ISAS Brief

No. 87 – Date: 25 November 2008

469A Bukit Timah Road
#07-01,Tower Block, Singapore 259770
Tel: 6516 6179 / 6516 4239
Fax: 6776 7505 / 6314 5447
Email: isassec@nus.edu.sg
Website: www.isas.nus.edu.sg

Global Economic Slowdown: Can Bangladesh Remain Resilient?

M. Shahidul Islam[*]

The financial crisis that originated in the United States and Europe is now hurting the real economies, and the crisis has spread to most parts of the world. Virtually no country has been spared from the shock, apart from countries such as Zimbabwe and Myanmar which are highly isolated from the global economy. Many developing countries, including Pakistan, have had to seek the International Monetary Fund (IMF) bailout to weather the external shocks. The Bangladesh economy, which is moderately integrated[1] with rest of the world, has shown significant resilience in the wake of the global economic crisis. The country's key macroeconomic and financial variables, particularly gross domestic product (GDP) growth, balance of payment, broad money, credit growth, exchange rate, remittances and foreign exchange reserves, registered either a positive growth or showed minimal fluctuations in recent months vis-à-vis the preceding period. Nevertheless, the economy still faces a double-digit inflation.

This brief looks at Bangladesh's ability to weather the global economic slowdown. At the same time, it assesses the ability of the economy to maintain its growth momentum in the face of the external shocks.

In some ways, the financial crisis has been a boon for the Bangladesh economy. First, let us look at the impact of the financial crisis on commodity prices and inflation. Following the financial crisis, the fall in actual demand and market speculations have lowered commodity prices. Since the Bangladesh economy depends on external markets for many food and non-food commodities, the imported inflation has been declining in the country, albeit not at a dramatic pace. The price difference of commodities between the international and domestic market remains high due to the sticky nature of prices. The point-to-point inflation that reached 11.59 percent in December 2007 has come down to 10.19 percent in September 2008.[2]

---

[*] Mr Mohammad Shahidul Islam is a Research Associate at the Institute of South Asian Studies, an autonomous research institute within the National University of Singapore. He can be reached at isasmsi@nus.edu.sg.

[1] One of the determinants of an economy's integration with the rest of the world is Trade-GDP ratio. For Bangladesh, the ratio is 45 per cent (World Trade Organization, available at http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=BD, accessed on 20 November 2008. Moreover, millions of Bangladeshis work abroad, and the remittances are the second-most important determinants of the country's current account after trade.

[2] Governor Secretariat, Bangladesh Bank, Dhaka, 19 November 2008.

The external shocks generally emanate through equity markets and trade channels that are being captured broadly in a country's current account balance. As foreign equity investment accounted for only three to four percent of market capitalisation, the shocks through the stock markets in Bangladesh have been limited. The index in Dhaka Stock Exchange, the country's major bourse, declined 12.62 percent in November 2008, compared to June 2008.[3] As the major Asian bourses are in a free fall, the money is moving to the United States in search of a safe haven. Nevertheless, some funds are now looking for opportunities in economies such as Bangladesh which have shown less volatility in the wake of the financial crisis and offer growth potentials. For instance, Sweden's largest hedge fund manager, Brummer & Partners, plans to grow the fund in Bangladesh by about US$500 million in the next five years, from its current US$53 million.[4]

The Bangladeshi banks and other financial institutions had limited exposure to banks and investment firms in the United States and Europe. As a result, the country's banking sector is largely insulated from the banking sector troubles in the West. Nevertheless, these also show that Bangladesh's financial sector is still highly autarkic.

Bangladesh's external sector has maintained a positive growth when most economies have experienced a contraction of trade and of other sub-sectors in their current accounts. The growth in Bangladesh's imports and exports has been positive. The textile and readymade garments (RMG) sector which drives the country's exports has not, to-date, been affected by the recessions in the United States and Europe. This is reflected by the fact that knitwear garments received roughly 12 percent higher export orders in October 2008 than the corresponding period last year.[5] The textile and the RMG sector grew by 42.9 percent in August 2008 vis-à-vis the corresponding period last year.[6]

The current economic crisis in the United States has increased the demand for Wal-Mart products as consumers switch from high-end fashioned clothes to low-end apparels. Wal-Mart, one of the world's largest retail shops, procures roughly US$1.7 billion worth of apparel products from Bangladesh every year.[7] Bangladesh's labour cost is one of the lowest in the world. Similarly, IKEA, a Sweden-based international home products retailer, plans to raise its purchases from Bangladesh, mainly home textiles.[8] It is expected that demand for Bangladesh's RMG is not likely to fall, if not increase, during this downturn period, owing to the 'Wal-Mart' effect.

Wage earners' remittances, which are the second-most important foreign exchange earners in Bangladesh, registered 17.34 percent growth in October 2008, compared to the corresponding period last year.[9]

As a result, the country's current account posted a surplus worth of US$672 million in FY2007-08, and it is projected that it will maintain a surplus, though in a relatively lower margin, in the period on July-August 2008-09.[10] The reason for this is that Bangladesh's

---

3 AT Capital Weekly Update, Asian Tiger Capital Partners, Dhaka, 16 November 2008.
4 www.bloomberg.com, accessed on 19 November 2008.
5 AT Capital Weekly Update, Asian Tiger Capital Partners, Dhaka, 16 November 2008.
6 Ibid.
7 http://www.tg-supply.com/article/view.html?id=26524 , accessed on 20 November 2008.
8 The Daily Star, 20 November 2008.
9 Governor Secretariat, Bangladesh Bank, Dhaka, 19 November 2008.
10 Ibid.

import payments have registered a much higher growth than exports in recent months. As a result, its foreign exchange reserves reached US$5,095.57 million on 18 November 2008, which was slightly higher than the corresponding period last year, though it reached US$6,148.82 million in June 2008.[11]

The strength in the current account balance and foreign exchange reserves are reflected in the country's exchange rate which faces virtually no pressure unlike many of its South Asian neighbours. In recent months, most South Asian currencies, particularly the Indian Rupee and the Pakistani Rupee, have witnessed a free fall, whereas the Bangladesh Taka has remained stable against the United States dollar, and it has experienced modest to significant appreciations vis-à-vis some major currencies, including the Euro, the Pound Sterling and the Singapore dollar.

Further, as the oil and other commodity prices have declined significantly, the authorities in Bangladesh are under less pressure to continue accommodative monetary policies and expansionary fiscal measures so that the economy maintains the target GDP growth without worsening its inflation. According to the Bangladesh Bank, the central bank of the country, the Bangladesh economy grew at 6.63 percent, 6.51 percent and 6.20 percent respectively in FY2005-06, FY2006-07 and FY2007-08.[12] The same source projects that the economy will grow at 6.50 percent in 2008-09, while the IMF, Citigroup and the Economist Intelligence Unit's forecasts have shown that the country's GDP growth will slow down to 5.5 percent, 5.7 percent, and 5.5 percent respectively.[13]

Can Bangladesh Remain Resilient?

The above data and analysis show that Bangladesh has been coping well with the current global economic crisis. The question is whether the economy is able to maintain its growth momentum in the coming months. What are the downside risks for Bangladesh?

As the financial crisis turns into an economic shock, the Bangladeshi economy's resilience will depend on a few factors.

The first factor is the outlook of the country's export sector. Bangladesh exports low-end labour-intensive manufacturing products and they are mostly related to people's basic needs such as apparel, frozen food and pharmaceuticals. A significant demand contraction for these products is less likely.

Secondly, the vulnerability in the country's current account will also depend on the inward flow of remittances. The lion's share of its remittances comes from the Middle East, followed by the United States. It is expected that the flows of remittances from the United States will slow down. However, the pace of inflows from the Middle East will depend on the stabilisation of crude oil prices. If China implements its new stimulus package and developing Asia maintains its growth momentum, the current oil price drop may see a trend reversal. Even if oil prices consolidate to below the US$50 mark, it would help Bangladesh's

---

11 Ibid.
12 Ibid.
13 AT Capital Weekly Update, Asian Tiger Capital Partners, Dhaka, 16 November 2008, and Economist intelligence Unit.

balance of payments, as import payments are also expected to fall in line with the drop in oil price.

However, the Bangladesh Bank should monitor the country's exchange rate movements. As its major export competitors experience a sharp drop in the value of their currencies, a significant appreciation in the Bangladesh Taka may erode the country's competitiveness to some extent, though it must be noted the exchange rate is not the sole determinant of a country's export competitiveness. Further, though the currency appreciation is not highly inelastic to remittances, significant appreciations in the Bangladesh Taka could affect the remittance flows moderately.

The domestic factors concerning the downside risks of Bangladesh's growth are no less important than the external dynamics. Natural calamities and political unrests are the two critical issues that could destabilise the growth. If a new democratic government takes over in early 2009 following the parliament elections, the political uncertainties could contract significantly. If so, the country could receive sizeable foreign direct investment (FDI) flows – these are currently very low. FDI projects that are in the pipeline also seek a stable political environment in the country.

Natural disasters that often cause crop failure and infrastructure damage in Bangladesh are persistent risks and these are very difficult to predict.

Private consumption is the main driver of growth in Bangladesh. As long as the global economic crisis does not deteriorate further, it is very likely that Bangladesh will remain resilient and will be able to maintain a six per cent GDP growth rate in the short-run.

Bangladesh's resilience and some South Asian economies' vulnerability in the wake of ongoing economic shocks are hardly surprising. The country has one of the highest trade-GDP ratios in the region and it remains a low-cost producer of low-end manufacturing output. Its financial system is rather protected through various measures. As a result, the economy has bilssfully avoided the shock that has emanated through the global equity markets. External shocks that originate through trade, remittances and other components of current account are generally less vulnerable and take substantially longer time to have an impact. Moreover, policy makers get enough room to fine-tune macro-economic variables to weather the current account shocks.

oooOOOooo