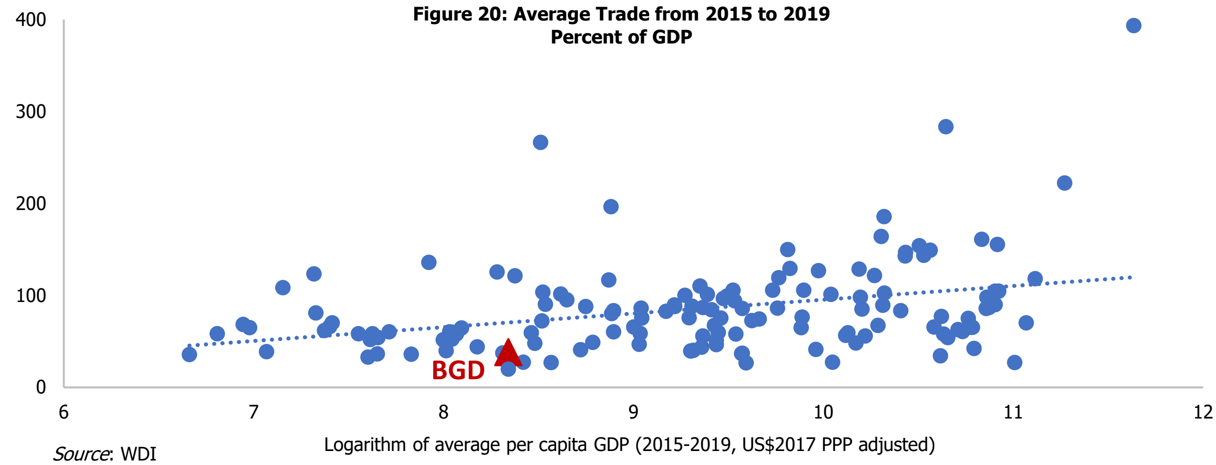


Source: WDI, PovcalNet and MPO (March 2021). FY20 trade to GDP ratio and poverty headcount rate are estimates.

[18] The special section is largely based on the report, "Moving Forward: Connectivity and Logistics to Sustain Bangladesh's Success" (Herrera Dappe et al 2020).

Despite robust trade growth over the past two decades, Bangladesh's trade remain relatively low as a share of GDP. At 15 percent of GDP in 2019 exports are low compared with the average of low-and middle-income countries (25 percent export to GDP ratio) and comparators such as Vietnam (106 percent). In fact, the ratios of both goods and services trade-to-GDP for Bangladesh were both below the benchmark for a country at its level of economic development (Figure 20). Bangladesh recognized the need to improve export performance in the Eighth Five-Year Plan (2021–26) which emphasizes a manufacturing-based, export-led strategy toward upper-middle-income status.

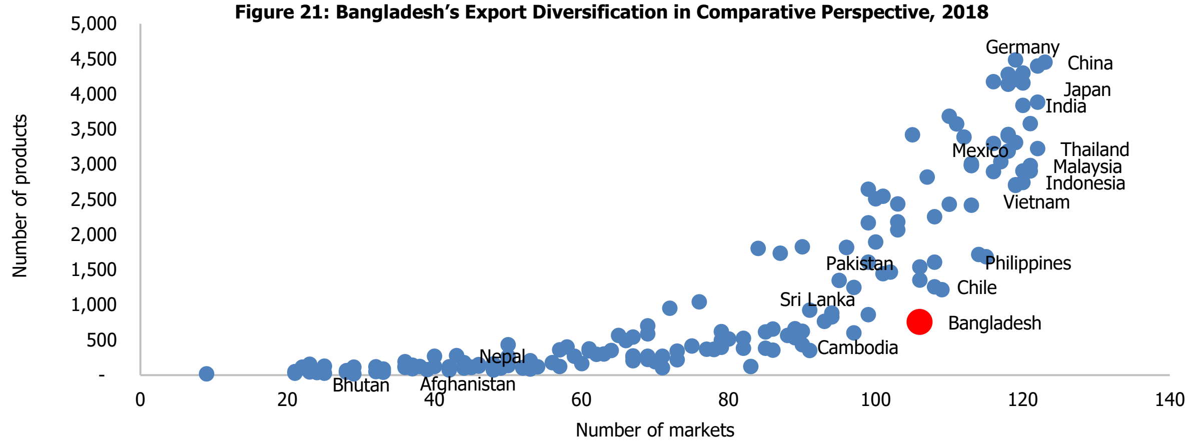
Figure 20: Average Trade from 2015 to 2019
Percent of GDP



Source: WDI

A highly concentrated export basked contributes to Bangladesh's relatively low exports. Bangladeshi exports are less diversified than those of peer countries such as Vietnam, Thailand, Malaysia, Indonesia, or the Philippines (Figure 21). Razzaque (2017) shows that Bangladesh's export basket is four times more concentrated than the developing country average and less diversified even compared with low-income countries. The current export basket is heavily dependent on RMG, which accounted for over 80 percent of all exports in recent years. Nearly all of the top 20 export products (at the Harmonized System (HS) 6-digit level) consist of RMG products. This strong reliance on RMG exports raises questions about the sustainability of

Figure 21: Bangladesh's Export Diversification in Comparative Perspective, 2018



Source: WITS

Bangladesh's growth model that is being challenged by the erosion of its traditional basis of export competitiveness based on low wages.[19] The Fourth Industrial Revolution (IR 4.0) is posing increasing challenges for Bangladesh's reliance on low labor cost but also presents opportunities for the manufacturing sector. Taking advantage of opportunities for diversification and upgrading export products will require a comprehensive approach that addresses the overall policy incentive environment while removing cross-cutting constraints such as logistics inefficiencies.[20]

Trade volumes declined sharply during the COVID-19 pandemic, negatively affecting firms in the logistics sector in Bangladesh. Exports fell by 16.8 percent in FY20 as external demand for RMG contracted sharply, while imports declined by 12.1 percent as industrial sector disruptions limited demand for intermediate goods and weaker private investment growth reduced demand for capital goods and machinery. Additional waves of COVID-19 in key export markets poses a continued risk to exports in FY21 (see Recent Developments). Lower trade and related business activities are expected to impact the short- and medium-term financial viability of logistics service providers. At the same time, economic recovery, especially among trade-oriented producers, requires continued availability of logistics services.

Nighttime lights visually demonstrate the impact of connectivity on economic development in South Asia. Nighttime lights closely trace the main highway network connecting cities in Bangladesh (Figure 22a) and illustrate the development of urban areas around Dhaka city following transportation infrastructure over the past decade. This data also alludes to the impact of limited international connectivity on spatial development. A clear line is visible between the high luminosity area around Kolkata (lower left corner of Figure 22a) and the cities of Kharagpur in West Bengal and Jessore in Bangladesh, which are just 68 km away.

Bangladesh lags its main competitors on measures of connectivity and logistics (Figure 22b). As of 2018, Bangladesh trailed India and Vietnam in every aspect of the Logistics Performance Index, especially in infrastructure and customs. Many garment firms report inefficient logistics as a significant share of logistics costs. Transport represents the largest share of direct logistics costs, and road transport is the dominant transport mode. Road transport rates in Bangladesh, which range from $0.06 for a 16-ton truck to $0.12 for a trailer (in per ton, per kilometer terms), are higher than in most countries, a primary constraint to exporting (Lopez-Acevedo and Robertson 2016). Logistics costs in Bangladesh are high in most sectors. Costs range from 4.5

[19] Recent studies show that over the last decade, the share of trade based on labor-cost arbitrage has declined. In labor-intensive goods, such as textiles and apparel, exports from low-wage to high-wage countries fell from 55 percent of all exports in 2007 to 43 percent in 2017. The decline in labor-cost arbitrage is partly due to the convergence of incomes across countries and the shift toward South-South trade (McKinsey 2019).

[20] World Bank (2021) *Bangladesh: Gearing up for the future of manufacturing.*

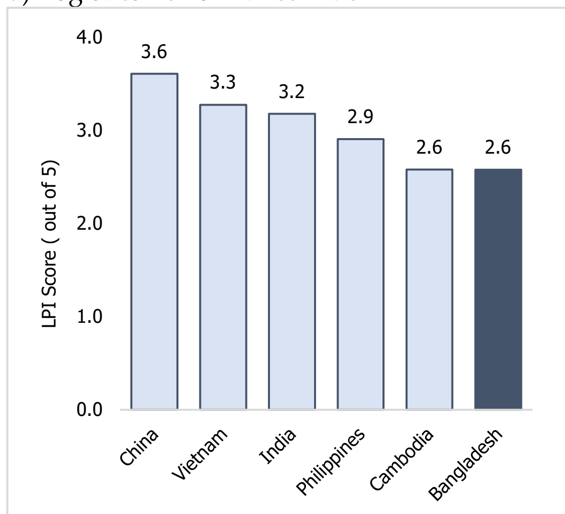
percent of sales for leather footwear to 47.9 percent of sales for horticulture. Inventory carrying costs[21] (in per ton, per kilometer terms), are higher than in most countries.

Figure 22: Bangladesh Logistics Performance

a) Nighttime lights in Bangladesh

Source: US Department of State Geographer.

b) Logistics Performance Index



Note: Most recent data is for 2018.
Source: World Bank

Congestion and delays are pervasive, from roads to seaports and land ports. If congestion on the roads was eliminated, logistics costs would be at least 7 to 35 percent lower, depending on the sector (Herrera Dappe and others, 2019). Beyond logistics costs, congestion accounts for almost 60 percent of the annual carbon dioxide ($CO2$) emissions from inter-district road freight transport, the social costs of which are estimated to be 1.2 percent of GDP. High dwell times (the amount of time which cargo or ships spend within a port), add to the high logistics costs. At the Chittagong Port, for example, average dwell times are 4 days for an export container and 11 days for an import container.

Mitigating congestion and unreliability is costly for shippers and service providers. Export-oriented industries and industries relying on imported inputs, such as RMG, footwear, and pharmaceuticals, need to maintain higher inventories (up to six months) to mitigate the impact of unreliable deliveries and longer lead times. Inventory carrying costs represent 17 to 56 percent of logistics costs, exceeding 30 percent of logistics costs in most industries. The share of inventory affected by inconsistent deliveries and congestion is very high, ranging from 53 to 75 percent across industries. To cope with unreliability and delays at ferry crossings, many truck operators

[21] Inventory carrying costs refer to the expenses related to holding and storing unsold goods. They are calculated based on the lead distances used to calculate transport costs, the inventory days used to calculate warehousing costs, the average waiting time at port for clearance, and the cost of capital in Bangladesh.

reportedly make "facilitation payments" amounting to 11 percent of operating costs, which are passed on to shippers.[22]

Bangladesh's logistics system is fragmented in terms of both infrastructure and services. The core infrastructure for all modes of transport is in place, but there is a lack of intermodal facilities. The multimodal facilities that do exist are poorly operated. Most logistics service providers are active in only one service category of logistics (Herrera Dappe et al 2020). Shippers typically work with more than one service provider to complete each shipment. Furthermore, service providers are characterized by low skills, poor quality of assets, and limited use of information technology (IT) tools (Herrera Dappe et al 2020).

A fragmented, ineffective, and outdated framework of governance over trade logistics in Bangladesh has led to inefficiencies and a lack of coordination in the sector. Nine ministries and more than 20 government agencies play roles in setting policies and regulations, planning, operating infrastructure, and providing services. The fragmented governance of the logistics sector exacerbates coordination problems. This has led to siloed development of transportation systems and basic mismatches of infrastructure standards among those systems, such as bridges that are narrower than approach roads. Sectoral policies are often made without considering potential negative effects on the overall logistics system. Customs policies that limit inland containerization provide a vivid example of this type of challenge. Customs allows only 37 commodities to be cleared outside the port. Companies are not allowed to open container freight stations at locations far from the Chittagong Port, and empty containers are treated as bonded goods. These policies have led to an increase in the number of vehicles on the roads, as 1.25 covered vans are required to transport the cargo in one 20-foot equivalent (TEU) container. This has also increased congestion inside the Chittagong Port, leading to inefficient port operation.

Logistics service markets in Bangladesh are not competitive. Although thousands of small operators provide trucking and inland water shipping services, drivers unions and owners' associations (or brokers related to them) set prices and control access to cargo, interfering with market mechanisms, and inhibiting full competition. The Competition Act aims to prevent collusion and price fixing through mechanisms such as bid rigging, control over the supply of goods or services, and abuse of dominant position. However, the Act has not yet been fully implemented, and the Bangladesh Competition Commission, which was established by the Act, still needs to become fully functional to execute its mandate.

The logistics sector suffers from outdated policies and regulations. Much of the legislation and regulations that govern transport and logistics services date back to the pre-independence period when the economy was mainly agricultural. A key weakness in the policy framework is an insufficient focus on services. Sectoral policies focus mainly on the development of infrastructure for various subsectors. By contrast, modern national-level policies in many other countries address upgrading infrastructure, integrating various modes of transport, and improving the

[22] Shippers and carriers in Bangladesh regularly make payments—at ports, ferry crossings, border posts, and weighbridge stations—to expedite the movement of their goods and vehicles and to get a cargo allocation. See World Bank (2019).

overall quality of services. Furthermore, the private sector has a minor role in the financing, management, and operation of infrastructure in Bangladesh. Restrictive policies on foreign private participation in the provision of logistics services is also harmful to the sector.

Improved logistics performance would strengthen the post-COVID-19 recovery through enhanced international competitiveness. A comprehensive approach could result in a meaningful impact on exports, contributing to Bangladesh's post-LDC graduation development targets. For example, reducing dwell times at the Chittagong Port by one day, increasing the minimum speed along national highways to 40 kilometers an hour, and implementing policies to tackle the low quality of logistics services, facilitation payments, and other inefficiencies could collectively reduce logistics costs for tradables by 26 percent and increase Bangladesh's exports by 19 percent (Herrera Dappe et al 2020).

B. Policy Actions to Increase the Efficiency of Bangladesh's Logistics Sector

Achieving efficient logistics requires a system-wide approach. A well-rounded system-wide approach should be guided by a logistics strategy focused on both infrastructure and services aimed at increasing logistics efficiency (Herrera Dappe and others 2019). The overarching goal of increasing logistics efficiency can be broken down into four interlinked objectives (see also Table 2 for a summary of the recommendations):

1. Developing a system-wide strategy aimed at increasing logistics efficiency
2. Improving the quality, capacity, and management of infrastructure
3. Improving the quality and integration of logistics services
4. Achieving seamless integration of regional logistics services

1. Developing a system-wide strategy for increasing logistics efficiency

A coherent, integrated logistics strategy would support increased efficiency. The strategy should ensure coordination among all public institutions involved in logistics and be co-developed with private sector shippers and logistics service providers. International experience has shown that inclusive institutional arrangements can facilitate multidisciplinary decision making in logistics. Such arrangements include logistics councils and committees made up of senior representatives of a wide array of public sector entities, such as mode-specific ministries; ministries of planning, industry, commerce/trade, agriculture, economy, and finance; customs administrators (often national revenue authorities); police and law enforcement agencies; governance and anticorruption agencies. They are chaired by the country's highest executive authority, such as the President or the Prime Minister. Logistics councils and committees can be particularly effective at: (a) coordinating interministerial priorities within budgetary, technical, legal, and other constraints; (b) monitoring the timely and cost-effective implementation of such priorities; (c) assessing systemwide performance improvements, by tracking selected key performance indicators; and (d) informing public policy through evidence-based research and consultations with concerned public and private parties.

A multi-modal transport and logistics master plan should be developed to inform policy makers about investments in transport and logistics infrastructure. Such a master plan should identify the mix of investments and policies that yield the greatest net benefits, considering all transport modes, both infrastructure and services, and the wider economic impacts of transport and logistics interventions. It should set measurable targets for progress to be continuously monitored. To continuously improve the logistics system, the public and private sectors need to collect and analyze data to monitor system performance looking at freight flows, logistics costs, infrastructure, services, and institutions. Policy makers would need to establish a national system for data gathering, monitoring, and evaluation of system performance. Establishing a logistics observatory—potentially in association with one or more academic institutions—linked to a logistics council or committee is one option for ensuring the sustainability of the effort.

2. Improving the quality, capacity, and management of infrastructure

Infrastructure investments should focus on service gaps instead of infrastructure gaps and should move away from the pattern of building infrastructure but neglecting its maintenance, and therefore rebuilding it later. Degraded transport infrastructure in Bangladesh reduces the capacity of the network and the quality of logistics services. Lack of proper maintenance also leads to higher capital investment needs. Passage of the Road Maintenance Fund Board Act and inclusion of maintenance in sectoral policies are steps in the right direction, but they are not enough. The government needs to ensure adequate funding for maintenance and implementation of similar policies that improve the quality of logistics services.

Improving service requires much more than just capital expenditure. Improving the operation of the Chittagong and Mongla ports and the Bangladesh Railway, for example, would expand their effective capacity. For example:

- *To handle the increased congestion at the Chittagong port, more inland container depots (ICDs) could be established*. At present there are 18 ICDs near the Chittagong Port, while one is close to Dhaka. Even though the port has been adding jetties and terminals to handle the growing container volume, more Inland Container Terminals and ICDs would relieve container congestion. To reduce the congestion at critical ferry ghats, platforms and tracking systems that inform truckers about the timing of the upcoming ferries and help them reserve spots for specific ferry times/slots could be put in place. While the opening of the Padma Bridge will shift the traffic from some of these ghats (like the Daulatdia-Paturia ferry), nodal ferry ghats will continue to stay important (for example, the Bhola-Lakshimpur ferry).

- *To address congestion, long-distance traffic could be separated from local traffic through the establishment of separate service lanes or slow-moving vehicular traffic (SMVT) lanes along key highways*. The GoB is already experimenting with such separate lanes on select regional corridors. However, a comprehensive policy framework for the development of these lanes needs to be developed. Moreover, the development of truck resting areas and designated loading and unloading areas at critical locations along freight corridors could play a significant role in relieving congestion on the road.

The logistics sector should address the effects of climate change. Large sections of the transport network are already exposed to natural disasters and it is expected that the frequency and the magnitude of extreme weather events will increase with global warming. It is therefore important to build connectivity infrastructure that will be able to withstand such events, especially flooding. Increasing resilience requires building climate-resilient infrastructure. The potential costs of disruption should be included in project cost-benefit analyses.

Policymakers should facilitate multimodal logistics. Locations for multimodal terminals with storage and handling facilities would need to be identified. Over time the terminals could be developed into logistics clusters or freight villages, which are commonly observed in the countries with the best logistics performance. Such cluster development would require close cooperation between the public and private sectors as well as with municipal authorities.

The regulatory framework and enforcement of laws must be strengthened. Some policies and regulations inadvertently end up increasing traffic on roads. Examples include policies that limit the inland use of containers and policies that favor road transport over other modes of transport. The government should ensure an equal operating environment for all modes of transport and align policies and regulations with the objective of improving logistics efficiency. In some cases, enforcement of laws and regulations could be strengthened. For example, axle-load regulations should be enforced more forcefully, as a lack of such enforcement is damaging roads. Overloading controls should be extended where available and established where they are not, through permanent weigh stations with weigh-in-motion capability.

The role of the private sector in the financing, management, and operation of infrastructure should be increased. The government has been unsuccessful in attracting private participation in transport infrastructure in part because infrastructure is not included in the list of permitted foreign investments. In addition, a private-public-partnership (PPP) framework remains to be developed to clarify the rules of engagement with the private sector for infrastructure investments. The absence of such a framework reduces private sector confidence about such projects. There is a need and an opportunity to rethink and improve the paradigm governing the provision of infrastructure services by allowing the private sector to play a larger role in the financing, management, and operation of infrastructure. The domestic capital market can also play a role in infrastructure and private sector financing. This would require advancement of the legal and regulatory framework as well as a streamlined tax framework to support development of new financing instruments and expanded corporate debt issuance through instruments such as green or infrastructure bonds, covered bonds, asset securitization, and mortgage refinancing. Issuance of foreign securities (including those from international financial institutions) in the local market and dual listing will also support investments mobilization and diversification and contribute to financial market deepening.

The COVID-19 pandemic demonstrated the advantages of moving from manual processes to automated solutions. UNESCAP (2020a) identified the lack of electronic processing systems as the single most critical constraint faced by the South Asian countries in facilitating cargo movement at ports, border stations, and logistic operations in the aftermath of COVID-19. Bangladesh's performance in terms of implementing measures for paperless trade has been below par so far. Enhancing digital connectivity and trade logistics in Bangladesh offers many opportunities. Digitalization of services, in particular logistics services and regulatory border controls, can reduce the cost of physical delivery, enabling previously remote areas or small producers and buyers to participate in trade. Coordination and exchange of data among public and private entities, for instance custom authorities and freight services, can facilitate the implementation of transit agreements. Digitization of customs management also helps increase transparency and reduce opportunities for corruption (OECD 2017).

3. Improving the quality and integration of logistics services

Logistics services can be upgraded by ensuring competition. If service providers are remunerated based on the quality of their services, they will be incentivized to increase the quality and innovate. Competitive markets for logistics services would provide adequate incentives for service providers to improve the quality of their services, invest in technology and equipment, and provide more integrated services to improve their efficiency. To achieve higher competition, the government could empower the Bangladesh Competition Commission that was established in 2016. Moreover, removing some of the constraints to the entry of foreign logistics firms would increase competition and raise the quality of service. The current regulations limit foreign firms from controlling the quality of the services they provide and the prices they can charge, setting high entry barriers that prevent the transfer of knowledge to local firms.

The outdated and patchy regulatory regime for logistics services need to be reformed. Numerous agencies regulate different aspects of the system. Some agencies issue directives that make the overall regime unpredictable and nontransparent. Basic principles should be adopted for regulating the sector, but regulation should be kept to a minimum and limited to issues related to safety and market failures. It is important to focus on improving road safety as it affects transport and logistics costs. Regulations should be easily accessible, simple, understandable, and consistent with transport and logistics policy goals. They should conform to bilateral, regional, and international agreements and offer clear guidelines and administrative structures for implementation and enforcement. For example:

- *The introduction of the new Customs Act (pending Parliamentary approval to replace the Customs Act 1969) would allow for improvements to support more efficient trading***.** Among the key elements in the Act are provisions requiring risk management as the basis of customs control, establishing the legal basis for electronic exchange of information, enabling better border agency coordination, and strengthening governance to ensure transparency and eliminate discretionary decision-making. Bangladesh Customs under the NBR has also taken up several modernization initiatives, including risk-based customs control, post clearance audit, pre-arrival processing, introduction of authorized economic operator, advance ruling, customs enquiry point and website amongst others.

- *There is considerable scope for streamlining import and export processes***.** While customs declarations in Bangladesh can be submitted and processed electronically, a substantial number of other documents need to be taken by hand to other agencies, then examined and approved before the goods are finally released. More than 38 government and private sector agencies as well as 13 ministries deal with trade facilitation. This inhibits trade and raise transaction costs, as the system is fraught with duplication and inefficiencies.

- *The bonded warehouse facility introduced in the RMG industry is a useful model for other sectors, but it is not provided in an inclusive manner.* The bonded warehouse facility has been extended to non-RMG exporters on a highly selective basis since 1993, but evidence shows that the system does not work as effectively as in the case of the RMG industry. One reason is that most of the instructions have been drafted to support the operation of bonded warehouses in the RMG sector. When they are applied to other sectors, the rules are often unfavorable and, in some cases, a barrier to seeking a bonded warehouse license. Providing a level playing field by extending an equal bonded warehouse facility to non-RMG exporters could result in an improved export performance and diversification. More recently, the NBR published information on the special bonded warehouse processes and rules on its website to provide greater transparency to firms interested in the system particularly from outside the RMG sector. However, the issuance of a revised bonded warehouse policy for non-RMG sectors has not yet been completed.

- *The overall process of obtaining a license and operating a bonded warehouse needs to be streamlined*. Even within the RMG sector, the process is cumbersome. The bonded warehouse system is based on a paper-based, manual system with complicated processes for licensing an entity and for seeking permission to imports intermediate goods. The authorities control every transaction, rather than relying on a risk-based and selective control mechanism. There is a significant amount of redundancy in documentation and data requirements (World Bank 2018).

More investment is needed in human resources, equipment, and facilities to enforce regulations. Solutions to promote consistent implementation, interpretation, and enforcement of regulations can generally be implemented in the short term. Interventions to reduce the incidence of facilitation payments take longer, given the strong behavioral component and the obvious entrenched interests. It would help to remove vagueness, ambiguity, and room for individual (especially idiosyncratic) discretion in regulations. Technology can help reduce corruption by limiting personal contact. Options include electronic issuance and payment of traffic violations, use of machines for vehicle fitness inspection, and electronic issuance of driver licenses and slots on ferries. Technologies such as blockchain can help reduce or even eliminate opportunities to tamper with the certification process.

Operators who meet specific criteria should be able to access bank financing. A common challenge faced by operators is the lack of financing from the banking sector that would allow them to scale up their operations. Because their assets are mobile, the transport and logistics services sectors are considered risky. Creating a business environment in which banks would accept movable assets as collateral—which should include creating a tamper-proof property registry, as the government is aiming to do—would be a step in the right direction. Across the world, countries have implemented schemes to modernize vehicles, vessels, and logistics services. Examples of fleet renewal policies include inducements offered in China, Germany, Jordan, Pakistan, and Turkey to encourage operators to purchase newer and more efficient truck fleets. The GoB could consider adopting similar policies.

4. Achieving seamless regional connectivity

Bangladesh should leverage its strategic location in South Asia to serve as a regional logistics node. Several recent developments in trade and transport raise the hope of enhancing Bangladesh's connectivity: (i) the almost-completed Padma Bridge will allow the establishment of an active link between Dhaka and Kolkata, which will be extended over time toward Myanmar and Southeast Asia more broadly; (ii) the envisioned Sylhet-Chittagong highway offers the prospect of connectivity to India's northeast and global markets; (iii) the Bangladesh-Bhutan-India-Nepal (BBIN) Motor Vehicles Agreement allows signatory countries to use each other's road networks for the transportation of goods and passengers. India and Bangladesh are also taking steps to reduce non-tariff barriers at the border crossing. Maximizing the benefits from these developments requires several measures like upgrading transport infrastructure, harmonizing regulatory regimes, and integrating customs and border management systems.

The COVID-19 pandemic has underscored the importance of regional cooperation and logistics coordination. The European Union, for example, implemented priority lanes for cross border freight transport at the onset of the crisis, while Eastern African Community countries directed member states to implement various transport-related measures to facilitate cross border goods flow (World Bank 2020, UNESCAP 2020). In South Asia, the outbreak of the pandemic led to uncoordinated border closures and additional controls and restrictions hampered the flow of freight. Preserving cross border connectivity is vital for the economic recovery.

Annex I - Bangladesh Macroeconomic Indicators

	FY15	FY16	FY17	FY18	FY19	FY20 (P)
GDP Growth Rates and Per Capita Income						
GDP Growth (percent, 2005-06 base year)	6.55	7.11	7.28	7.86	8.15	2.37
GDP Growth Per Capita (percent)	5.43	6.01	6.20	6.80	7.12	1.34
Per Capita GDP (current USD)	1,249.0	1,401.4	1,563.8	1,698.0	1,856.6	1,903.7
Per Capita GDP (USD, official estimate)	1,236.0	1,385.0	1,544.0	1,675.0	1,828.0	1,970.0
Per Capita GNI (USD, official estimate)	1,316.0	1,465.0	1,610.0	1,751.0	1,909.0	2,064.0
Per Capita GDP Atlas Method (USD)	1,149.7	1,294.6	1457.6	1,671.5	1,865.7	1,874.8*
Inflation						
Rate of Inflation (CPI, percent) (year on year)	6.4	5.9	5.4	5.8	5.5	5.6
Inflation (GDP deflator)	5.9	6.7	6.3	5.6	4.5	5.5
Saving & Investment (percent of GDP)						
Gross Domestic Saving	22.2	25.0	25.3	22.8	24.8	25.1
Private Investment	22.1	23.0	23.1	23.3	23.5	23.7
Of which: FDI	0.9	0.6	0.7	0.6	0.8	0.4
Public Investment	6.8	6.7	7.4	8.0	8.0	7.9
Central Govt. Budget (percent of GDP)						
Total Revenue	9.6	10.0	10.2	9.6	9.9	9.6
Total Expenditure	13.5	13.8	13.6	14.3	15.4	15.2
Overall Budget Deficit	3.9	3.8	3.5	4.7	5.5	5.6
Balance of Payments (percent of GDP)						
Trade (merchandize export + merchandize import)	35.0	33.1	31.0	32.9	31.4	25.8
Exports	15.7	15.1	13.6	13.2	13.1	10.1
Imports	19.3	18.0	17.4	19.9	18.3	15.6
Services & Income (net)	-3.1	-2.1	-2.1	-2.5	-2.0	-1.7
Current Transfers	8.1	6.9	5.3	5.6	5.6	3.4
Current Account Balance (including transfers)	1.5	1.9	-0.5	-3.5	-1.7	1.9
Public Debt and official reserves						
Total Debt as percent of GDP	31.8	31.5	30.8	31.9	33.2	37.6
External Debt (USD b.)	23.9	26.3	28.3	33.5	36.6	43.4
External Debt as percent of GDP	12.2	11.9	11.3	12.2	12.1	13.4
Gross Reserves (USD b.) (end of period)	25.0	30.1	33.7	32.8	32.7	36.0
Gross Reserves (in months of imports)	7.0	7.9	8.0	6.3	6.0	7.2
Money and Credit						
M2 Growth (percent, year-on-year)	12.4	16.3	10.9	9.2	9.9	12.6
Net Domestic Asset Growth (percent, year-on-year)	10.7	14.2	9.8	12.8	12.1	13.2
Ratio of Private Sector Credit to GDP (percent)	37.9	38.7	39.3	40.3	39.8	39.2
Ratio of Total Deposits (Time + Demand) to GDP (percent)	46.1	45.8	44.4	43.0	39.7	42.2
Exchange Rate						
Nominal Period Average (BDT/USD)	77.7	78.3	79.1	82.1	84.0	84.7
Nominal End of Period (BDT/USD)	77.8	78.4	80.6	82.8	84.5	84.9
Real Effective Exchange Rate-REER Index, 2010=100	119.5	132.2	138.3	132.3	139.6	146.5
Memorandum Items						
GDP at Current. Prices (BDT billions)	15,158.0	17,328.6	19,758.2	22,504.8	25,424.8	27,463.1
GDP at Current. Prices (USD billions)	195.2	221.4	249.7	274.0	302.7	324.2
Population (millions)*	156.26	157.98	159.69	161.4	163.0	170.3
Population Growth Rate	1.1	1.1	1.1	1.1	1.0	1.0

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