

# ***Bangladesh Economic Review***

## ***2019H1***

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# Economy at a Glance (FY19)

<b>National Income</b>		<b>Budget Detail</b>	
GDP growth (%)	8.13	Revenue (BDT bn)	3,166.3
Nominal GDP (USD bn)	302.43	Expenditure (BDT bn)	4,425.41
Per Capita GDP (USD)	1,827	Fiscal Deficit (% of GDP)	5.0
Per Capita GNI (USD)	1,909	Tax Collection (% of GDP)	12.50
<b>GDP Growth Drivers</b>		<b>Sovereign Rating</b>	
Agriculture growth	9.13%	Moody's	Ba3 (Stable)
Industry growth	17.61%	S&P	BB- (Stable)
Manufacturing growth	19.28%	Fitch	BB- (Stable)
Services growth	12.10%		
* Growth figures are in nominal terms			
<b>Foreign Flows (FY18)</b>		<b>Debt Profile</b>	
Net Foreign Direct Investments (USD mn)	1,583	Total Public Debt (% of GDP)	34.0
Foreign Portfolio Investments (USD mn)	365	Domestic Debt (% of GDP)	19.8
Foreign Exchange Reserves (USD bn)	32.94	External Debt (% of GDP)	14.2
Exchange Rate (BDT per 1 USD)	83.73		
<b>Inflation and Monetary Aggregates</b>		<b>External Sector</b>	
General Inflation (12-month average) (%)	5.47	Total Exports (USD bn)	40.54
M2 growth (%)	11.76	Total Imports (USD bn)	56.03
Private sector credit growth (%)	12.16	Total Remittance (USD bn)	16.42
Total Domestic credit growth (%)	15.12	Current Account Balance (% of GDP)	-1.71
<b>Major Exports (FY18)</b>		<b>Major Imports (FY18)</b>	
	<b>USD mn</b>		<b>USD mn</b>
Ready-made Garments	22,578	Industrial raw materials	25,583
Jute and Jute Products	906	Capital machinery & goods	14,556
Leather and Leather Products	709	Food grains & other food items	6,913
Fish, Shrimp and Prawns	499	Petroleum and fuel	4,017
<b>Social Indicators</b>		<b>Demographics</b>	
Literacy Rate (%)	72.76	Total Population (mn)	165.55
Poverty Rate (%)	24.3	Population growth rate (%)	1.17
Education Expenditure (% of GDP)	2.09	Total Labour force (mn)	63.5
Health Expenditure (% of GDP)	0.92	Unemployment Rate (%)	4.2

## Executive Summary

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Global growth has started to slow down going into the second half of 2019. The robust growth experienced up to the present time, driven by the global recovery is finally starting to lose momentum on rising trade risks, sluggish investment and rising debt levels. Slower-than-expected growth in several developed and emerging economies such as Euro area economies, China, India and Singapore pose key downside risks to global growth. The World Bank has downgraded global growth outlook for 2019 to 2.6%, which is 0.3% lower than previous forecasts.

The Bangladesh economy maintained its growth momentum in the first half of 2019, with the Bangladesh Bureau of Statistics (BBS) estimating provisional GDP growth of 8.13% for FY19. Growth momentum was supported by strong domestic and external demand. Remittance inflow picked up, with 11.3% growth in the second half of FY19 compared to the same period of FY18. The government's efforts to implement the mega projects underway picked up pace, boosting domestic demand. Industry saw high growth, while agricultural productivity picked up on back of bumper harvests further spurring economic activity. Exports registered growth of 6.8% in the second half of FY19 compared to FY18, while import growth remained unchanged in the first 5 months of FY19 compared to the same period of FY18.

12-month average general inflation remained subdued at 5.47% in June 2019, squarely within central bank target range of 5.30%-5.60%. Food inflation decreased from 6.21% in December 2018 to 5.54% in June 2019, helped by adequate stocks of food grains along with a bumper harvest in early 2019. Non-food inflation, on the other hand, witnessed a rise from 4.51% in December 2018 to 5.39% in June 2019. Prospects for food inflation remain muted in the future due to adequate stocks of food grains amid healthy harvests, but non-food inflation is likely to rise even further as hike in gas prices and introduction of VAT cause prices of goods and services to rise. Overall, inflation risks are tilted toward the higher side in coming months, but extensive government intervention is likely to keep inflation at around the 5.50% level.

Exports grew by 6.84% in the first half of 2019 compared to a year earlier. The depreciation of the BD, tariffs imposed on Chinese goods by the US and the completion of remediation works in the crucial RMG sector contributed to this rise. Export growth is likely to be continue to be robust for the coming months due to continuing trade tensions between the US and China.

Imports declined by 0.7% in the first six months of 2019 compared to a year ago. Depreciation of the BDT along with a slowdown in the government initiating new megaprojects caused import growth to slow down from the high rates seen in FY18.

Remittance levels bounced back in the first 6 months of 2019, growing by 11.28% over the same period of the previous year. Factors contributing to this increase were the depreciation of the BDT, larger number of workers going abroad in recent years as well as better fiscal conditions in the destination countries where a majority of workers go to..

The exchange rate depreciated by 0.72% in the first six months of 2019. The current account deficit stood at USD 5.18 billion in June 2019. However, the overall balance of payments recorded a surplus of USD 184 mn in Q3 of FY19, which reflects a somewhat improved outlook for the BDT. Any capital account inflows, such as foreign direct investment (FDI) or foreign loans would further reduce the pressure on the BDT.

Domestic liquidity conditions tightened further in the first 6 months of 2019 due to increased public sector credit growth amid lukewarm increase in broad money growth. Public and private sector credit grew by 42.47% and 12.16% respectively, for an overall growth in domestic credit of 15.12%. Broad Money (M2) growth recovered gradually to reach 11.76% while reserve money growth spiked up to 16.41% in May 2019 on back of increased government borrowing. Interest rates increased gradually in the first six months of 2019. Deposit rates stood at 5.42% in April 2019 while lending rates stood at 9.50% in April 2019.

# Global Outlook: Global growth slowing amid trade tensions

After a period of robust growth, global growth has started to slow down amid heightened risks to international trade. Investment growth in both emerging and developing economies remains sluggish, while rising trade barriers, increase in sovereign debt and slower-than-expected growth in several major economies pose key downside risks to the global growth outlook for the near future.

The World Bank downgraded global growth outlook for 2019 to 2.6%, which is 0.3% below the previous forecast, due to weaker-than-expected international trade and investment. Growth is estimated to gradually rise to 2.8% by 2021, assuming continued benign conditions in international financial markets and recovering emerging and developed economies. However, sluggish investment caused by heightened trade tensions and tariffs pose a key threat to recovering economies.

Growth momentum in the US continued to be boosted by government spending and corporate tax cuts, but momentum has started to weaken. US growth is forecast to slow down to 2.5% in 2019 and further decelerate to 1.7% in 2020 and 1.6% in 2021, as the effects of the fiscal stimulus recede. Continued trade tensions with China, along with weaker global growth outlook has led the Federal Reserve chairman Jerome Powell to signal a 0.25% cut in benchmark interest rates at the end of July. The S&P 500 consequently hit a record high, breaking the 3,000 level for the first time in history, based on expectations on lower interest rates. Rising trade uncertainty and high valuation levels continue to pose key risks to the US financial system.

Economic conditions in the Euro area have slowed down rapidly since mid-2018, led by a decline in the manufacturing sector on back of decline in exports, especially to China and the Europe and Central Asian regions. Domestic demand has also decreased, though declining unemployment and positive real wage growth has stemmed the decline to a certain extent.

Chinese growth is stabilizing following several quarters of deceleration, supported by monetary and fiscal stimulus. Growth is projected to decelerate from 6.6% in 2018 to 6.2% in 2019, reflecting a slowdown in trade and manufacturing due to tariffs imposed by the US on Chinese exports.

Despite increased tensions in the Gulf region, oil prices have remained subdued on back of increased production in North America and decreased demand due to slowing international trade. Brent crude prices have hovered between USD 70 and 60 per barrel in the first half of 2019.

Chart: GDP Growth - World

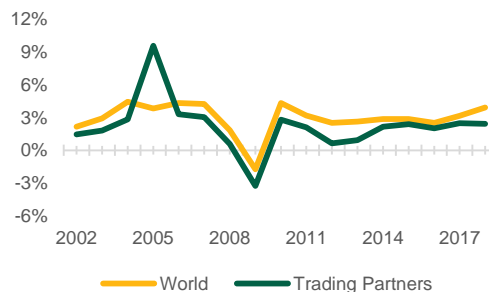


Chart: GDP Growth - Advanced Economies

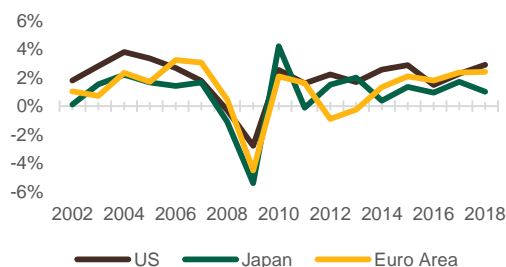
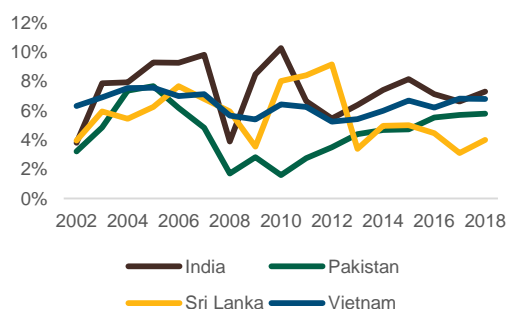


Chart: GDP Growth - Regional Peers



The Bangladesh economy maintained its momentum in the second half of FY19, recording provisional growth rate of 8.13%, which was 33 basis points greater than the 7.80% budget target. Growth momentum was supported by strong domestic and external demand. Remittance inflow picked up, with 11.3% growth in the second half of FY19 compared to the same period of FY18. The government's efforts to implement the mega projects underway picked up pace, boosting domestic demand. Industry saw high growth, while agricultural productivity picked up on back of bumper harvests further spurring economic activity. Exports registered growth of 6.8% in the second half of FY19 compared to FY18, while import growth remained unchanged in the first 5 months of FY19 compared to the same period of FY18.

12-month average CPI inflation reached 5.47% in June 2019, which was just under the FY19 budget target of 5.50%. 12-month average food inflation came down to 5.54% in June 2019 from a high of 7.30% in February 2018. This was achieved due to bumper rice harvests pushing the price of rice down. On the other hand, non-food inflation is on a rising trend, reaching 5.39% in June 2019 from a low of 3.50% in December 2017. Gradual depreciation of the BDT has led to higher prices for imported goods, consequently driving non-food inflation. Looking forward, the increase in gas prices is likely to lead to continued increase in non-food inflation in the upcoming months.

The strong remittance inflows, coupled with growth in exports and moderation in import growth in Q3FY19 contributed to the narrowing of the current account deficit to USD 936 million. Strong FDI and Medium and Long-term loan inflows boosted the capital and financial accounts for an overall balance of payments surplus of USD 184 million. Despite the slight balance of payments surplus, the BDT depreciated slightly against USD to reach BDT 84.5 per USD in June 2019.

Looking forward, favourable growth prospects are expected to continue due to solid domestic demand, pickup in exports due to the trade war between the US and China and inflation kept under control. However, global slowdown in growth, increasing trade related tensions, tighter liquidity conditions in the domestic money market and rising NPLs in the domestic banking system pose key downside risks to continued growth.

Chart - Bangladesh GDP Growth and Inflation

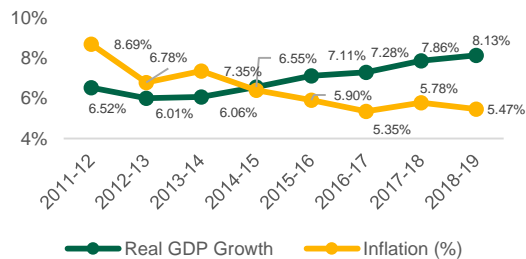


Chart: Evolution of Per-Capita GDP and GNI of Bangladesh (USD)

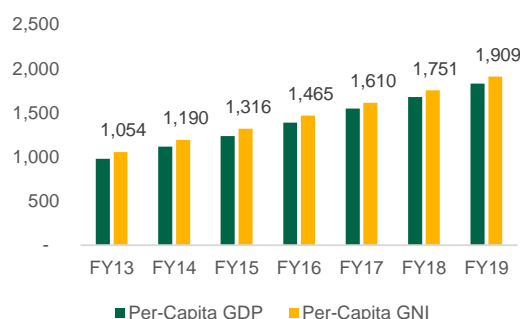
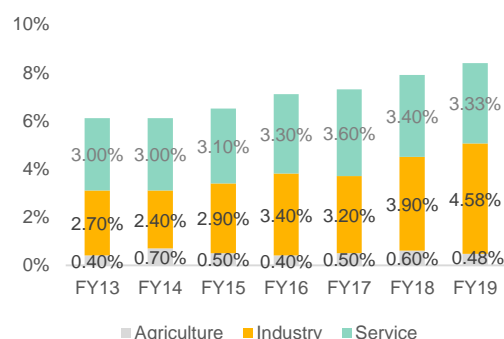


Chart: Sectoral Contribution to GDP Growth



**12-month general CPI inflation gradually came down from 5.51% to 5.47% in the first six months of 2019.** General inflation for April, May and June was 5.47%, 5.48% and 5.47% respectively. Food inflation fell in the first 6 months of 2019, from 6.21% in December 2018 to 5.54% in June 2019. The fall in food inflation was due to bumper food grain harvests easing the supply situation. Non-food inflation, on the other hand, witnessed a rising trend in the first 6 months of 2019, rising from a level of 4.51% in December 2018 to 5.39% in March 2018. Increase in price of gas along with introduction of VAT is likely to lead to higher non-food inflation starting from July 2019 and continuing thereafter.

The Monetary Policy Statement for H2FY19 set the inflation projection at 5.30%-5.60%. The actual inflation rate of 5.47% is within the targets, indicating that the central bank has succeeded in meeting its inflation target. The H1FY20 MPS is due to be released at the end of July 2019, and is likely to continue the same cautious policy stance and rates of the previous Monetary Policy Statement.

The outlook for food inflation continues to remain muted, as flooding caused by seasonal monsoon rains have been limited and have occurred after harvest of the main rice crop. Stocks of food are also adequate, with the government exploring options for export of rice and therefore the chances of rise in prices of rice is muted.

The outlook for non-food inflation, on the other hand, is biased towards the upside. The government has raised gas prices by an average of will have a ripple effect in increasing non-food inflation rates. Depreciation of the BDT is also likely to increase costs of imported goods, which is likely to increase non-food inflation.

General inflation is expected to remain around 5.50% as restrained food inflation offsets rising non-food inflation.

Chart: Inflation

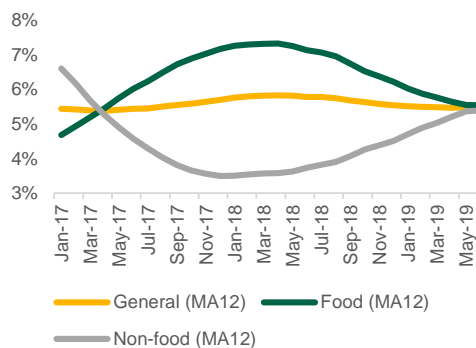
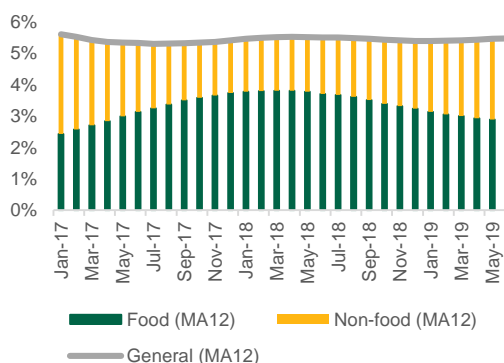


Chart: Relative Contribution of Food & Non-food inflation



# Money and Credit: Public sector credit shoots up to 43% in May-19

**Reserve Money (RM) growth spiked up to 16.41% in May 2019 while Broad Money (M2) growth rose gradually to 11.76%.** Domestic credit growth spiked up to 15.12% in May 2019 as increased government borrowing led to public sector credit growth of 42.47%. Private sector credit growth also started to recover to reach 12.16% for a total domestic credit growth of 15.12%.

Private sector investment started to pick up in FY18, driving private sector credit growth to a record 16.94% in FY18, exceeding the central bank target of 16.90%. The central bank subsequently reduced the Advance-to-Deposit ratio (ADR) of banks in order to restrain the private sector credit growth. This led to private sector credit growth coming down to 13.20% in December 2018, well below the central bank target of 16.80%. Private sector credit growth continued to decline due to tight liquidity conditions, coming down to 12.07% in April 2019. Private sector credit growth saw a slight recovery to 12.16% in May 2019.

Public sector credit growth saw sharp rise since April 2018, to stand at 42.47% in May 2019. Public sector credit growth had been backsliding since FY15 due to the government's reliance on National Savings Certificates (NSCs) instead of bank borrowing to finance its operations. NSC instruments offer a guaranteed fixed interest rate which is higher than rates available for deposits in banks and financial institutions. However, the government has introduced online management system for NSC sales to cut down on individuals or corporations buying more than the maximum ceiling. This led the government to sharply increase its borrowing from the banking system since the end of 2018. This growth in public sector credit growth is set to continue as the government borrows additional money in order to finance its infrastructure projects.

Net Foreign Assets (NFA) growth stood at -3.54% in April 2019 due to the current account deficit constraining growth in foreign exchange reserves. Net Domestic Asset (NDA) growth stood at 13.39% in April 2019, due to domestic credit growth of 13.62%. Until the current account deficit is reversed, NFA growth is expected to remain low, and lead to tightened monetary conditions.

Chart: M2 & RM Growth

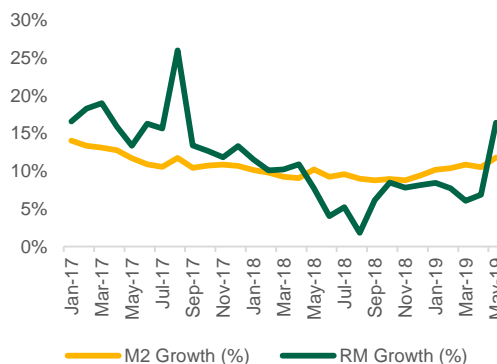


Chart: Public & Private Credit Growth

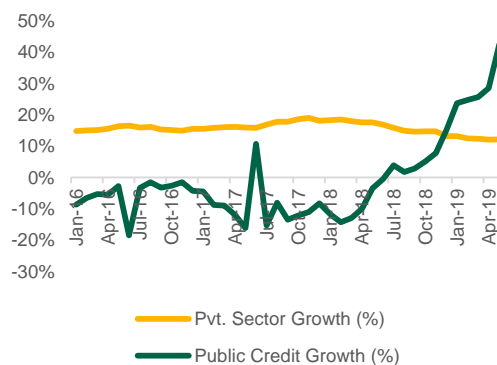
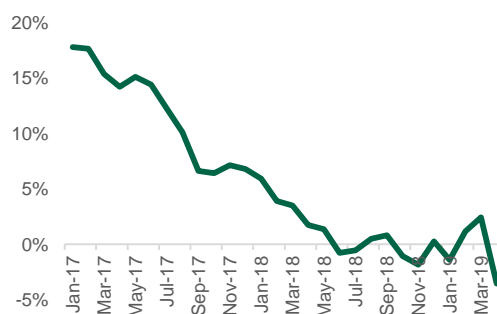


Chart: NFA Growth



# Interest Rates: *Interest rates on the rise amid tight liquidity conditions*

Interest rates continue to rise gradually due to an ongoing liquidity crunch in the financial system. Deposit rates are rising gradually, from 5.25% in October 2018 to reach 5.42% in April 2019. Lending rates stayed stable at the 9.50% level in the first six months of 2019. Bank interest rates has been on a declining trend for the past 6 years, with lending rates coming down from 13.75% in June 2012 to 9.47% in October 2018. However, that trend has started to reverse as excess liquidity in the banking system has been extinguished by strong private sector credit growth and a high current account deficit in FY18. However, there has been some relief on the liquidity situation due to the reduction in current account deficit in FY19, and any further reduction in the current account deficit might cause the liquidity crunch to ease. Interest rates are likely to stay at current levels for the near future.

The spread between deposits and advances have continued their downward trend in the first quarter of 2019. The spread reached a record low of 4.04% in April 2019. The decreasing spread is due to increased competition between lenders and greater operational efficiencies. Going forward, the spread is likely to have reached a bottom and is likely to remain at around the 4% range for the next few months.

Call money rates remained in the 4.50%-4.60% level in the three months ending June 2019. The increasing trend in call money rates is a result of tighter liquidity conditions in the money market. Call money rates could have been even higher if not for the intensive surveillance by the central bank which constrains banks and financial institutions from relying too much on this financing source.

The yield curve in May 2019 shows that yields for all maturities increased against one year ago, reflecting the short term liquidity pressures. The yield curve is likely to persist at current levels as higher domestic credit growth is balanced by an improving current account balance.

Chart: Avg. Deposit and Lending Rates of Banks

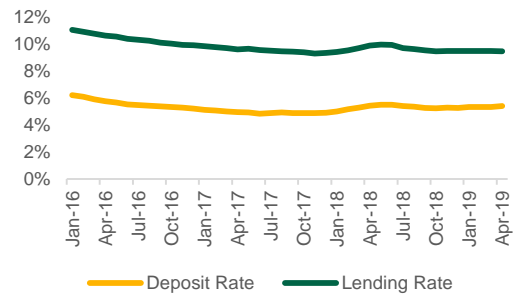


Chart: Call Money Rates



Chart: Treasury Yields (Y-o-Y)

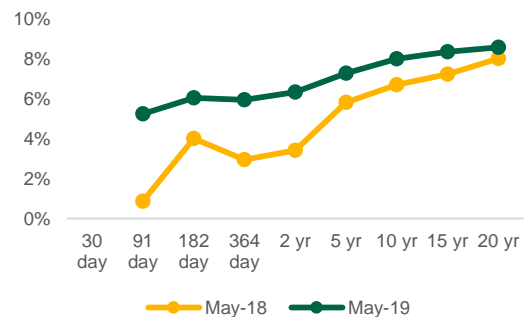
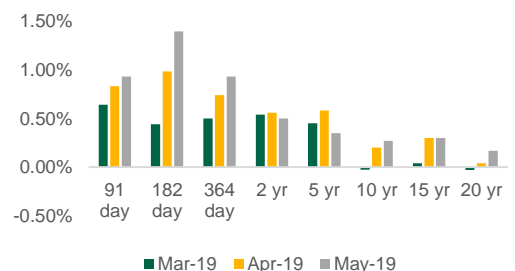


Chart: Monthly Evolution of Treasury Yields



## External Sector: Exports and Remittance bounce back while Imports restrained

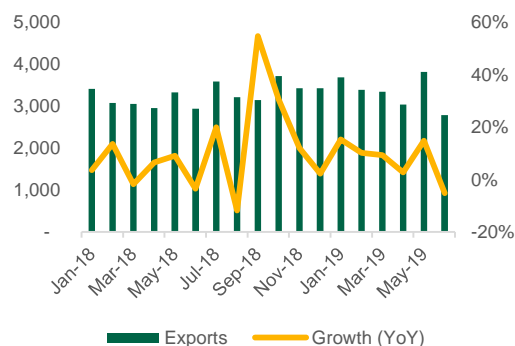
**Exports for the first six months of 2019 totalled USD 20 bn, a 6.84% growth over the same period of 2018.**

Monthly export growth for the Apr-Jun period of 2019 stood at 2.69%, 14.78% and -5.27% respectively. A few favourable factors led to the increase in exports. The depreciation of the BDT led to exports becoming relatively more competitive in export markets, while additional US tariffs on Chinese exports opened up an opportunity for Bangladeshi exports to the US. Favourable world economic growth also contributed to increasing demand for exports, while the completion of the RMG factory remediation works ensured that Bangladeshi exporters were able to take full advantage of the opportunity. Looking forward, with US purchasing managers looking to increase sourcing from Bangladesh, exports are expected to continue to grow, especially to non-traditional markets such as Japan and India. Given the imposition of new additional tariffs on Chinese exports by the US, the trade war looks set to continue for the rest of 2019, which boosts export prospects.

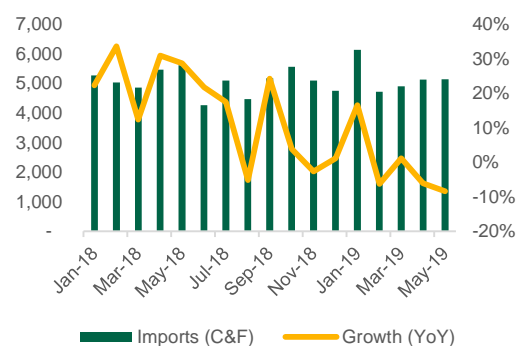
Imports saw a slight decline of 0.7% in the six months up to June 2019 compared to the same period in 2018. Monthly import growth for the Mar-May 2019 period stood at 1.07%, -6.12% and -8.45% respectively. The restrained import performance can be attributed to the depreciation of the BDT, causing imports to be relatively more expensive. At the same time, bumper rice harvests have resulted in reduced requirement to import food grains, while reduction in international oil prices have reduced the fuel import bill. The government has also restrained its appetite for mega-projects in the FY19 budget, choosing to focus on finishing the existing projects rather than starting any new ones. The combined effects of the above factors have resulted in a slowdown in imports, thus reducing the pressure on the current account.

Remittance levels have bounced back since November 2018, growing at an average of 11.28% in the first 6 months of 2019. Monthly remittance growth levels for the 3 months ending June 2019 stood at 8.05%, 18.41% and -0.97% respectively. The main drivers of the increased remittance levels were depreciation of the BDT, greater numbers of workers going abroad and better fiscal conditions in the destinations countries. Looking forward, stable oil prices, and continuing growth in workers going abroad is expected to lead to increasing remittance levels.

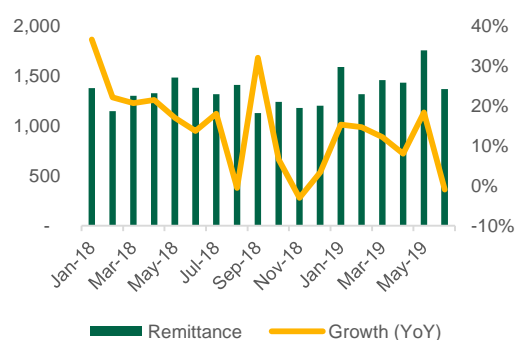
**Chart: Monthly Exports (USD mn)**



**Chart: Monthly Imports (C&F)**



**Chart: Remittance**



# Exchange Rate: *BDT depreciates by 0.72%, forex reserves stable at USD 32.3 billion*

**BDT depreciated 0.72% in the first six months of 2019, from 83.9 per USD in December 2018 to 84.50 in June 2019.** The depreciation was due to the persistent current account deficit, which increased from USD 3.08 bn in December 2018 to USD 5.18 bn in May 2019.

Bangladesh Bank has been providing support to the BDT, injecting USD 2.3 bn in FY18 and a further USD 435 mn in the first four months of FY19, which has reduced volatility in the foreign exchange market. Although the monetary policy statement for H2FY18 mentioned increasing exchange rate flexibility, in reality the central bank has often intervened in the market to keep the BDT stable. The central bank is likely to continue supporting the exchange rate in coming months, but the task is expected to get easier given the alleviation in the overall balance of payments.

Among peer countries, the Pakistani Rupee (PKR) has seen the highest depreciation owing to a balance of payments crisis, depreciating by 32.67% since October 2018. The CNY and INR both recovered their value to some extent in early 2019 after having undergone depreciation in 2018. The INR and CNY stayed stable at INR 68.95/USD and CNY 6.87 per USD at the end of June 2019.

Foreign exchange reserves of Bangladesh has been under strain due to a continuing current account deficit, which has seen forex reserves come down from a level of USD 33 bn in June 2018 to USD 32.3 bn in June 2019. The forex reserve has been fluctuating between USD 31-32 bn for the past six months. Due to a narrowing current account deficit and a depreciating exchange rate, the forex reserves are likely to stay at the USD 31-32 billion range for the next few months.

Chart: BDT/USD Exchange Rate

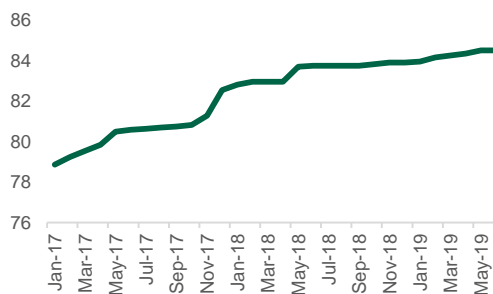


Chart: Peer Currencies vs USD (Rebased)

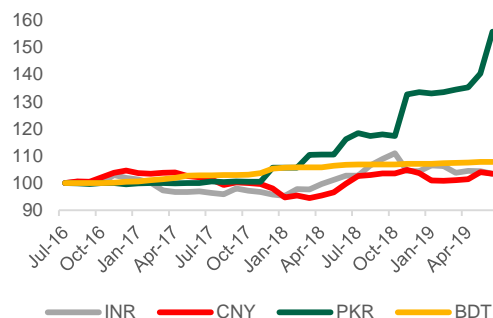
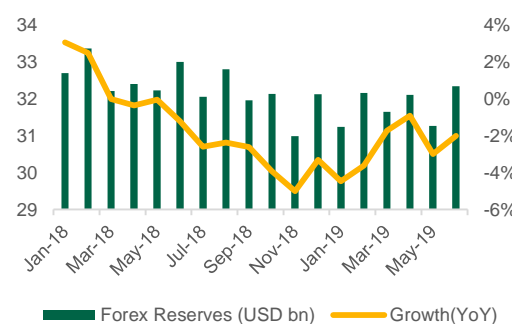


Chart: Foreign Exchange Reserves (USD bn)



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