LightCastle Economic Update 2018

Unraveling Fault Lines to Falter Progress

A Publication by LightCastle Partners

Acronyms

ADB	Asian Development Bank
AI	Artificial Intelligence
API	Active Pharmaceutical Ingredient
BAL	Bangladesh Awami League
BB	Bangladesh Bank
BBS	Bangladesh Bureau of Statistics
BCG	Boston Consulting Group
BDT	Bangladeshi Taka
BEZA	Bangladesh Economic Zone Authority
BIBM	Bangladesh Institute of Bank Management
BIMSTEC	The Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
BIDA	Bangladesh Investment Development Authority
BNP	Bangladesh Nationalist Party
BOP	Balance of Payment
CRR	Cash Reserve Requirement
CRAR	Capital to Risk Weighted Asset Ratio
DSE	Dhaka Stock Exchange
EIU	Economist Intelligence Unit
EPB	Export Promotion Bureau
EPZ	Export Processing Zone
ERD	Economic Relations Department
EU	European Union
FDI	Foreign Direct Investment
GCC	Gulf Corporation Council
GDP	Gross Domestic Product
G2G	Government to Government
HIES	Household Income and Expenditure Survey
ICT	Information Communication Technology
ICB	Investment Corporation of Bangladesh
IMF	International Monetary Fund

Acronyms

IOT	Internet of Things
JICA	Japan International Cooperation Agency
LCP	LightCastle Partners
LDC	Least Developed Countries
LNG	Liquefied Natural Gas
MAC	Middle and Affluent Class
MOU	Memorandum of Understanding
NPL	Non-Performing Loan
NBFI	Non-Bank Financial Institution
NEET	Not in employment and not in education or training
NG	Natural GAS
NPL	Non –performing Loans
ODA	Official Development Assistance
RMG	Ready-Made Garments
SEZ	Special Economic Zone
S&P	Standard & Poor's
SME	Small and Medium Enterprises
SMEF	SME Foundation
SOB	State Owned Bank
TRIPS	Trade-Related Aspects of Intellectual Property Rights
UK	United Kingdom
USD	United States Dollar
WB	World Bank
WTO	World Trade Organization

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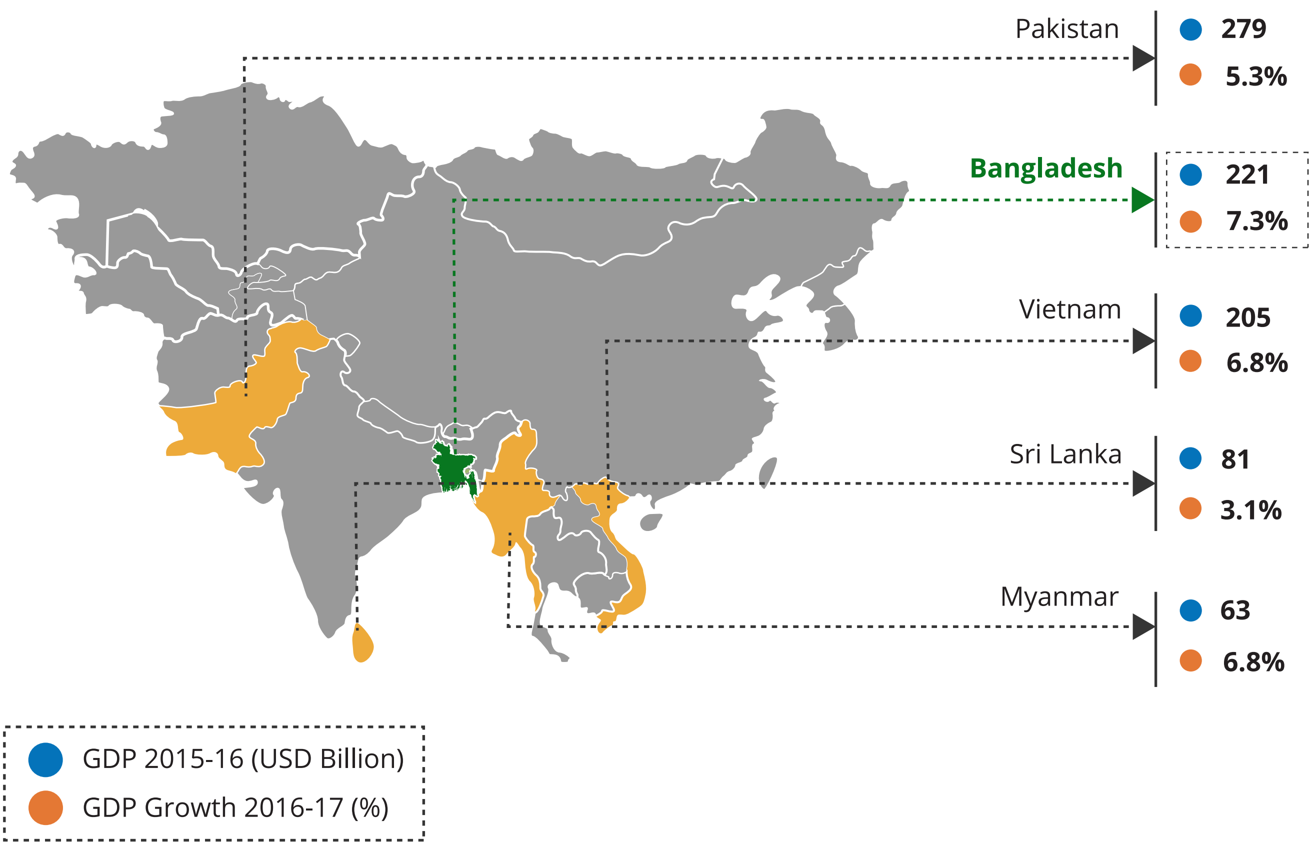
Economic Backdrop

Bangladesh Going Strong Compared to Regional Peers

Bangladesh economy has arrived at the cusp of achieving the middle-income status with a number of indicators matching the graduation requirements. This has been possible due to steady macroeconomic performance led by an impressive growth trajectory. Good performance is reflected in the form of steady sovereign ratings (Moody's, S&P and Fitch) and growing forex reserves (USD 33 billion, May 18). However, a number of fault lines have emerged that may potentially derail future growth.

Persistent GDP growth above 6.5% over the last 3 years has not translated into in higher job creation within the economy, confounding policymakers. Although the country's GDP growth remains positive compared to regional peers, the actual base value remains low.

Alongside, the country's overreliance on apparel export for earning a major chunk of export earnings may prove detrimental-amid the onslaught of the fourth industrial revolution, carrying the possibility to automate a significant number of factory jobs. The ailing banking industry casts a shadow on the investment climate by disrupting credit flow across the economy. Fear of potential political turmoil, leading up to the national election, looks likely as well - dampening spirits of potential domestic and international investors.



Source: ADB[1] & World Bank[2]

1 https://www.adb.org/countries/main
2 https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG

Economic indicators showing reserved development

The country's economic growth is driven both by internal and external factors. In spite of stagnating exports (RMG) and slightly declining remittance trend, the economy has grown due to rising consumption and increased government investment on infrastructure. International trade connectivity with regional neighbors and Bangladesh's inclusion in different trade facilitation, initiatives like BIMSTEC and Asian Highways, can significantly bolster international trade and export potential.

GDP growth is expected to be maintained, with official government figures predicting growth to hover around 7.2%, while ADB and WB expect growth to remain around 7% and 6.5%, respectively. Despite the apparent differences, all sources are bullish on the country's growth prospects in 2018-19. Healthy political and economic outlook alongside progressive government policies have contributed to Bangladesh's strong performance, which has resulted in positive sovereign ratings, higher than most of regional peers.

Although Bangladesh's GDP per capita has been on a constant rise, it is lower in value compared to neighboring countries like Sri Lanka, Vietnam and Pakistan. In 2016, while Bangladesh held a GDP per capita value of around USD 1,359, Vietnam was at USD 2,171 and Sri Lanka was at USD 3,835 according to World Bank statistics.

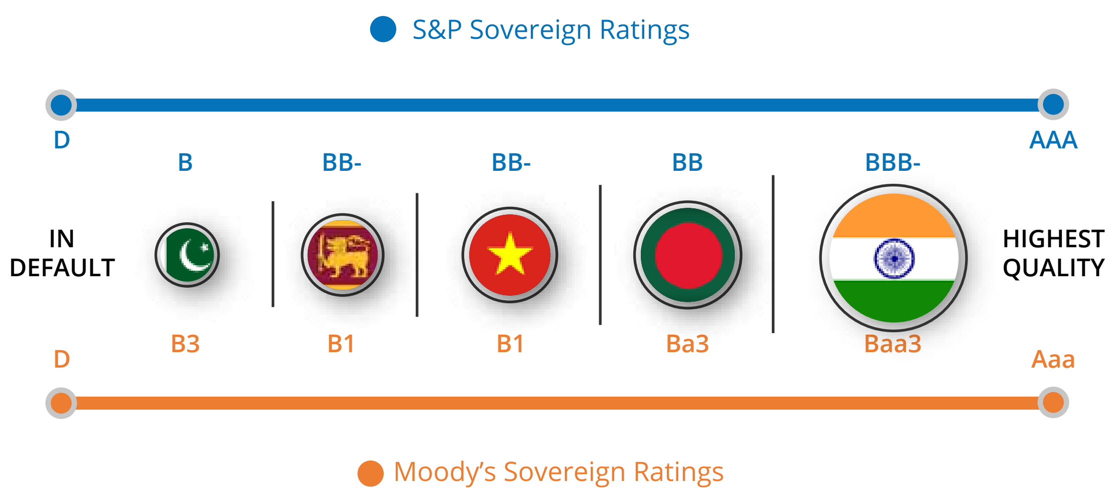
The government is investing heavily on infrastructure and connectivity for increasing the country's attractiveness as an investment destination. A few mega projects undertaken by the government for alleviating infrastructural bottlenecks include the Padma Bridge, Rooppur Nuclear Power Plant, Payra Sea Port, Coal-fired Matarbari and Rampal Power Plant, Metro Rail and Liquefied Natural Gas Terminal. However, challenges remain in terms of propagating an investment friendly climate, as Bangladesh languished at the 177th position out of 190 countries at the World Bank's Doing Business Survey 2017-18.

GDP Per Capita 2015-16 (USD Thousand)

Sri Lanka	Vietnam	Pakistan	**Bangladesh**	Myanmar
3,835.4	2,170.6	1,443.6	**1,358.8**	1,195.5

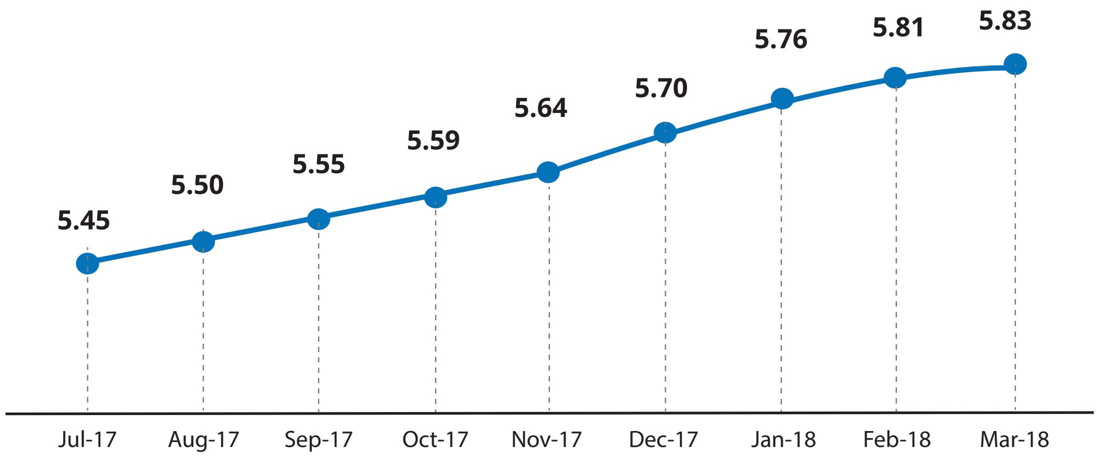
Source: World Bank [3]

3 https://data.worldbank.org/indicator/NY.GDP.PCAP.CD



Inflation rate remains within control, rising partially during the July-Oct 17 period, due to nationwide flood. However, the rate is expected to climb up again in 2018, due to expected rise in price of utilities like electricity and natural gas at end consumer level.

Inflation Rate (%)



Source: Bangladesh Bank [4]

The country is experiencing demographic dividend with 60% of population aged below 30 years, and 2.2 million entering the workforce each year. This makes Bangladesh an attractive investment destination. Although official unemployment figure hovers around 5-6% (Source: BBS) for FY 2015-16, unofficial figure recounts unemployment rate to be as high as 18%, and graduate unemployment higher than 30%. (Source: EIU)

International trade stagnating with apparel export decelerating

Bangladesh's export basket is skewed towards Apparel and Textiles with few other exportable items like Jute, Pharmaceuticals and Frozen Food. In terms of service, remittances is one of the

4 https://www.bb.org.bd/econdata/index.php

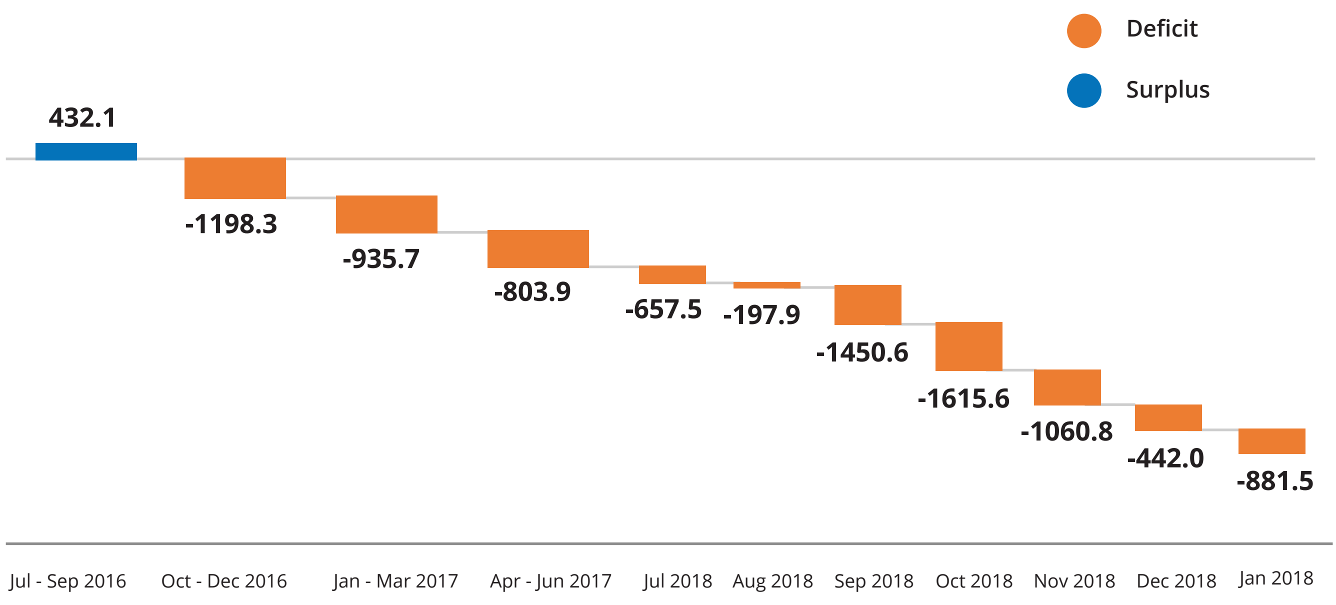
key foreign currency earners. Over the last couple of years, apparel exports have begun to plateau. Growth outlook is also not upbeat this year as manufacturers face a squeeze in unit pricing. The country is putting efforts to diversify the export basket, by introducing different products, and stressing on more value added Light Engineering, Agro Processing and ICT services.

Remittance, which contributes roughly USD 14.5 billion, has declined as a knock on to deteriorating international oil price, adversely impacting economies of labor importing Gulf Cooperation Council (GCC). Remittance for 2016-17 had dipped below USD 14 billion mark, but growth is expected to rebound in 2017-18 due to expected growth in international oil prices.

Balance of payments deficit widening with higher imports

Import bill has been growing since July 2016 due to increased import of essential food grains for replenishing deficit created by the nationwide flood of that time. Additionally, increased import of capital machinery and raw materials for infrastructure development contributed to higher outflow. Experts are predicting a large scale illegal fund outflow, which is a common phenomenon during the election year. Because of this, current account balance has persistently remained negative from October 2016 onwards.

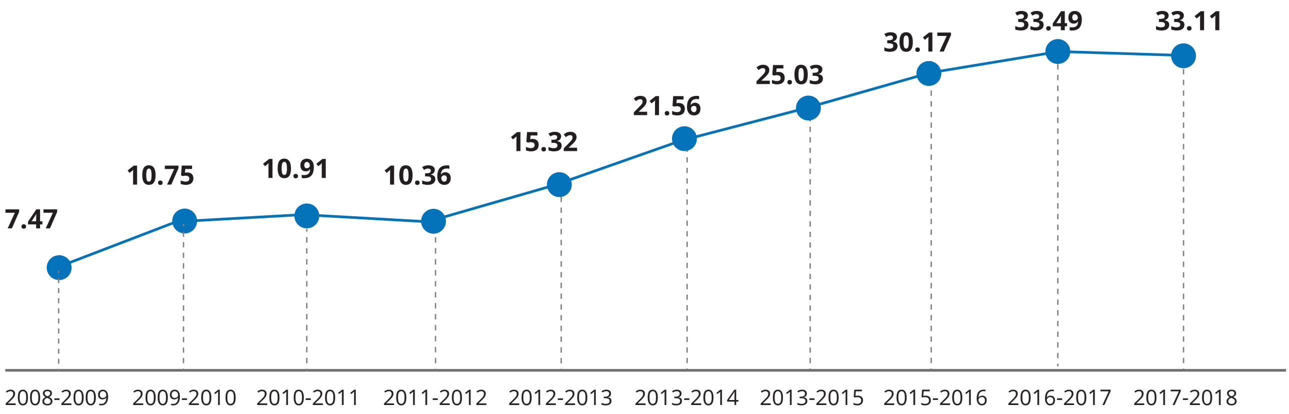
Balance of Payments (USD Million)



Source: Bangladesh Bank [5]

5 https://www.bb.org.bd/econdata/index.php

Foreign Exchange Reserve (USD Billion)

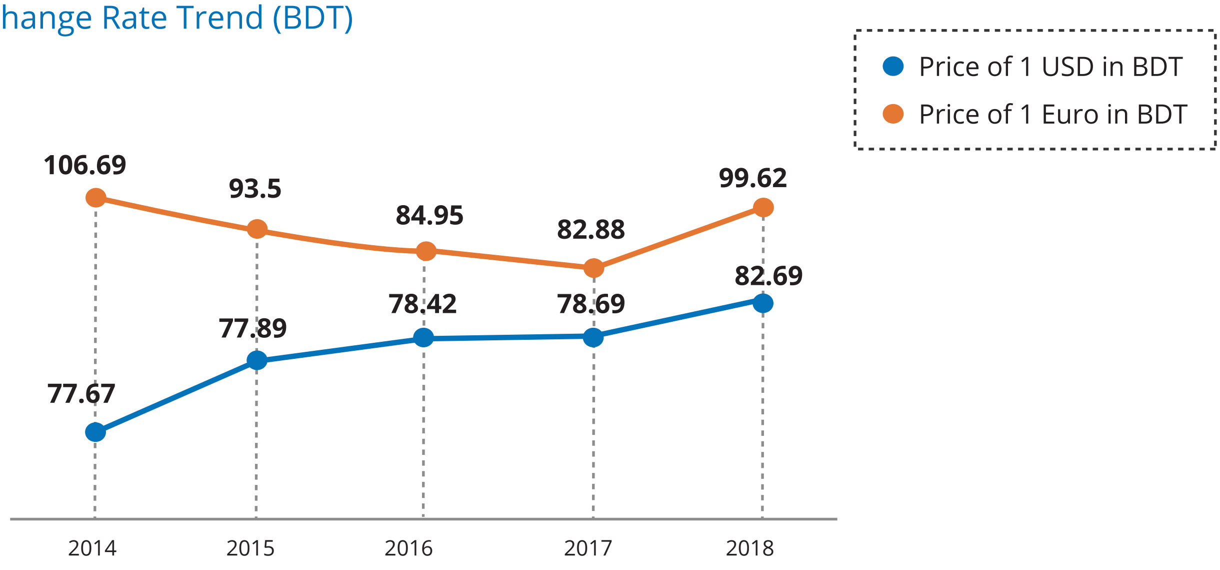


SOURCE: Bangladesh Bank *Till April 2018 [6]

Foreign currency reserve currently stands at USD 33.11 billion (April 2018), which can cover 8 months of the country's import bill. Due to persistent BOP deficit and central bank's foreign exchange activities (selling USD to prevent BDT depreciation), the foreign currency reserve is under pressure.

The local currency has been depreciating against all major currencies, despite efforts from central bank in reverting the slide. The exchange rate is expected to depreciate further in the coming months due to growing demand for USD in making import payments. Cheaper BDT will directly benefit export led sectors like RMG, but may result in higher prices for imported products, especially essential food grains, contributing to inflationary pressure.

Exchange Rate Trend (BDT)

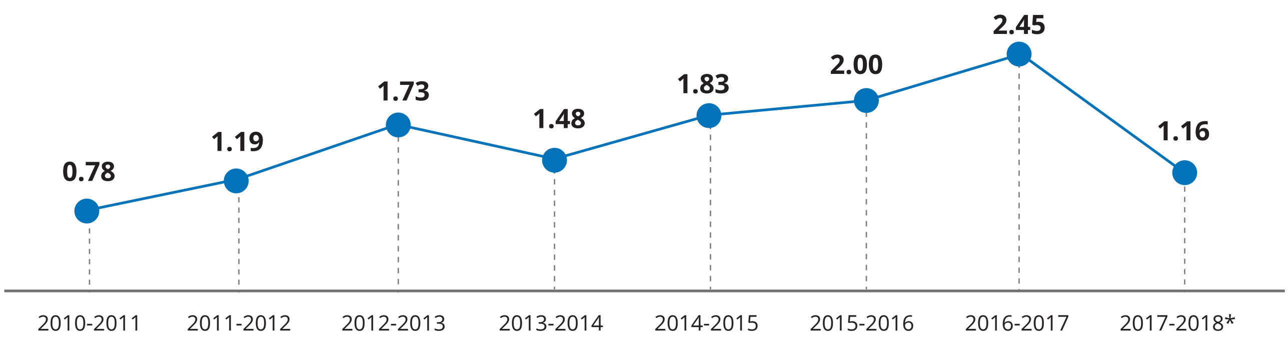


Source: Bangladesh Bank [7]

6 https://www.bb.org.bd/econdata/index.php
7 https://www.bb.org.bd/econdata/index.php

According to World Bank data, FDI inflow of Bangladesh is significantly lower compared to regional peer Vietnam, and is on par with Pakistan. Historically, FDI to Bangladesh has been low, mainly due to bureaucratic red tape, scarcity of land and inadequate infrastructure and utilities. Which has contributed to the lower ranking in World Bank's Doing Business Survey. However, the newly reformed Bangladesh Investment Development Authority (BIDA) has been undertaking initiatives for attracting FDIs.

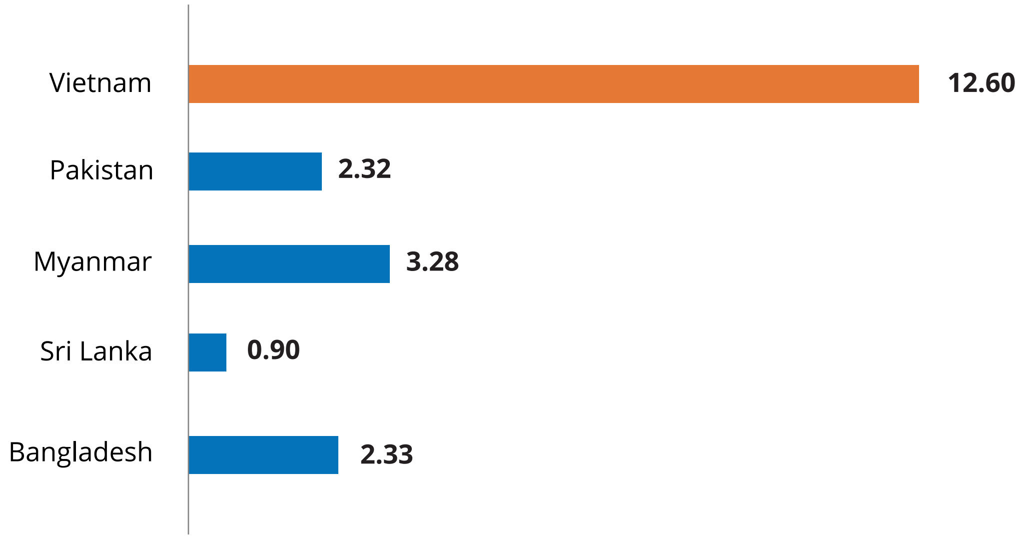
FDI Inflow Bangladesh (USD Billion)



SOURCE: Bangladesh Bank (*Jul-Dec 2017-18) [8]

Stagnating FDI trend is a major worry for the government as it looks to accelerate growth by fostering the secondary sector. The ultimate aim is to create new jobs in the economy.

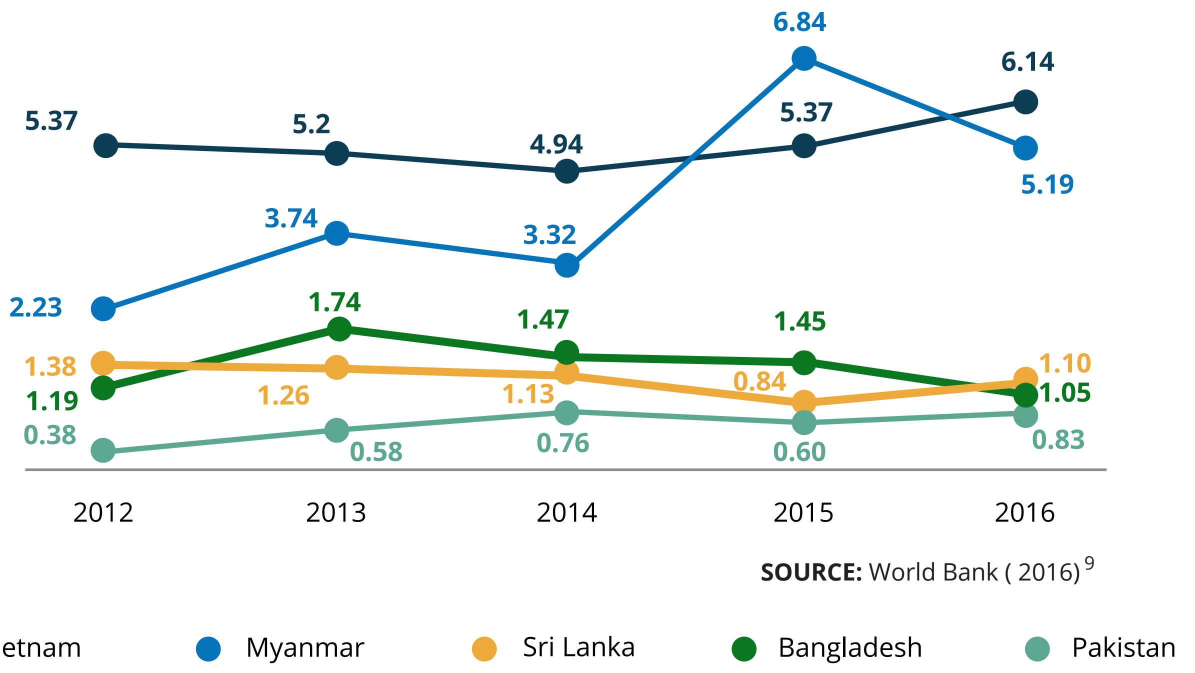
FDI Inflow (USD Billion)



SOURCE: World Bank (2016) [9]

8 https://www.bb.org.bd/econdata/index.php
9 https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD

FDI Inflow to GDP (%)



SOURCE: World Bank (2016) [9]

The FDI to GDP ratio portrays a more contextual picture, where it is seen that Vietnam and Myanmar's FDI inflow is much higher against GDP growth compared to Bangladesh. These countries are receptive of higher FDI which is contributory to economic growth.

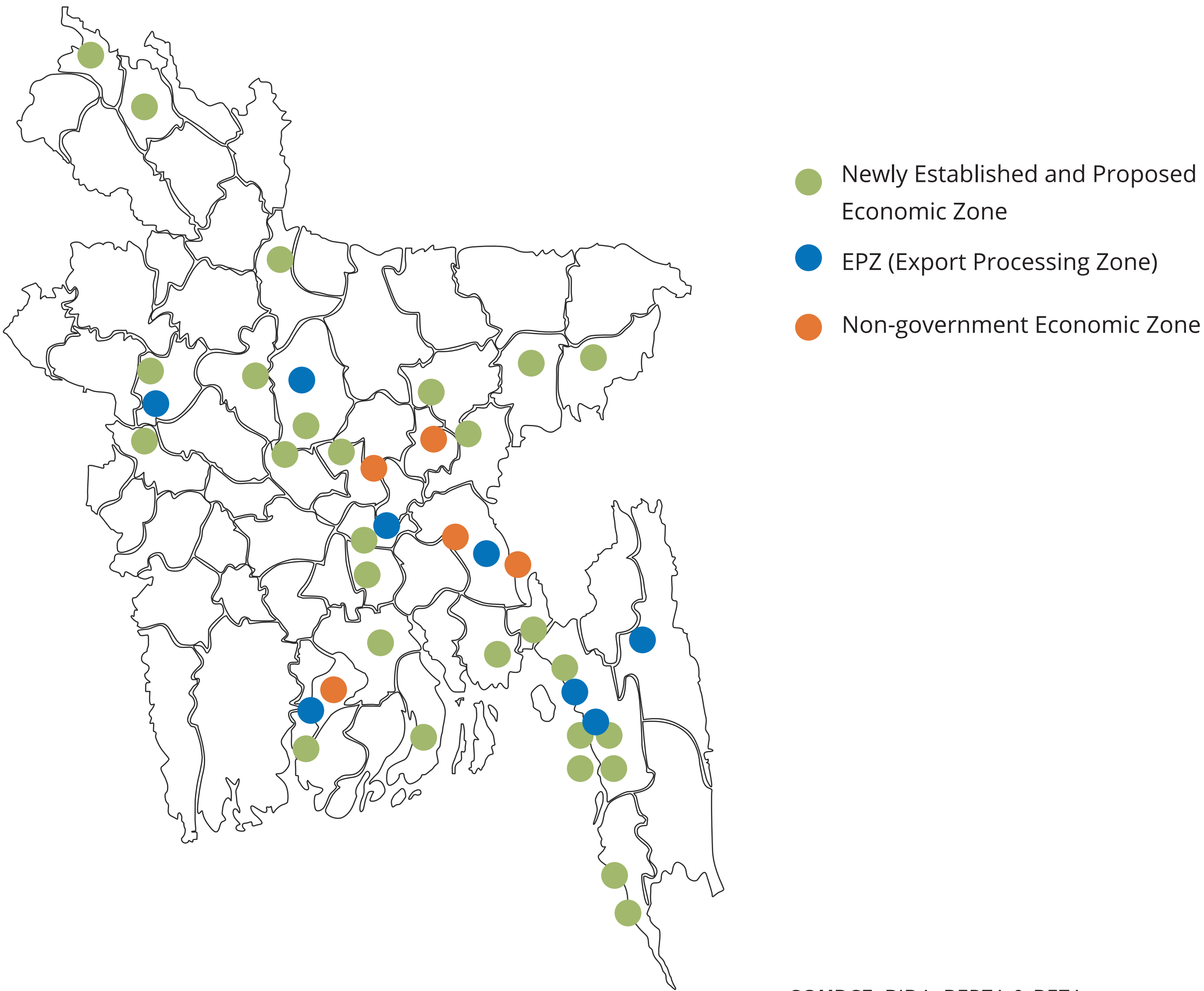
Investment increasing in infrastructure and special economic zones

Due to persistent demand-supply mismatch for export processing zones, among local and international investors, government decided on amending the EPZ Act in 1996, enabling private conglomerates to build privately held economic zones. Although the experience of Korean EPZ, built by the Youngone Group, has not been very pleasant, some local conglomerates are confident of successfully operating privately owned economic zones. Recently, government has approved 37 new Economic Zones, consisting of governmental, non-governmental and specialized economic zone. The government is also investing in erecting Hi-Tech parks for the ICT ministry and it is predicted that almost 33 ICT parks will be constructed all over the country.

Furthermore, government is setting up special economic zones under the supervision of Bangladesh Economic Zone Authority (BEZA), with the view of attracting local and international investments. Some of these zones have been promised exclusively to Chinese, Japanese and Indian investors. The issue lies in the fact that although almost a hundred SEZs are targeted for completion, progress has been snail-paced.

Large infrastructure investments from China, India and Japan

In 2016, Bangladesh and China signed 27 MOUs, with an estimated budget of USD 24 billion during Chinese President Xi Jinping's visit to Dhaka. The projects included infrastructure development like roads and highways, port facility development, power plants among others. Bangladesh will partner with China for implementing the 'One Belt, One Road' initiative, conceptualized to boost trade through transport linkage between Asia and Europe. In 2017, USD 4.5 billion credit line was offered by the Indian government to Bangladesh for infrastructure development.



SOURCE: BIDA, BEPZA & BEZA

Zhejiang Jindun Pressure Vessel Co. Ltd, a Chinese company, is investing USD 5 billion in a special economic zone for establishing industries that include a colossal 2,640-megawatt power plant. Japanese ODA loans of up to 178.223 billion yen for six projects Inflows (Net), which includes important infrastructure projects such as the USD 4.6 billion sea-port and power plant in Matarbari with JICA, and USD 137.3 million for building primary infrastructure facilities at Payra Sea Port.

Recently, country's premier bourse, the Dhaka Stock Exchange (DSE), approved a Chinese consortium's offer for procuring 25% of the bourse's stake for USD 111 million. The consortium is composed of Shenzhen and Shanghai stock exchanges. This is expected to open the doorway for attracting Chinese investors in the domestic market.

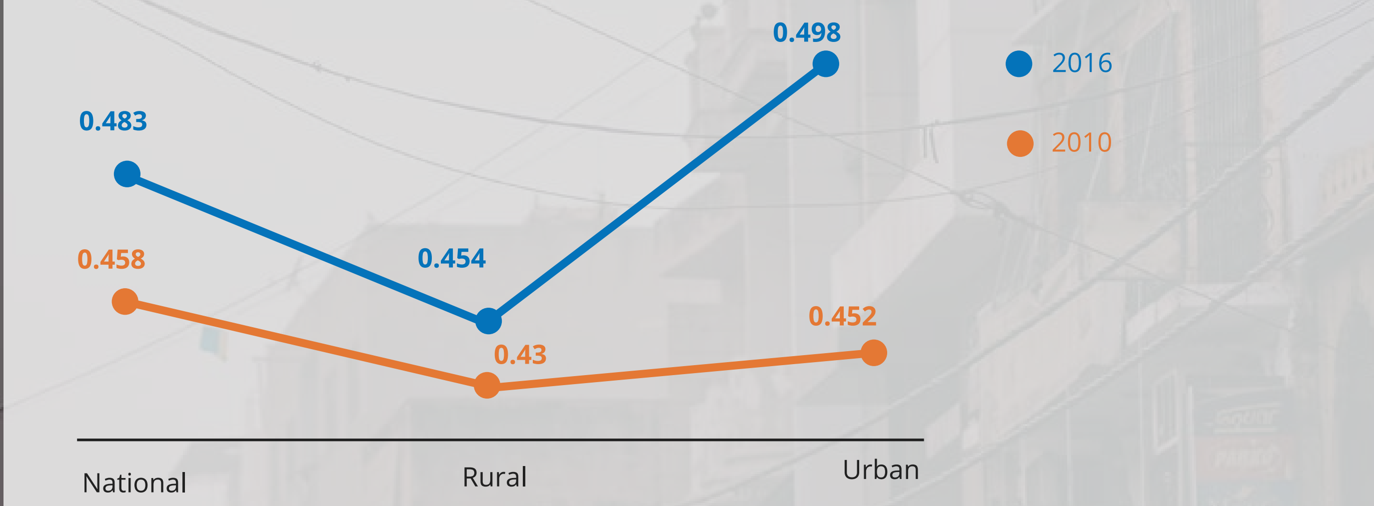
Although some of these signs are encouraging, there are impending fault lines in the economy which need to be meticulously navigated in order to make the successful transition into a middle income nation.

Economic Challenges

Endemic Inequality to Hamper Inclusive Growth

With a growing population, there's also a growing Middle to Affluent (MAC) population in Bangladesh with higher disposable income and living standards. A study by the Boston Consulting Group predicts the cities with major concentration of MAC population will increase from 10 key cities in 2015 to 33 by the year 2025. However, according to the Household Income and Expenditure Survey (HIES) released in 2017, the poorest five percent of Bangladesh's population had their national income reduce from 0.78% in 2010 to 0.23% in 2016. The richest five percent however, saw their income increase from 24.61% to 27.89% of national income from 2010 to 2016. This increase in income inequality, further accelerated the increase in the Gini Co-efficient, which is the most efficient composite indicator of inequality of a country. The Gini co-efficient increased from 0.458 in 2010 to 0.483 in 2016.

Gini Co-efficient (0 to 1)



Source: Household Income and Expenditure Survey (HIES) 2016 [10]

According to the HIES 2016, income inequality in the urban areas has risen faster than in the rural areas. This is highly attributable to the asymmetrical growth of jobs in the services sector and concurrent fall in the growth of blue collar jobs, especially in the urban areas. Although the economy has achieved commendable growth, it has done so without creating new jobs.

In the year 2016-17, there has been a net increase of 2.8 million new jobs from the 60.7 million jobs that existed in the economy since 2013. In the last five years, according to the Labour Force Survey, Agricultural jobs fell by 1.5 million, industrial sector increased by a mere 0.3 million and majority was created in the service sector with an increase of 3.9 million requiring a skilled workforce. The manufacturing job segment with higher manual worker focus dropped alarmingly to 8.76 million in 2016-17 from 9.53 million in 2013.

10 http://203.112.218.65:8008/PageWebMenuContent.aspx?MenuKey=366

Majority of the jobs, more than 85 %, created were alarmingly in the informal sector. According to the Labour Force Survey, male jobs increased by a mere 1 million from 2013, to 42.2 million in 2016-17 while female jobs increased by 1.8 million to 18.6 million. However, this increase in female jobs can be attributed to the increase of 1.9 million female jobs in the informal sector, indicating a drop of 0.1% in the formal sector. Additionally, there's been a surge in the (age 15-29) 'not in employment and not in education or training' (NEET) segment from 25.4% in 2013 to 29.8% in 2016-17. Even though the country is experiencing strong demographic dividend with a bottom-heavy youth population, unemployment of 10.6% (2016-17) among the youth is higher than the national unemployment rate of 4.2%. At the risk of sounding pessimistic, youth unemployment will increase due to scarcity in blue-collar jobs; consequently the economy may take a sharp down-turn due to possible social unrest.

Undiversified Export Basket a key Economic Fault Line

Bangladesh’s apparel sector has been growing at a significant pace over the last couple of decades, securing its position as the second largest player in the global apparel market. According to the Export Promotion Bureau (EPB), currently the sector is exporting USD 34.83 billion worth of apparel as of FY2016-17. In the recent past, China has been plagued by rising labor costs and more recently by economic slowdown. According to the EPB, apparel shipments, which typically account for more than 81% of Bangladesh's total export receipts, raked in USD 2.88 billion in January 2018, up 6.67% from the same period in 2017.

Total exports delivered the highest value in five months, USD 3.41 billion in January, due to a spike in shipments of apparel, jute, jute goods and furniture. The growth in export comes partially due to depreciating value of BDT boosting competitiveness of Bangladeshi made products. However, growth of the apparel sector has been decelerating due to higher competition in the global market. New players have emerged with more robust backward linkages. For example, new players like Ethiopia have access to locally produced cotton, which can be cheaply processed for producing fabric. Apparel manufacturers in Bangladesh are specialized in producing less complex products, which can be easily outsourced away to cheaper competitors.

The advent of robotics in apparel manufacturing as an aftermath of the fourth industrial revolution, can potentially revolutionize the industry and neutralize Bangladesh’s competitive cost advantages in the long run. Considering these structural challenges, it is imperative that the export basket is diversified over the next decade to ensure continued growth of the economy. In order to achieve that, it is crucial to develop existing industries with strong prospects for growth such as pharmaceuticals, leather and ICT among others.

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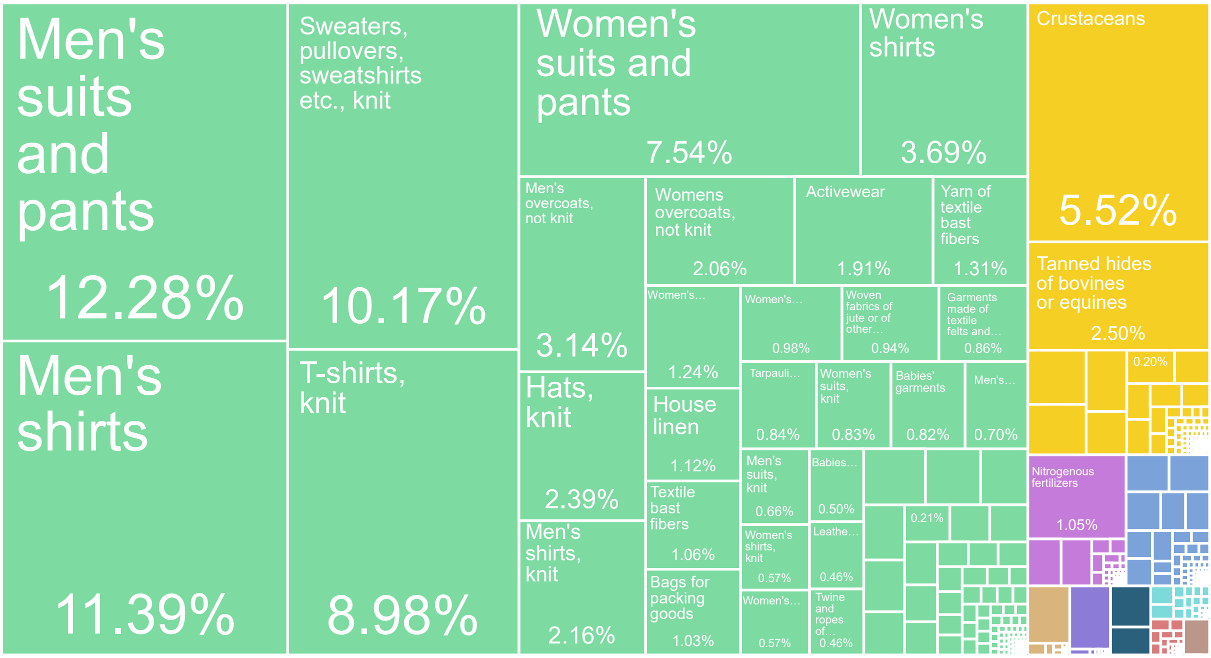
Currently, the sector is exporting **USD 34.83** billion worth of apparel as of FY2016-17 (EPB)

Bangladesh Export Basket

2000 ($6.34B)



Source: Harvard Economic Complexity Atlas [11]

Textiles and Furniture

Vegetable, food stuffs and wood

Stone and Glass

Minerals

Metals

Chemicals and Plastics

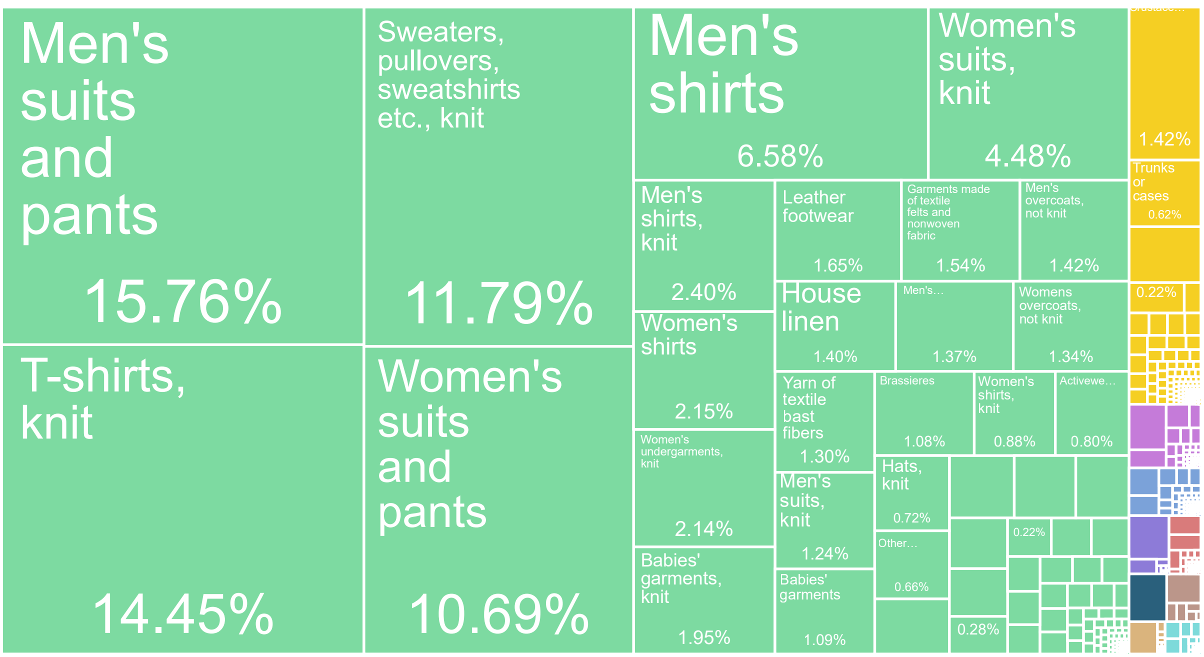
Transport Vehicles

Machinery

Electronics

Others

2016 ($35.9B)



Source: Harvard Economic Complexity Atlas [11]

11 http://atlas.cid.harvard.edu/

For the year 2016, Vietnam had an export diversified mix with almost one-third of its export contributed by electronics, closely followed by textiles and furniture and agricultural goods. Sri Lanka had a mix of textiles, agricultural products followed by chemicals and plastics. Similarly, both Pakistan and Myanmar had a healthy mix of textiles and other industries. In contrast, Bangladesh had almost 85% of its export coming from textiles and apparel (details in annexure).

Export shipments of frozen foods such as shrimp and fish brought in USD 312.46 million in Jul-Dec 2017. Leather and leather goods, which represent the second-largest export earning sector, fetched USD 620.27 million in the July-December period as of 2017, down 1.2% year-on-year. Jute and jute goods are seeing a spontaneous rise in exports on the back of a revival in demand worldwide for the natural fiber and a return of conducive political climate in different Middle Eastern countries - Turkey and Egypt - which largely import raw and semi-processed jute for their carpet industry.

Bangladesh has also made notable strides in the Information and Communication Technologies (ICT) sector, earning nearly USD 190.9 million in 2017 by exporting locally made software, and providing ICT-related services such as outsourced and freelance work. However, the industry is not yet at a stage to deliver high value export. Pharmaceutical export has also been growing with export of USD 50.36 million for July-December 2017, growing at 11.66%, as top manufacturers are increasingly exporting to African, European and North American markets.

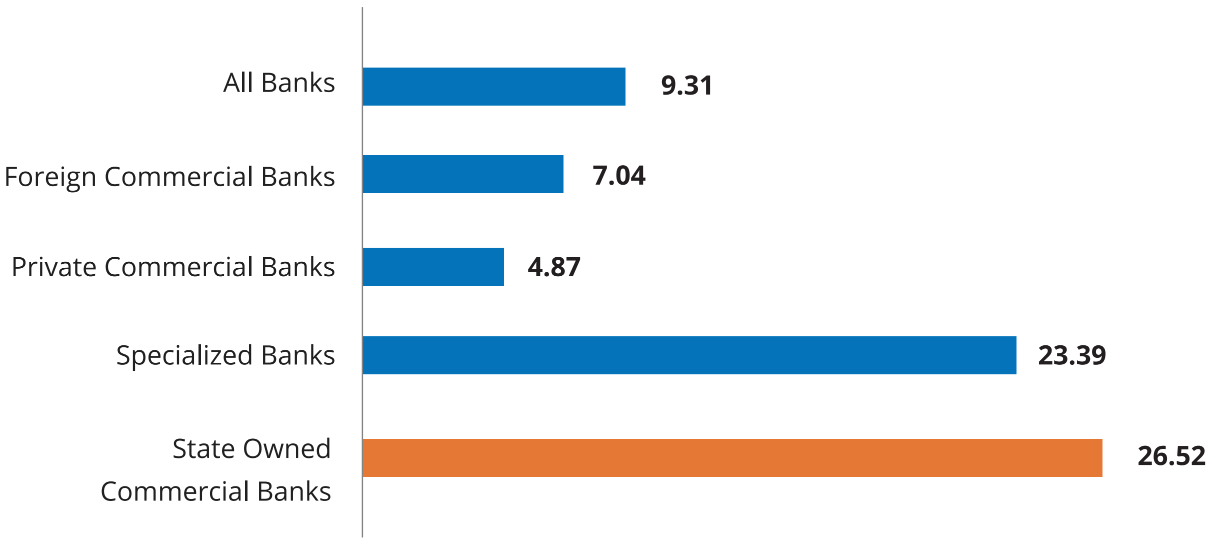
The Bangladesh government has set its export target at USD 41 billion, with a growth target of 7.87%, riding on apparel products, for the 2017-18 fiscal year. Of that amount, USD 37.50 billion is expected to come from manufacturing, including the apparel sector, while USD 3.5 billion will come from the service sector, including ICT. Without adequate investments in the aforementioned sectors to diversify the country’s export basket, graduating from LDC status by the year 2021 will be uncertain.

Bangladesh Banking Sector Stuck in a Quagmire

Bangladesh's banking sector has been in free-fall due to rising non-performing loans from both state and private banks alike. According to Bangladesh Bank, the total NPL combined from the 8 state-owned, 40 privately owned and 9 foreign banks stood at BDT 803.97 billion as of September 2017. This is in total 10.67% of all outstanding loans and 4% of the country's GDP. If restructured and rescheduled loans are taken into consideration, the total classified loan reaches around 17% of total outstanding loans. State banks historically have performed worse than the private banks with state owned banks carrying 55% of the total NPL as of 2017, approximately BDT 441.26 billion. The banks combined also had a capital shortfall of BDT 126.83 billion by June, 2017. The finance ministry proposed to reduce the cash reserve requirement (CRR) by one percentage point to 5.5%, which the Bangladesh Bank carried out in April, 2018, to mitigate the ongoing liquidity crisis in the banks.

According to a study by Bangladesh Institute of Bank Management (BIBM), annually, banks on average rescheduled bad loan of BDT 109.1 billion from 2010 to 2014. At the end of 2016, the defaulted loan value stood at BDT 626.32 billion after continuous rescheduling. A fourth-generation bank has suffered tremendously due to embezzlement and irregularities in loan disbursement, and the government plans to bail out the bank by obtaining BDT 11 billion worth of shares of the bank, through The Investment Corporation of Bangladesh (ICB).

Gross NPL Ratio (%)

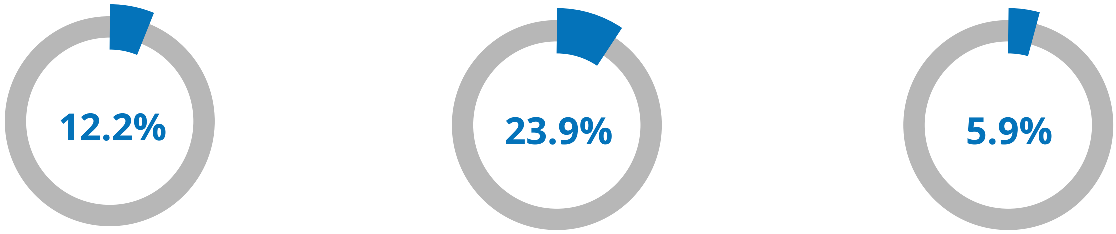


Source: Bangladesh Bank [13]

The Capital to Risk Weighted Assets Ratio (CRAR), which is a strong indicator of a Bank's performance, has consequentially lowered for both private banks and state-owned banks as indicated below.

13 https://www.bb.org.bd/pub/weekly/selectedindi/20180517secindi.pdf

Capital to risk weighted assets ratio (CRAR)



Private Banks | **Foreign Banks** | **State Owned Banks**

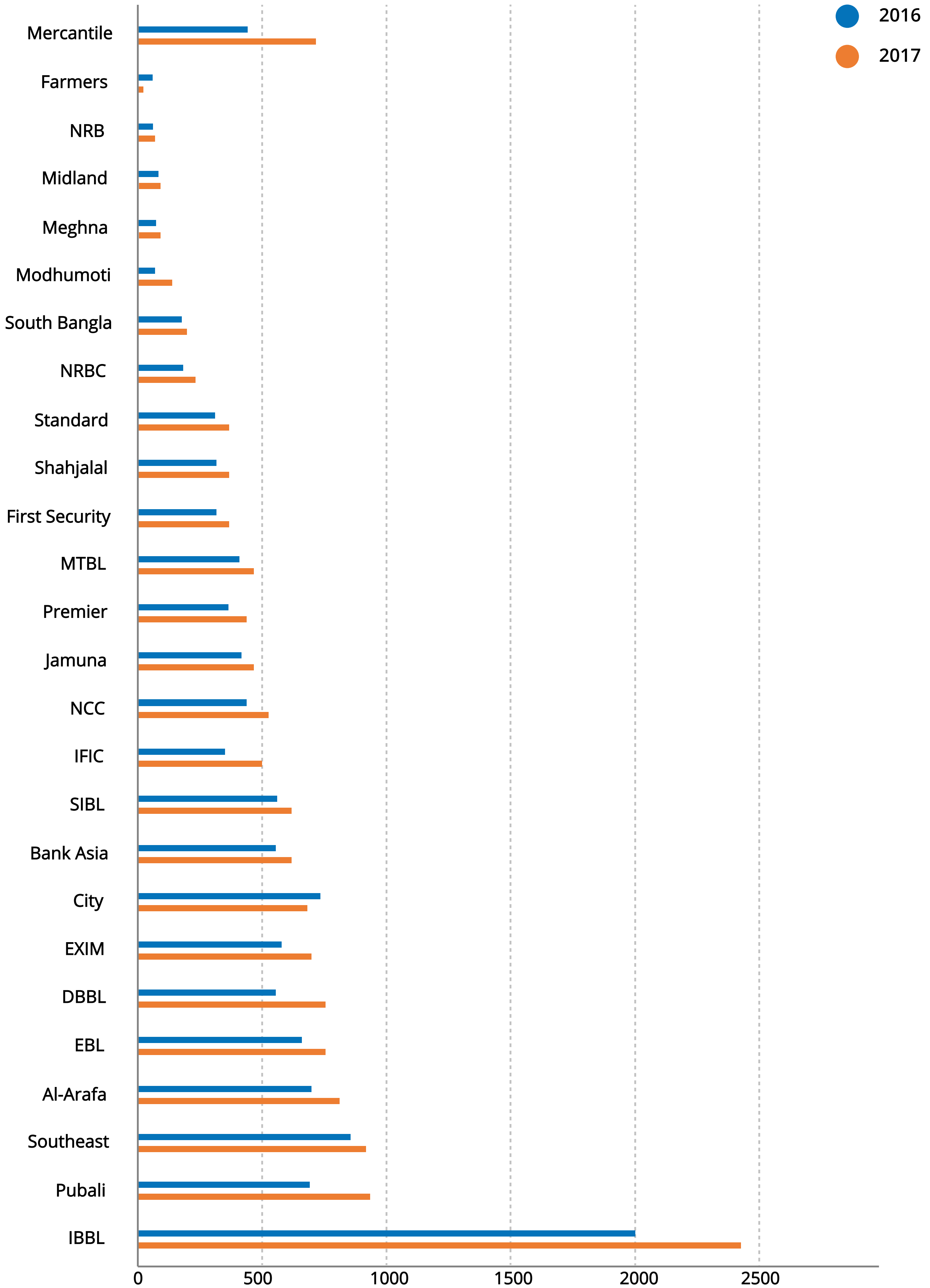
Source: Bangladesh Bank [13]

The finance ministry has strong influence on whom to appoint as directors of the State-owned banks and this has led to several irreversible losses. BB is supposed to get autonomous access in regulating the banking industry but that is not happening due to the overarching reach of the respective ministry. They coordinate decision making in appointing directors in SOBs boards, who hold limited accountability due to their connection. According to the government, there's been capital injection of around BDT 116.6 billion to the state-owned banks between fiscal year 2011-12 (July-June) and 2016-17. On top of that, the government has recently moved BDT 20 billions of tax payer's money into these state-owned banks in the form of bailouts.

Although majority of commercial banks are reporting higher profits for 2017, this is partly due to the Central Bank's leeway for extending the period for classified loans.

In summary, the banking industry is precariously balanced by the influx of government bailouts and increasingly local banks are scurrying to ensure loan repayments and maintaining required deposits. As customers' sentiments deteriorate about the banking sector, they'll be less likely to keep their surplus income in the bank and without sufficient deposits, banks will be unable to give out loans for investments, which would in-turn stagnate economic growth. As banks are unable to give out sufficient loans due to low liquidity, businesses will suffer searching for capital to invest in expansion. Without growth in the business sector, job creation will fall, employment growth will falter and so will disposable income among consumers.

Banks Operating Profit in 2016 -17 (Crore BDT)



Source: Bangladesh Bank (2016) and relevant banks (2017)[14]

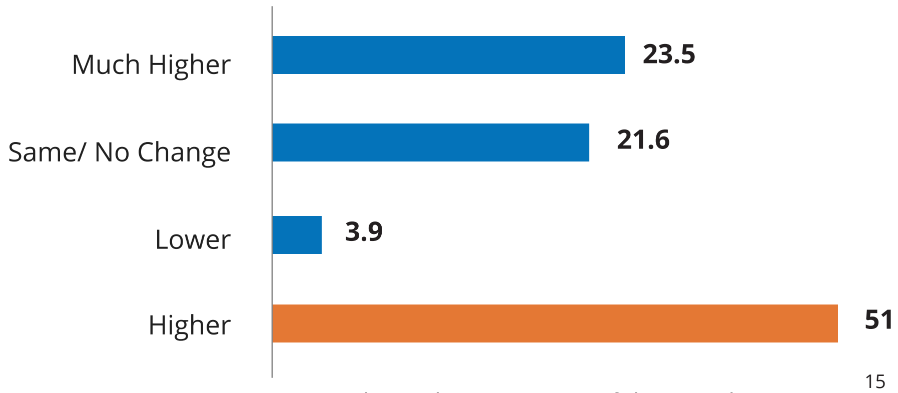
14 https://www.bb.org.bd/pub/publictn.php

Looming Political Uncertainty to Hamper Progress

Bangladesh has a history of experiencing political turmoil during the election year, especially over the last two terms. Since the 2014 election, which brought the incumbent Bangladesh Awami League (BAL) to power for a second consecutive term, relationship has frailed with the major opposition parties. The situation may further exacerbate in the latter half of 2018, especially if the main opposition, Bangladesh Nationalist Party (BNP), chooses to boycott the elections. Experts predict protests to be more subdued compared to 2013-15, as the opposition's field strength has somewhat weakened over the last 3-4 years and the party's chairman has been incarcerated on corruption charges.

Investors are cautiously optimistic about making new investments. According to LightCastle Business Confidence Index 2018, business confidence has marginally increased from +39 in 2016-17 to +43 in 2017-18. In terms of plans for investments, 74% of the sample C-Suite Member respondents have expressed plans for making fresh investments during 2018-19. However, the ongoing banking sector liquidity crises may prove to be a dampener as the private sector credit growth has already started to peter out.

Investment Plans (%)



Source: LightCastle Business Confidence Index 2017-18[15]

Despite persistent efforts from the government in wooing international investments, the FDI trend is at best stagnant, which can be partially explained by the cautious nature of international investors. Local investors are also looking to see out 2018 for gaining further visibility on political and investment climate, before making significant investments.

In terms of international relations, a regime change may not directly impact relationship with China and Japan, which constitute a significant chunk of investments, loan and grant. But relationship with immediate neighbor, India, may potentially take a battering. Ties between the two countries have markedly improved over last 10 years, despite disappointments of not securing the Teesta water sharing deal. Both economies are highly entrenched with direct import of power and increased road connectivity. The Indian government's extended credit line, investment plans maybe directly impacted in the event of a regime change.

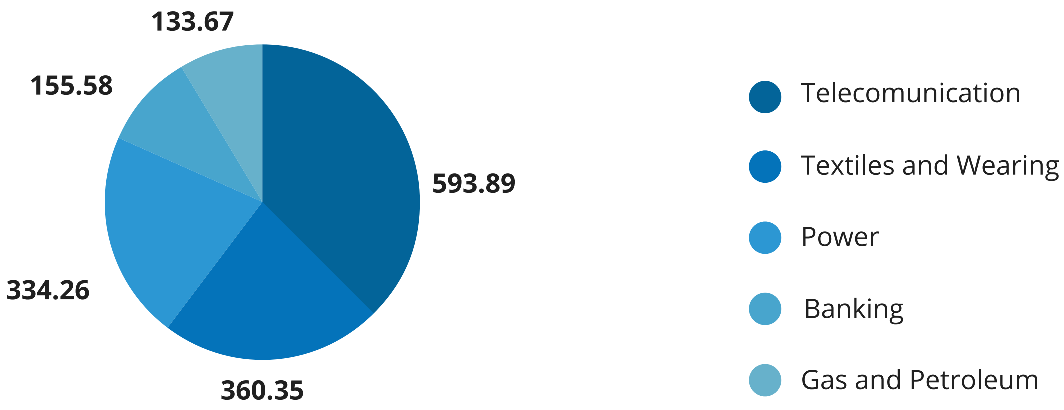
Regardless of the outcome from next year's election, a peaceful transition of power will uphold a positive political culture and allay investors' fear of cyclic political turmoil. However, with the election expected under a partisan government, latter half of 2018 is expected to be mired with some form of political unrest.

15 http://www.lightcastledata.com/drive/

Jittery Private Sector Investment Scenario

Despite mounting roadblocks, FDI increased by 22.54% for the fiscal year 2016-17 to a record high of USD 2.45 billion due to a surge in direct investment by telecom companies and increase in reinvestment of profits by multinational companies operating in Bangladesh. Poor logistics, lack of infrastructural development, frequently changing tax policies and corruption are some of the detrimental factors marring growth in FDI. According to the Doing Business Index, Bangladesh's worst performances are observed in the areas of 'enforcing contracts', 'getting electricity' and 'registering property' with rankings of 189th, 187th and 185th respectively.

FDI Inflow FY 2016-2017 (Jan-Jun) (USD Million)



Source: Bangladesh Bank [16]

Textile and wearing received the second highest foreign investment with USD 360.35 million for the sector. Central bank takes intra-company loan, reinvestment and equity investment to be the three parts of FDI. To this effect, reinvestment for the period January- June alone amounted to around 65% of total FDI and direct equity investment amounted to only around 27% for the same period according to Bangladesh Bank. This shows an over-inflated FDI with higher reinvestment than actual money coming in as foreign investment. Around 35% of the investment came from Singapore followed by around 16% from the UK.

Government is working to secure FDIs in the short to medium term by setting up 100 plus special economic zones within 2030. These zones are expected to attract USD 20 billion in FDIs generating USD 40 billion export and contributing to 10 million new jobs. According to BEZA, around BDT 10,000 crores have already been invested by local conglomerates in these economic zones.

However, the development of EPZs is fraught with land acquisition issues and timelines are being constantly revisited due to lack of progress. Mirsarai economic zone is set to be the first state owned economic zone but only around 50% land acquisition has been done. Although the Mongla

16 https://www.bb.org.bd/econdata/index.php

economic zone is complete, it cannot start operations due to a stay on construction of factories near the Sundarbans. Lower gas supply, specifically availability of piped gas supply, is one other impediment hindering foreign investment. It is expensive and difficult to set up gas and power infrastructure in smaller economic zones and this is stagnating progress. Bangladesh just recently started LNG import which should address demand but has a short-term higher cost implication for setting up the new piped gas network.

Economic Impact on Key Sectors

Sector	Challenges	Opportunities
Apparel	• According to a report by Economic Relations Department (ERD), Bangladesh may lose around USD 2.7 billion every year in export with an increase of tariff by 6.7% due to graduation from LDC category. • The fourth industrial revolution is ushering in an era of automation globally in major sourcing destinations. The ones producing clothes with the least intricacies, like Bangladesh, will be the first to go as those processes are easier to automate.	• As of January 1, 2017, USD 1 stood at BDT 79.365 and by February it strengthened to BDT 80. Subsequently in April, it touched BDT 84.25 as a boon to apparel exporters. Depreciating domestic currency will increase export competitiveness of apparel exporters. • With the import of LNG, the power supply scenario will improve significantly as LNG will mitigate scarcity of natural gas and also increase efficiency in production. • Even though the LNG will be three times the current price, availability of NG will significantly increase productivity of textile factories. • Some denim manufacturers are highly competent and are moving to produce higher value products for the global market.
Building Materials Cement/Steel	• Due to over capacity within the industry and intense competition, price has remained depressed in the cement sector. • The real estate industry itself is experiencing a down-turn contributing to lower demand for building materials.	• Government investment in infrastructure has increased as the economy develops. Demand for building materials is also increasing in tie with it.

Sector	Challenges	Opportunities
	• Setting up of new manufacturing operation is also getting hampered due to inadequate utility connections. • Depreciating currencies has increased import prices for billet and scrap which has contributed to higher cost for flat and long steel. • Tighter private credit disbursement will constrict available loans for setting up manufacturing operations as well as procurement in the industry. • High interest rate due to constrained credit flow will dissuade potential investors to make fresh investments.	• Indian and the Chinese government are providing Government to Government (G2G) facilities for the country and will increase their investments in the coming year.
Banking	• Over-competition within the industry due to issuance of new banking licenses and surveillance and monitoring by the government and Bangladesh Bank which is supposed to police the industry is ineffective and not robust enough. • There are irrefutable governance issues, contributing to over exposure of loans to clients and corporates with questionable credit ratings.	• The Government is closely monitoring the sector as a whole and has already provided some preliminary respite in the form of revised CRR and bail-out deposits. • Government is supporting the defaulting financial institutions by offering share purchase through state owned banks and ICB. A troubled fourth generation bank was recently saved by four state owned banks and ICB buying off BDT 11 billion worth of share.

Sector	Challenges	Opportunities
	• More stringent monetary policy has reduced credit flow within the economy. •Due to current predicament of a fourth generation bank and a local NBFI the depositor's trust has deteriorated and positive sentiment and trust of depositors is crucial for the banking industry to ensure deposits and cash flow.	
ICT	• Due to industrial revolution, the nature of outsourcing industry is gradually changing with more focus on Ai, Internet of Things (IOT) based initiatives. Bangladeshi companies are currently ill-prepared to take advantage of this changing landscape as the industry is just crossing its nascent stage. • Inadequate employable engineers within the industry as skill-sets are basic or entry-level and few academic institutions providing quality resource output. • Domestic e-commerce industry is yet to pick up due to lack of demand and inadequate last mile logistics across the country.	• The government will give tax breaks to the industry till the year 2024. • ICT is another thrust sector for the government and has received considerable support in the form of ADB and World Bank projects. • Some IT players in the domestic market have gained considerable traction. For example Pathao, a ride sharing app has received a valuation of USD 100 million in recent times.

Sector	Challenges	Opportunities
Pharmaceuticals	• Although a thrust sector for the government and a promising industry, around 85% of the industry's input, the Active Pharmaceutical Ingredient (API) is imported from other countries, mainly China. This dependence on large scale import of raw materials has to be reduced in order to mitigate external shocks and global supply chain period.	• TRIPS, the trade agreement which allowed developing nations to produce pharmaceutical products without having to pay royalty for the IP of the medication was due to expire in 2015. However, The World Trade Organization (WTO) council on TRIPS has extended the expiration timeline to January 1, 2033. • The pharmaceutical industry itself has been identified as one of the thrust sectors by the government with exports hitting USD 82.11 million for the fiscal year 2015-16. Government will provide support as it sees fit to develop the industry as a new engine for growth. • Top manufacturers have received Food and Drugs Administrations (FDA) approval to export to the US and some like Square Pharmaceuticals is also tapping into the growing low-cost market in South Africa. • Growing local market with an increasing middle-income class and a surge in demand for pharmaceutical products.

Sector	Challenges	Opportunities
Agro Processing	• The industry is highly fragmented with only a few players dominating the market. • The agro-based export led initiatives has not fostered due to falling demand and quality issues. • Frozen food regulatory challenges, e.g. incorrect weighing of shrimp products due to fraudulent practices, which led the industry to face significant backlash. Export to the EU has significantly dropped due to this.	• Some local players like PRAN have already penetrated regional markets. • MAC consumers have increased demand for agro-processing products with changes in lifestyle and increase in living standards.

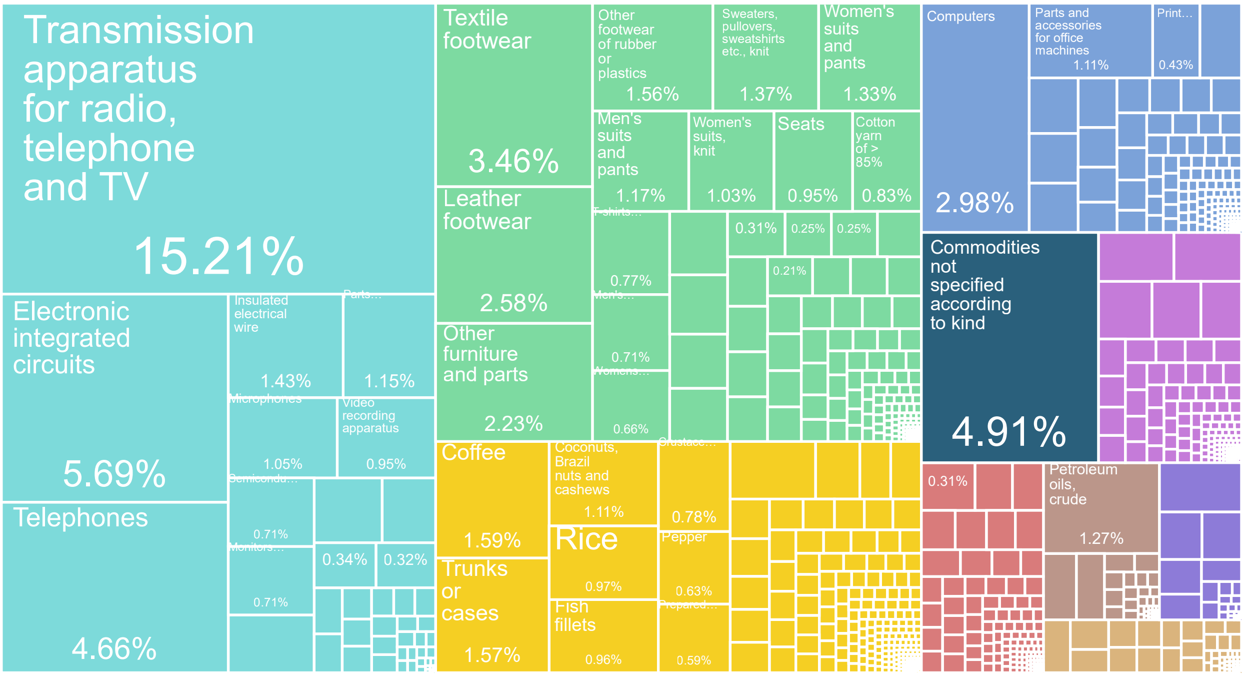
Conclusion

Bangladesh stands at a crossroad, joining the league of growing economies. Although the country has been achieving commendable economic growth, there are a number of pitfalls which can easily derail the economy by stunting future progress. A number of structural challenges like the imploding banking sector, stagnating exports, sustained corruption, bureaucratic red-tapes, inadequate infrastructure and growing unemployment may become more pronounced in the upcoming years. As the government undertakes a more aggressive strategy for attracting foreign investments, potential investors would seek to further assess the economic fundamentals for a frontier market like Bangladesh. A much clearer picture on Bangladesh's short to medium term prospects is likely to emerge post national election in 2019.

Annexure

Export Basket for Regional Peers

Vietnam (2016, $213B)



Source: Harvard Economic Complexity Atlas [11]

Textiles and Furniture

Vegetable, food stuffs and wood

Stone and Glass

Minerals

Metals

Chemicals and Plastics

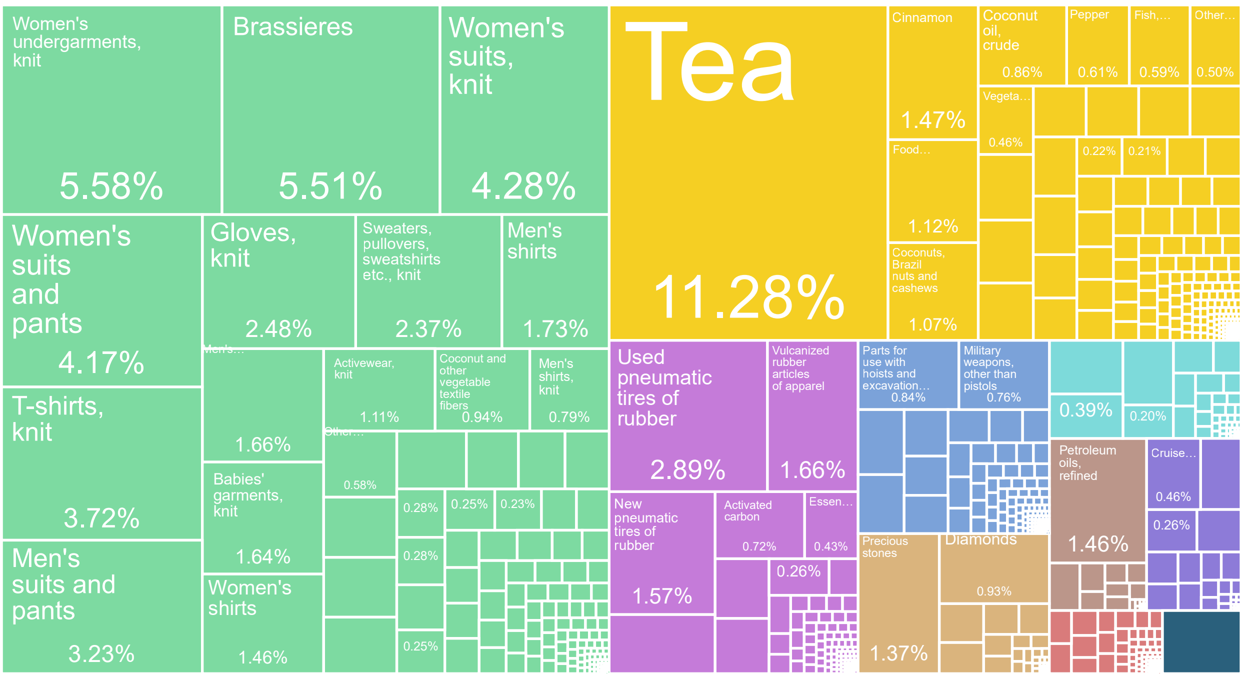
Transport Vehicles

Machinery

Electronics

Others

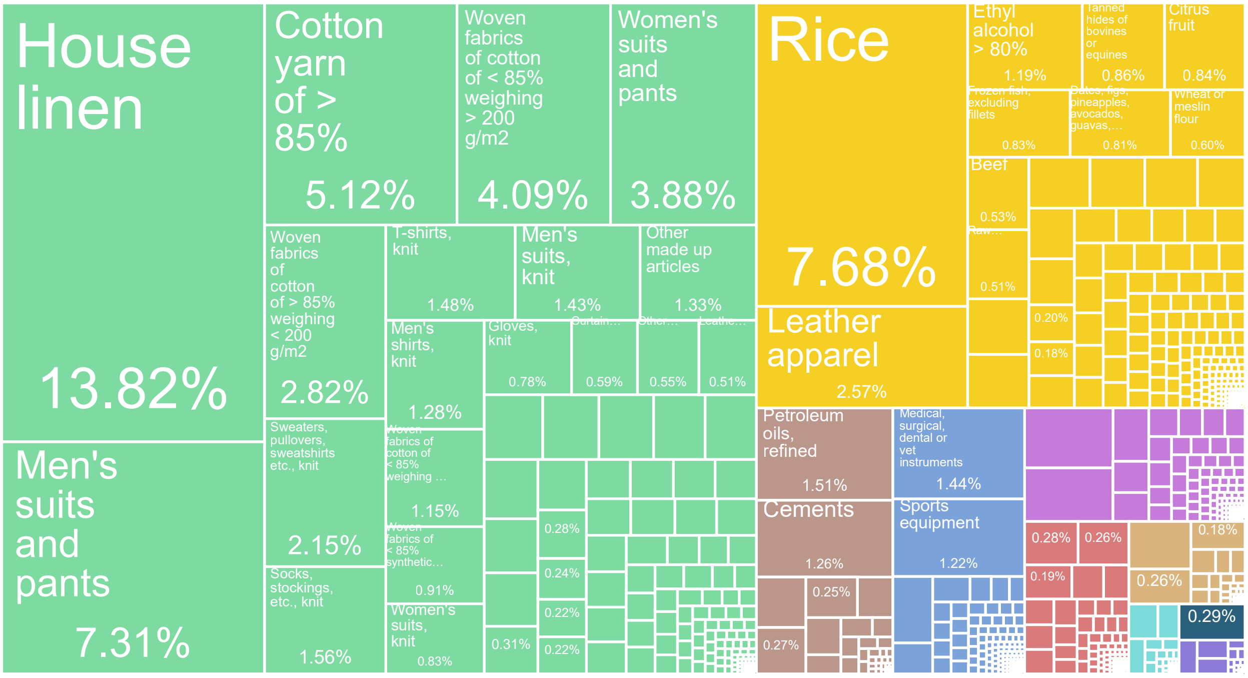
Sri Lanka (2016,$10.9B)



Source: Harvard Economic Complexity Atlas [11]

11 http://atlas.cid.harvard.edu/

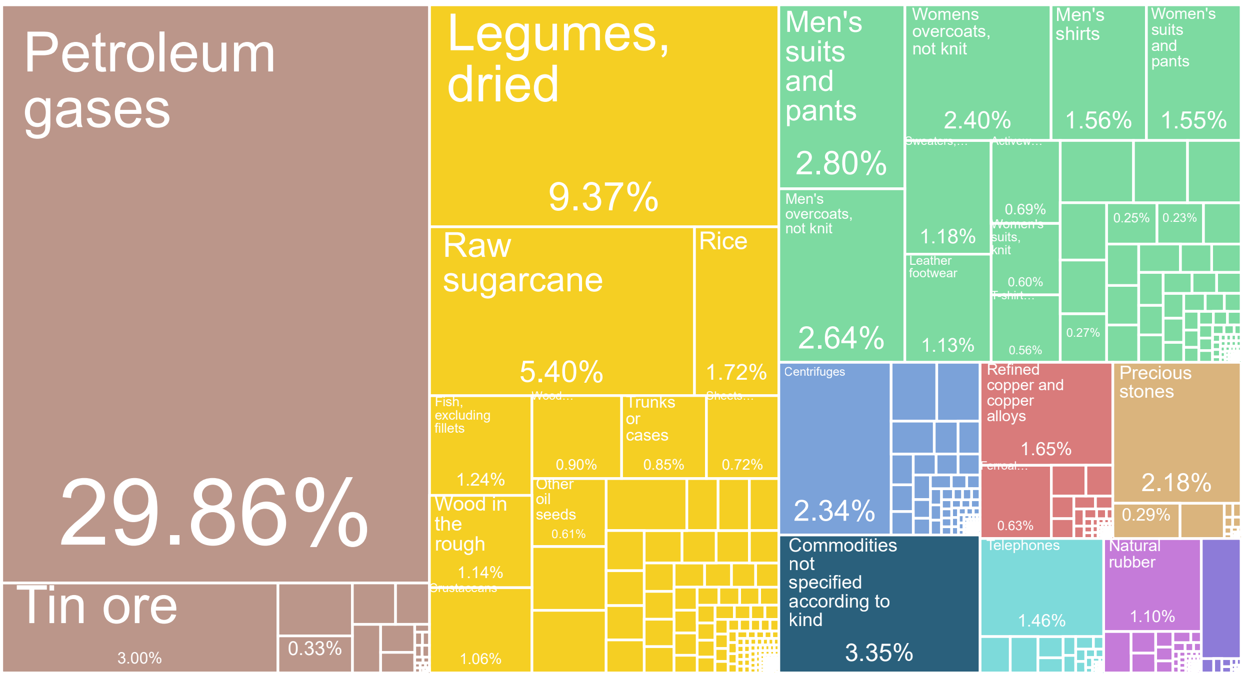
Pakistan (2016,$22.8B)



Source: Harvard Economic Complexity Atlas [17]

- Textiles and Furniture
- Vegetable, food stuffs and wood
- Stone and Glass
- Minerals
- Metals
- Chemicals and Plastics
- Transport Vehicles
- Machinery
- Electronics
- Others

Myanmar (2016,$12.6B)



Source: Harvard Economic Complexity Atlas [17]

17 http://atlas.cid.harvard.edu/

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