LightCastle Economic Update

LightCastle Research and Analysis Wing

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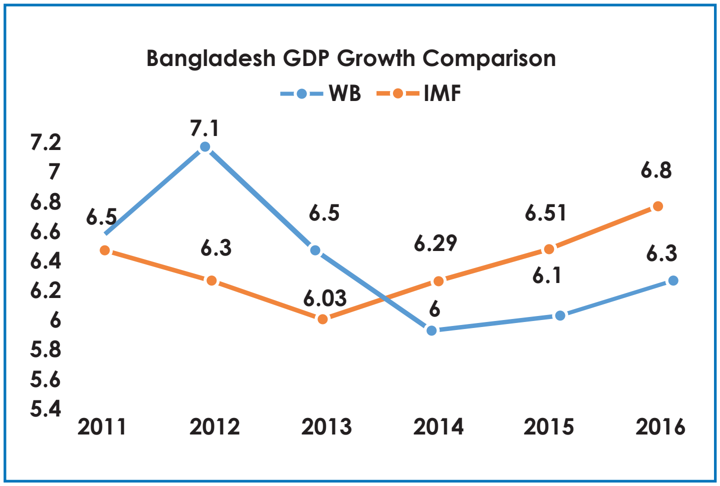
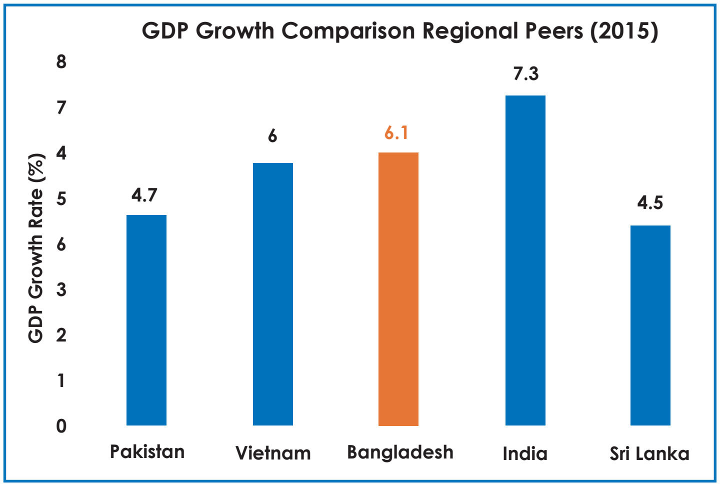
Bangladesh economy has exhibited impressive growth over the last decade despite myriad challenges. Rising GDP and stagnating population growth have contributed to rising per capita income, exceeding lower income threshold. Growth prospects for 2017-18 is upbeat with ADB, World Bank and Government forecasts predicting GDP growth to hover within the 6-7% range. Recent regional connectivity agreements with neighboring countries – India, Nepal and Bhutan – will add further impetus on growth. Additionally, inauguration of the Padma bridge (expected to open in 2018) will be connecting the economically backward Northern region with the rest of the country, contributing to higher GDP trajectory.

A Consistent Performer within the Region

Bangladesh economy has been growing steadily on the back of the tertiary sector, RMG led secondary sector and remittance earning proceeds from semi-skilled and unskilled labor working abroad. It's remarkable that the country has remained largely immune from the fall-out of the global financial crises because of lower external dependency. Apparel exports continue on the upward momentum, remaining largely inelastic due to their inexpensive proposition.

In 2015, the economy grew faster than most of the regional peers. For 2016-2017, the projected growth is hovering over 6%. Regardless of a significant disparity in projected GDP growth rates, reported to have arisen from different multilateral development organizations and the Government, the growth trends are moving in the positive direction.





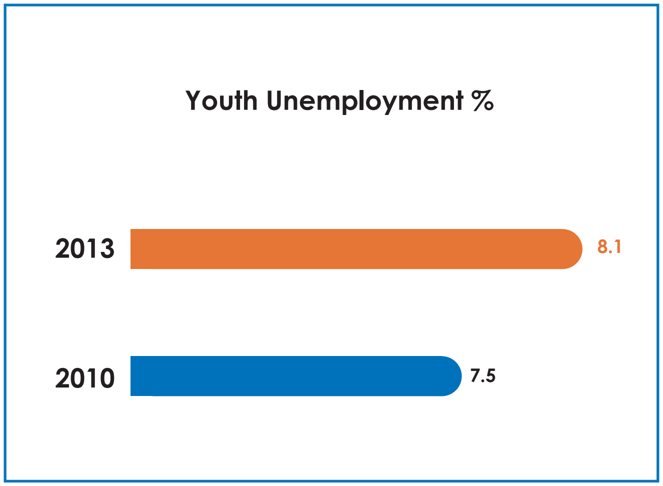
Source: World Bank and IMF Dataset

According to Citi Bank estimates, services sector (3%) dominates the GDP growth contribution, followed by secondary (2.7%) and primary sectors (0.5%). Despite experiencing steady growth, the economy has been unable to absorb the rising entry in workforce.

Secondary Sector Key to Containing Unemployment

Over the last decade, Bangladesh has been partially benefitting from the 'demographic dividend,' resulting in a bulge in the working population. According to BBS statistics, almost 70% of the population are aged less than 30, with the mean age standing at 23.4 years. Although the growing working population has scope for generating national wealth, many are unable to contribute due to lack of employment opportunities. According to BBS statistics, the youth unemployment rate had risen to 8.1% as of 2013 from 7.5% in 2010. In addition, a report by the Economic Intelligence Unit found graduate unemployment to be 47% in Bangladesh, which is alarming.

Growing secondary sector is key to absorbing the 1.2 million potential workforce entering the working population each year. Since the secondary sector can accommodate both semi-skilled and highly skilled workers, growing manufacturing jobs will contribute to fresh employment across various strata of the economy.



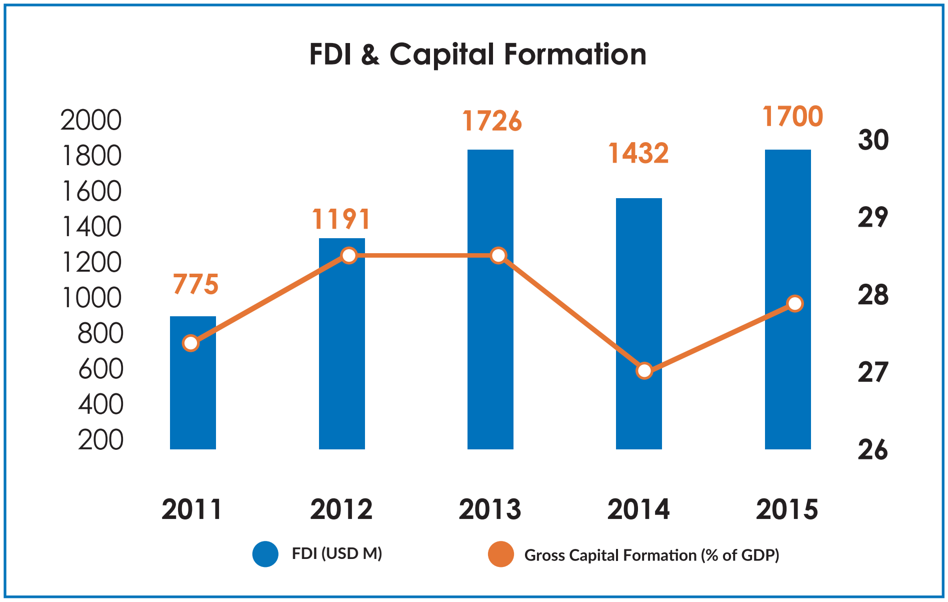
Source: Bangladesh Bureau of Statistics

Investment and Infrastructure Key to Growth

For creating jobs across the economy and for breaking into the coveted higher middle-income threshold, large scale investments are required for propping up particularly the secondary sector. According to WB and BB statistics, for accelerating growth, gross capital formation should ideally be at 32% of GDP, which should in turn be supported by domestic investments and FDIs. Due to large savings-investment gap and jittery business confidence, investments are not being channeled from domestic sources. Although international investors are showing renewed interest for tapping into the 160 million consumer base, actual FDI is tepid and much below expectations. In 2015, Bangladesh's FDI inflow stood at USD 1.7 Billion, while Myanmar's FDI inflow shot up to USD 8.1 Billion.

In terms of doing business, Bangladesh's performance deteriorated significantly, going down to 174th position among 189 countries in 2015, from 130th position in 2014, according to the Doing Business survey conducted by World Bank.

Complexity in registering a company and unavailability of new utility connections make it difficult to set up more factories. Furthermore, inadequacy of factory plots pose another challenge while making long-term investments.



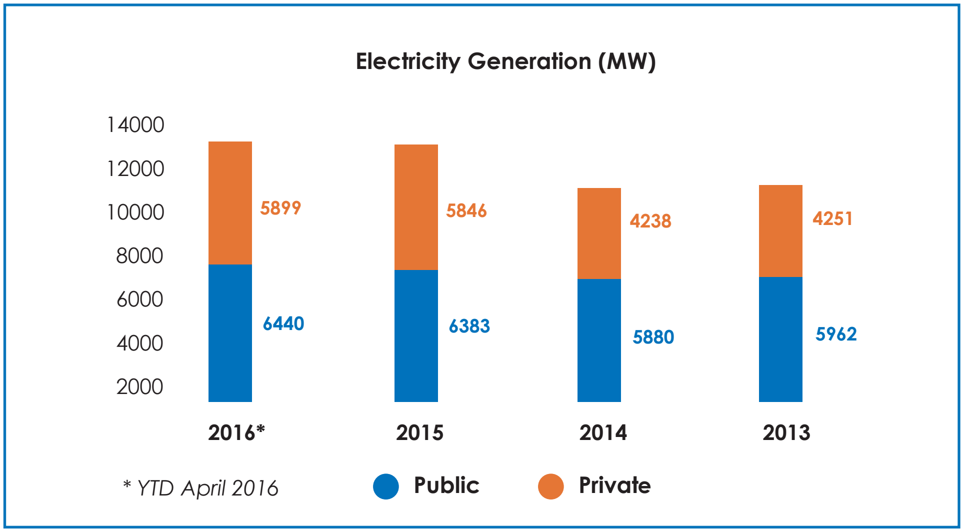
Source: World Bank and Bangladesh Bank

Government is breaking into the bureaucratic red tape by simplifying the company registration process and by transitioning to a more fast, efficient and transparent digital system. They are also providing policy support for encouraging private sector players in developing their own special economic zones across the country.

Infrastructure Development Will be a Game Changer

Government has been making significant investments for infrastructure development, especially in terms of building roads and highways, power generation, sourcing of natural gas from internal and external sources and developing/building port facilities. The Dhaka-Chittagong highway, connecting Dhaka with Chittagong port, is being upgraded to four lanes. Development work is expected to be completed within 2016. The government has been floating concrete plans for investing USD 8 billion over the next 4-5 years for making large scale infrastructure development.

The government has also started developing the third seaport in Payra on a public private partnership (PPP) basis, which would require USD 187 Million in investments. Investments are also being made for improving capacity for the Chittagong Port.



Source: Power Development Board (PDB) Bangladesh

Although the plan for developing the deep sea port is currently stalled, a number of countries including the likes of China, India, Japan and Netherlands have expressed interest in financing and developing the deep sea port.

Electricity deficit has markedly declined to below 2,000 MW level (during peak season), due to government's strategy of involving private players for setting up quick rental power plants. Alongside, Government is planning to construct a nuclear power plant with financial and technical support from the Russian government. Given the growing supply of electricity, power shortage will cease to be a bottleneck for growth within the next 3-4 years.

The government has been addressing the issue of depleting gas reserves by romping up the process for discovering new gas fields, both off-shore and on-shore. As a quick alternative, government has recently inked a deal with an American energy company for developing a LNG terminal in Maheshkhali Island, for regularly supplying natural gas, mainly from Qatar. The LNG terminal will have a capacity of 5 million per year with re-gasification capacity of 500 million cubic feet per day. The LNG terminal will start operating from middle of 2017 on Build-Own-Operate-Transfer (BOOT) basis.

Connectivity will Open Doors

Resolving the enclave issue with India and subsequent cross-border transport agreement involving Bhutan, Nepal and India will contribute to growing regional trade. Additionally, Bangladesh will financially benefit from transshipment of goods through Bangladeshi territory and through usage of Chittagong port by landlocked Bhutan, Nepal and North Eastern 'seven sister' states in India. Higher cross-border trade is expected to yield 1% additional GDP growth per annum for Bangladesh, which is a good sign.

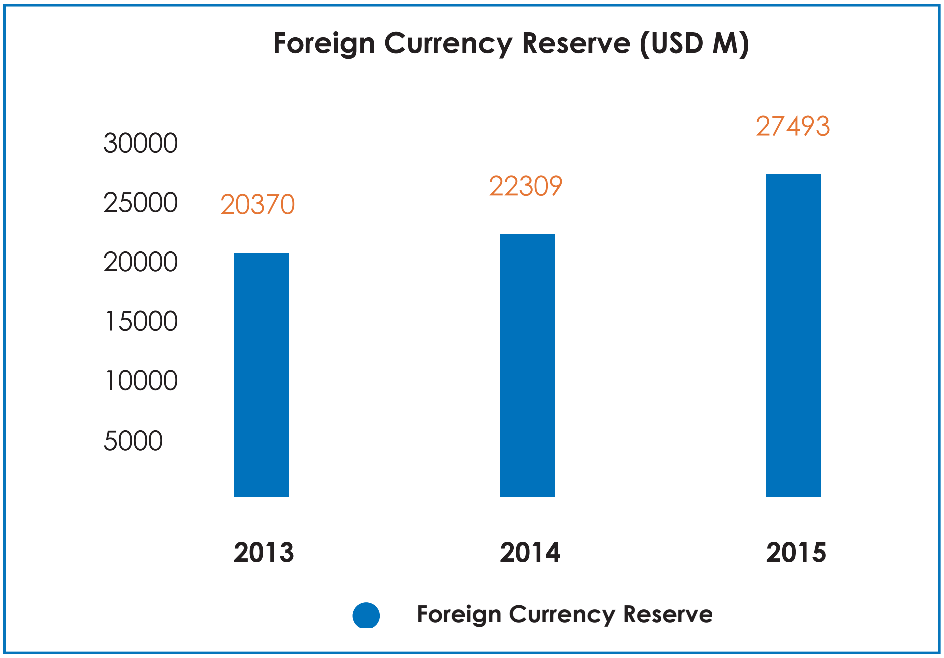
For improving roads and railways infrastructure, India has already extended a soft loan of USD 1 Billion. The funding has been beneficial for improving roads and highways. Additionally, government is re-channeling local funding for development of Padma Bridge which will not only connect the Northern region but also further support regional connectivity.

Bangladesh is also getting connected to the Asian highway through roads and railways. If integrated, Bangladesh can directly establish connection with China and Thailand through Myanmar, which will further boost trade and FDI inflow.

International Headwind favoring Bangladesh

Bangladesh benefits from a positive current account balance due to growing RMG export and steady remittance flow. Current account balance has been positive resulting in record high foreign currency reserves (USD 28 Billion, Feb 16). As an oil importing country, falling oil prices have been a boon for Bangladesh, contributing to declining import volume. Strong export performance, lower import and continued support from development partners have resulted in surging foreign currency reserves. One matter of concern has been the sluggish growth of machinery import volume, which is possibility due to lackluster investor confidence.

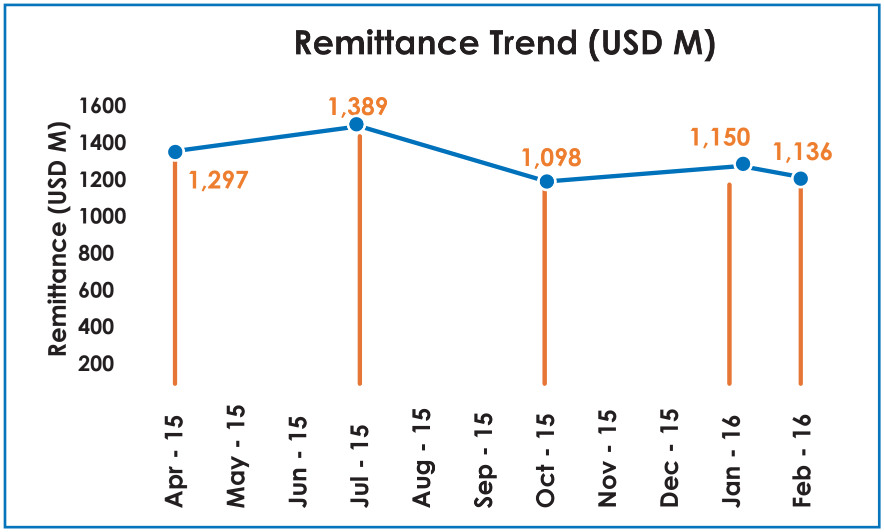
RMG sector export has been the main export contributor accounting for 82% of country's export. Despite facing a number of challenges within the country owing to political turmoil, apparel export has been growing steadily, retaining the second largest exporter position after China. Apparel export is expected to reach USD 50 Billion within the next 5 years.



Source: Bangladesh Bank (as of 31st of each year)

Eurozone crisis and resulting depreciation of Euro against USD will make Bangladeshi apparel more expensive, possibly reducing demand for apparel in the short and medium term.

Remittance income has been growing steadily, as a result of re-opening of labor market in Malaysia and Saudi Arabia. Demand for labor has been further contributed by a flurry of construction activities in Qatar as a build up to the 2022 FIFA World Cup. However, recent free-fall of global oil prices have constrained spending for many gulf countries. Many Gulf governments are contemplating reduction of subsidies and cutting down on construction activities. This may possibly result in lower remittance from the Middle-East in the near future.



Bureau of Manpower , Employment and Training (BMET)

Although apparel is currently dominating the export basket, a number of sectors has been growing in importance. Among other industries, agro, pharmaceutical, leather and frozen food, have been making important contributions to the country's export. For moving ahead, many companies in secondary sectors are looking inwards for tapping into the growing Middle and Affluent Class (MAC) segment, currently standing at 11.7 Million with potential for tripling in size within the next 6 years. These import substitution industries are primarily catering to the domestic market, before attaining the scale for launching in the regional market.

Moving to League of High Middle-Income Nation

- While Bangladesh has been consolidating growth over the last decade, there are areas that need to be addressed earnestly for augmenting progress. Infrastructure development remains a major challenge, with slow implementation of development project. According to government statistics, only 41% of Annual Development Program (ADP) has been implemented. Revving up of implementation of projects will significantly improve economic growth.

- Apart from roads and highways, government must make prudent investments for developing the Mongla port, along with setting up of the much awaited Payra seaport. Additional Berthing facilities will support handling of incremental goods transiting from regional neighbors. Electricity generation capacity should be enhanced through public sector entities, while reducing dependence on more expensive quick rental plants.

- Government has partially transferred some of the benefits of lower oil price to the end consumers, which should help in lowering inflation. Lower diesel prices will benefit farmers by reducing cost of production and contributing to higher profit margin.

- Government's efforts in setting up new economic zones for Chinese and Indian investors will help flesh influx of FDIs, while involving private sector for running dedicated economic zones will contribute to higher efficiency. Potential investors need to be guaranteed regarding availability of fresh utility connections.

- Government should initiate policies for developing Chittagong as the main commercial hub by adopting the ‘Dhaka plus one’ policy. The Chittagong region should be adequately supported by ensuring availability of power and gas connections, along with necessary infrastructure and financial support base. This will be the first step in collectively decentralizing economic activities.

- The Hi Tech park initiative should also be expanded by inviting international ITES and technology firms for setting up branch offices. Preferential facilities to top technology hardware and software companies will instill confidence among different technology players across the globe, positively swaying their opinion towards making investments in Bangladesh.

Bangladesh’s push towards the higher middle-income threshold can only be achieved through addition investments in secondary and tertiary sectors, which should be augmented by infrastructure and policy support for easing the investment process. The regional competitors like Myanmar, Sri Lanka and India are forging ahead economically. Bangladesh must have followed suite in order to remain relevant in this hyper competitive age.

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LightCastle Partners is a business data firm. We work at the intersection of market data and company specifics to simplify decisions and drive growth for our clients by providing advisory services (data and analysis).

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