

Bangladesh Business Forecast Report Q4 2013

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Abstracts

Core Views

In a widely anticipated move following the Savar building collapse in April, the government passed amendments to the labour law in July, which are likely to hit Bangladesh's business environment. In the grand scheme of things, we believe that global retailers will be hard-pressed to find other sourcing alternatives in the region.

Public unrest owing to heightened tensions between the ruling Bangladesh Awami League (AL) and its main opposition, the Bangladesh Nationalist Party (BNP), are unlikely to subside as both sides continue to confront each other regarding the restoration of the caretaker government system. In addition, unrest stemming from the ongoing war crimes trials is unlikely to completely dissipate in the near term. The ongoing trials could be a catalyst for Islamist militancy in the country.

The Bangladeshi economy has demonstrated resilience in the face of multiple headwinds (such as political unrest at home), which bodes well for our view that real GDP growth will bounce in FY2013/14 (July-June) to 6.5%. Key tailwinds – loose monetary policy and improving external demand – are expected to remain in play.

While we continue to believe that the country's fundamentals remain favourable for further taka strength, we have decided to temper our stance on the unit as there is now more pressure than ever on the central bank to keep the unit competitive amidst the ongoing currency sell-off taking place across the region.

The AL-led government's final budget should help the economy rebound this fiscal year. While the looming elections pose a downside risk to fiscal stability, we continue to expect the government to keep within its stated budget targets as it has done so in its present tenure.

Based on our reading of the central bank's biannual monetary policy for the first half of FY2013/14, we believe that the monetary authority is likely to maintain a dovish bias towards policy, and we continue to see 50 basis points worth of further easing.

Major Forecast Changes

We have marginally downgraded our taka expectations and now see the unit ending 2013 and 2014 at BDT77.75/US\$, down from BDT75.00/US\$ previously, implying little to no change from the current spot rate.

Key Risks To Outlook

Downside Risks To Growth: Bangladesh's increasingly murky political environment puts the expected recovery in FY2013/14 at risk. Growing uncertainty over the looming elections (scheduled to take place within the next few quarters) could keep fresh investment activity on the sidelines for the time being. Should Europe's ongoing recovery quickly lose steam, the country's export sector could once again find itself facing a slowdown in growth.

Downside Risks To Taka Stability And Current Account Surplus: The collapse in the number of Bangladeshis leaving for overseas employment poses a risk to continued taka stability and to the country's current account surplus, given their importance with regards to future remittance inflows. While migration flows appear to have stabilised in recent months, the lower levels of late pose the biggest risk to the country's external accounts.

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In a widely anticipated move following the Savar building collapse in April, the government passed amendments to the labour law on July 15, which are likely to hit Bangladesh's business environment. That said, these changes could help the country regain and secure trade privileges with its two largest export markets, the US and the EU. The new regulations are unlikely to completely spook international buyers, most of who are similarly in the process of guaranteeing better working standards. In the grand scheme of things, we believe that global retailers will be hard-pressed to find other sourcing alternatives in the region.

Long-Term Political Outlook

Limited Chances Of Major Improvement

Although Bangladesh returned to full civilian rule following elections in December 2008, the political system remains immature and prone to instability. We see only limited prospects for a substantial improvement over the next 10 years.

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Resilience Amidst Multiple Storms Bodes Well For Bounce

The Bangladeshi economy has demonstrated resilience in the face of multiple headwinds, which bodes well for our core view that real GDP growth will bounce in FY2013/14 (July-June) to 6.5%. In the face of the disruptive nature of confrontational

politics in the country and the ongoing financial market stresses currently plaguing the region, its economy has continued to fare well. Key tailwinds – loose monetary policy and improving external demand conditions (particularly in Europe) – are expected to remain in play.

Balance Of Payments

More Pressure To Intervene As Competitiveness Takes A Hit

While we continue to believe that Bangladesh's fundamentals remain favourable for further taka strength, we have decided to temper our stance from a constructive outlook to one that sees broad stability, as there is now more pressure than ever on the central bank to keep the unit competitive amidst the ongoing sell-off in its regional peers. We now see the unit ending 2013 and 2014 at BDT77.75/US\$, implying little to no change from the current spot rate.

Fiscal Policy

FY2013/14 Budget To Support Growth Bounce

The Bangladesh Awami League (AL)-led government's final budget should help the economy rebound in FY2013/14 (July-June) from its two-year growth slump. While the looming elections pose a downside risk to fiscal stability, we continue to expect the government to keep within its stated budget targets as it has done so in its present tenure. In this article, we focus more on the growth supportive aspects of the FY2013/14 budget, briefly discussing some of the key measures.

Monetary Policy

BB To Maintain Dovish Bias

Based on our reading of Bangladesh Bank's biannual monetary policy statement for H1 FY2013/14 (July-December), we believe that the central bank is likely to maintain a dovish bias towards policy, and we continue to see 50 basis points worth of further easing. Crucially, inflation is unlikely to be much of a concern for the monetary authority and the economy remains mired in a soft patch.

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Long-Term Potential Strong But Restricted

We believe that a real GDP growth rate above 6.0% for Bangladesh is sustainable in the long term given the increasing size of the workforce. However, to achieve growth in the 7-8% range and higher, productivity will need to improve. Until this happens, GDP per capita – while on an upward trajectory – will remain relatively low.

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