INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE

Fiftieth Meeting
October 24–25, 2024

Statement No. 50-23

Statement by Ms. Sitharaman
India

On behalf of
Bangladesh, Bhutan, India, and Sri Lanka

Statement by Ms. Nirmala Sitharaman, Minister of Finance and Corporate Affairs, India, and Member, International Monetary and Financial Committee (IMFC), representing the Constituency consisting of Bangladesh, Bhutan, India and Sri Lanka, to the 50th Meeting of the IMFC at the Annual Meetings 2024.

October 2024

Global Economy

1. The global economy has remained largely resilient since the Spring Meetings in April 2024, and inflation has continued to moderate across major economies. Despite persistent headwinds, the global economy grew by 3.3 per cent in 2023, *albeit* growth performance was uneven across economies. As projected by the IMF, global GDP growth may stabilize at 3.2% in 2024 and 2025, with further disinflation helping support demand in several major economies. Emerging Market and Developing Economies (EMDEs) continue to be the global growth drivers but have displayed diverse growth patterns. In particular, Emerging and Developing Asia led by China and India will remain the largest growth engine for the world economy. These two economies together are projected to contribute about 44 per cent of global growth in 2024 and 2025.
2. Medium-term growth prospects, however, may remain weak due to the lack of push for structural reform across economies. Furthermore, high global debt, escalation of geopolitical tensions in several regions and growing geo-economic fragmentation are also major downside risks to the medium-growth prospects. International community needs to take cognizance of these risks and work together to address challenges relating to transformative changes, *e.g.*, the green transition, demographic shifts, and digitalization, including artificial intelligence. Structural reforms need to be prioritized further to lay the foundations for strong global growth recovery.
3. In recent period, global inflation has also moderated which led several economies to ease their policy rates. However, sticky services inflation due to rise in wages in several economies remains a concern. Moreover, disruptions to the disinflation process from rising international crude oil prices due to escalating conflict in the Middle East igniting

fears of sudden supply disruptions can't be underestimated. The central banks must remain vigilant about the array of such challenges that their monetary policies need to adjust to with focus on anchoring longer-term inflation expectations. By contrast, if the disinflation process continues across economies, enabling central banks to further ease monetary policies, then it is an opportunity for highly indebted economies to manage their debt dynamics by focusing on fiscal consolidation.

4. Depending on country circumstances, growth friendly fiscal consolidation encompassing better targeted policy measures is needed to create space for governments to respond to future shocks and generate sufficient resources to help meet future spending needs. In this regard, the joint domestic resource mobilization initiative of the Fund and World Bank focusing on reforms on tax capacity, spending effectiveness and efficiency, and strong public debt markets can support emerging and low-income developing countries in mobilizing additional resources to fund the sustainable development goals. EMDEs' overall resilience will also depend on (i) their preparedness to deal with global spillovers of uncertain monetary policy actions in advanced economies, (ii) their capacity to deal with supply-side disruptions caused by intensifying geo-economic fragmentation and geo-political tensions and (iii) their willingness to undertake structural reforms to address long-term challenges.
5. The shared challenges that several developing economies face need to be addressed jointly through multilateral efforts. Further coordination is required to ensure that debt distressed countries slowly move towards path of debt sustainability without facing solvency crisis or compromising on social spending and ongoing climate endeavors. We welcome the progress made so far with regard to the sovereign debt restructuring process, but faster and more predictable debt treatments are expected going forward.

India

6. In an uncertain global environment, the performance of Indian economy remains resilient. National Statistical Office has placed the Q1 real GDP growth for 2024-25 at 6.7% — led by a revival in private consumption and improvement in investment – the highest among large economies. The share of investment in GDP reached its highest since 2012-13. Government expenditure, on the other hand, contracted during the quarter as election-related restrictions were in place. On the supply side, gross value added (GVA) expanded by 6.8% in Q1:2024-25 surpassing GDP growth, aided by strong industrial and services sector activities.

7. The Government of India has adhered to the budgeted gross fiscal deficit target of 5.6% of GDP in 2023-24, now set lower at 4.9% for 2024-25 in line with the medium-term target. Central government revenue expenditure (net of interest payments and subsidies) grew by 9.6% in July-August, after contracting by 1.5% in the previous quarter. Central government capex increased by 25.8% in July-August 2024 after contracting by 35% in Q1:2024-25. As in 2023-24, focus of the government budget continues to be on infrastructure development and capital expenditure, which are expected to crowd-in private investment. Private investment continues to gain steam on the back of expansion in non-food bank credit, higher capacity utilization and rising investment intentions.
8. On the supply side, agricultural growth is supported by above normal south-west monsoon rainfall and better *kharif* sowing. Higher reservoir levels with good moisture conditions of soil augur well for the ensuing *rabi* crop. Manufacturing activity is gaining on the back of improving domestic demand, lower input costs and a supportive policy environment
9. Headline inflation declined sharply to 3.6 and 3.7 per cent in July and August respectively from 5.1 per cent in June, 2024 before increasing to 5.5 per cent in September 2024. Core inflation at 3.6% in September remains lower than the headline number. Undoubtedly, India’s performance is better than many other countries on the inflation front.
10. With better prospects for both *kharif* and *rabi* crops and ample buffer stocks of foodgrains, there is now greater confidence on the disinflation path. The Monetary Policy Committee has accordingly changed its policy stance from withdrawal of accommodation to neutral on October 9, 2024. The policy repo rate is retained at 6.5% as the disinflation process is still on.
11. India’s current account deficit (CAD) declined to 0.7% of GDP in 2023-24 from 2% in 2022-23. It stood at 1.1% in Q1:2024-25 on account of higher trade deficit as against 1% in Q1: 2023-24. Buoyancy in services exports and strong remittances are expected to keep CAD within a sustainable level. Foreign portfolio investment (FPI) flows have seen a turnaround from net outflows in April-May 2024 to net inflows during June-October (till October 8, 2024). Both gross and net foreign direct investment (FDI) inflows improved in April-July 2024. India’s external debt to GDP ratio stood at 18.8% at end-June 2024.

12. Indian Rupee has remained one of the least volatile currencies among major economies. India's foreign exchange reserves have already crossed a new milestone of US$ 700 billion, amounting to US$ 704.9 billion on September 27, 2024.
13. Looking ahead, India's growth story remains intact as its fundamental drivers – consumption and investment demand – are gaining momentum. Given healthy balance sheets of banks and corporates, supply chain normalisation, business optimism, and robust government capital expenditure, the real GDP growth is expected at 7.2% for 2024-25 and inflation at 4.5%.

Sri Lanka

14. Sri Lanka has made significant strides in recovering from the severe economic crisis of 2022. Real economic growth has exceeded expectations, with positive momentum continuing. Inflation has decelerated, and foreign reserves are improving, contributing to exchange rate stability. The tourism sector is recovering, and workers' remittances have steadily improved. Despite challenges, the financial system remains resilient, with narrowing risk premia in the government securities market. Market confidence has been bolstered by the IMF-supported Extended Fund Facility (EFF) program and progress in debt restructuring. Market interest rates are adjusting in line with accommodative monetary policy stance. Public finance stresses have eased due to robust revenue performance and restrained government expenditure. State-owned enterprises are performing better, reflecting cost-reflective pricing. Social spending has increased, easing the burden on vulnerable populations, though efficiency improvements are needed. However, sustaining this momentum faces challenges such as lackluster investment, productivity issues, and the impact of skilled labor outmigration. Rising tensions in the Middle East and climate vulnerabilities also pose risks. Strengthening social spending is crucial for inclusive growth. In September 2024, Sri Lanka elected a new President in a smooth election. Following the Presidential Elections, the Parliament was dissolved, with elections scheduled for mid-November 2024. The government's commitment to the IMF-supported reform agenda reassures investors, fostering a conducive environment for economic activities. Early negotiations on the Third Review of the EFF are set to begin soon. Economic reforms aimed at simplifying regulations, reducing corruption, improving tax policies, and enhancing infrastructure are expected to attract foreign investment and stimulate local businesses. Improved infrastructure, especially in digitalization, will support trade and commerce. The reform drive under

the EFF program could strengthen exports and attract foreign direct investment. Social policies addressing poverty, unemployment, and inequality are expected to enhance human capital and productivity. Support for SMEs, innovation, and entrepreneurship would help drive economic diversification and resilience.

15. In 2024, Sri Lanka made significant progress in debt restructuring, building on developments from 2023. In November 2023, an agreement in principle on debt treatment terms was reached with the Official Creditor Committee (OCC), formalized in a Memorandum of Understanding (MoU) by June 2024. Bilateral agreements with OCC members are expected to conclude a substantial portion of the debt treatment process. In October 2023, Sri Lanka also reached an agreement in principle with China Exim Bank, its largest single creditor, with revised loan agreements signed in June 2024. Other official creditors have confirmed their willingness to implement the agreed terms. For external commercial creditors, core financial terms for restructuring International Sovereign Bonds (ISBs) were agreed upon in July 2024 with the Ad Hoc Group of Bondholders (AHGB). By September 2024, agreements in principle were reached with AHGB, the Local Consortium of Sri Lanka (LCSL), and China Development Bank (CDB). In early October 2024, the OCC confirmed that these terms are compatible with the Comparability of Treatment (COT) principle, and the IMF confirmed they meet the EFF arrangement parameters. The Ministry of Finance has appointed a Dealer Manager for the country's proposed sovereign bond exchange. These confirmations will complete Sri Lanka’s sovereign debt restructuring under the IMF-supported program, aiming to restore long-term debt sustainability.
16. Sri Lanka has made significant progress under the 48-month Extended Fund Facility (EFF) arrangement, amounting to SDR 2.286 billion (approximately USD 3 billion), approved by the IMF in March 2023. The first three tranches, totaling about USD 1,000 million, were disbursed in March and December 2023, and June 2024. Progress is regularly monitored through various performance criteria and benchmarks. The third review of the EFF, initially scheduled for October 2024, was delayed due to the Presidential Elections in September 2024. The new administration is preparing for negotiations with the IMF, with initial discussions starting in early October 2024. Both parties are committed to the program’s goals, despite potential delays due to the upcoming General Elections in November 2024. Under the IMF program, Sri Lanka has implemented key reforms to restore macroeconomic stability, ensure debt sustainability, and foster sustainable growth. These include cost-reflective pricing

policies in the energy sector, governance reforms for financial transparency, and significant legislative changes such as the Central Bank Act and Anti-Corruption Act, Public Finance Management Act, Public Debt Management Act, among others. A welfare benefit payment scheme has been introduced to support vulnerable populations, though efficiency improvements are needed. Efforts to promote exports, attract foreign direct investment, and enhance labor skills remain crucial. Measures to improve the efficiency and fiscal transparency of state-owned enterprises are also in place, reducing fiscal risks and ensuring a level playing field for the private sector.

17. In 2024, Sri Lanka's economy has shown resilience, building on the macroeconomic stability restored in 2023 after the 2022 crisis. In Q2 2024, GDP grew by 4.7% year-on-year (y-o-y), following a 5.3% y-o-y growth in Q1 2024, marking the fourth consecutive quarter of growth. Key sectors such as agriculture, manufacturing, and services contributed significantly to this recovery. Agriculture grew by 1.7%, with notable increases in animal production (+8.6%) and marine fishing (+7.7%). The industrial sector surged by 10.9%, driven by electricity production (+21.9%), mining and quarrying (+21.5%), construction (+15.5%), and manufacturing (+7%). The services sector expanded by 2.5%, with strong contributions from accommodation, food and beverage (+21.1%), Financial Service activities, except insurance and pension funding and auxiliary financial services (5.7%), and IT (+14%). Tourism also showed strong signs of revival, further boosting economic activity. Strategic initiatives and policy measures have helped achieve this positive trajectory, indicating resilience and potential for sustained development. The Purchasing Managers' Index (PMI) for August 2024 showed expansion in both manufacturing (55.5) and services (65.2), reflecting growth in new businesses and activities. The robust growth in the first half of 2024 is expected to continue, leading to higher-than-projected annual growth.
18. Sri Lanka's efforts to maintain price stability have yielded positive outcomes, supported by prudent monetary policy, currency appreciation, and improved supply conditions. Recently, headline inflation softened significantly due to reductions in electricity tariffs, fuel, and LP gas prices, along with a decline in volatile food prices. Notably, headline inflation turned negative, recording a deflation of 0.5% y-o-y in September 2024, the first since September 2015. The food category saw a deflation of 0.3% y-o-y in September 2024, compared to an inflation rate of 0.8% y-o-y in August 2024. Similarly, the non-food category recorded a deflation of 0.5% y-o-y in September 2024, compared to an inflation rate of 0.4% y-o-y in August 2024. Core inflation moderated

to 3.3% y-o-y in September 2024. Projections indicate that headline inflation will remain well below the 5% target in the coming months, while core inflation is expected to stay around current levels. Market lending interest rates have continued to decline in line with the accommodative monetary policy stance. Consequently, credit to the private sector by Licensed Commercial Banks (LCBs) has expanded notably since May 2024, with Q2 2024 data showing broad-based growth across major economic sectors. Looking ahead, the expansion of credit to the private sector is expected to continue, supported by lower market lending interest rates and the anticipated recovery in domestic economic activity.

19. Sri Lanka's external sector has shown positive momentum recently, with encouraging trends in exports and remittances, despite challenges in managing the trade deficit and fluctuations in tourism earnings. From January to August 2024, the merchandise trade deficit widened due to a larger increase in import expenditure compared to export earnings. The EFF-supported program has boosted market confidence and foreign exchange liquidity, aiding the buildup of gross official reserves and stabilizing the exchange rate. Total export earnings rose to USD 8.5 billion, up from USD 8.0 billion in 2023, driven by robust industrial exports. Merchandise imports increased to USD 12.1 billion from USD 11.0 billion last year, primarily due to higher expenditures on intermediate and investment goods. Consequently, the trade deficit widened to USD 3.6 billion, compared to USD 3.0 billion in the same period in 2023. Other services sector inflows, excluding tourism, rose to USD 2.4 billion from January to August 2024, up from USD 2.2 billion in the corresponding period of the last year, mainly driven by sea transport and IT/BPO earnings. The current account is expected to record a surplus of about 0.8% of GDP for 2024. Despite this, the financial account remained subdued with low FDI inflows and continuous net outflows from the government securities market. The Sri Lanka rupee appreciated by 8.2% against the US dollar as of September 2024, reflecting improved liquidity in the domestic forex market. The Central Bank bolstered Gross Official Reserves, which stood at USD 6.0 billion at the end of August 2024, including the swap facility from the People's Bank of China.
20. In 2024, Sri Lanka's fiscal sector has shown significant improvement, driven by strong revenue-based fiscal consolidation measures. This has resulted in a notable primary surplus and a reduced overall deficit. During the first half of 2024, total revenue and grants grew by 41.6% compared to the same period in 2023, primarily due to increased tax revenue collection from reforms in VAT and Excise Duties. Consequently, the IMF-

EFF tax revenue target of Rs. 1.5 trillion for June 2024 was met. Non-tax revenue also increased by 30.4%. Total expenditure (including net lending) decreased by 3.8%, mainly due to a 4.6% reduction in recurrent expenditure, driven by a 10.3% decrease in interest payments and a 1.4% decrease in subsidies and transfers. The government spent Rs. 73.3 billion on the 'Aswesuma' social welfare program, below the IMF-EFF target of Rs. 100 billion, reflecting delays in streamlining the program. Capital expenditure and net lending increased by 4.6%, with only 19.6% of the budget estimate spent by June 2024. During the first half of 2024, the primary balance recorded a surplus of Rs. 543.4 billion (1.8% of projected GDP), well above the QPC target of Rs. 140 billion, compared to a surplus of Rs. 30.7 billion in the same period in 2023. The overall budget deficit decreased to Rs. 598.7 billion (2.0% of projected GDP) from Rs. 1,242.6 billion (4.4% of GDP) in the same period in 2023. The current account deficit narrowed to Rs. 357.8 billion (1.2% of projected GDP) from Rs. 1,010.7 billion (3.6% of GDP). Net domestic financing decreased to Rs. 515.8 billion from Rs. 1,218.6 billion, while net foreign financing increased to Rs. 82.9 billion from Rs. 23.95 billion. The central government debt stock slightly decreased to Rs. 28,563 billion by the end of June 2024, with foreign debt accounting for 38.5% and domestic debt for 61.5% of the total outstanding debt.

21. Sri Lanka's financial sector has shown resilience despite significant challenges. In 1H 2024, the banking sector's Profit After Tax (PAT) increased by 39.2% to Rs. 112.2 billion, driven by a rise in Net Interest Income (NII) to Rs. 57.7 billion and a net trading gain of Rs. 10.1 billion. Profitability indicators improved, with Return on Equity (ROE) at 12.7%, Return on Assets (ROA) at 1.8%, and Net Interest Margin (NIM) at 3.9%. The Capital Adequacy Ratio (CAR) rose to 18.%, due to the retention of profits and fresh capital raising despite an increase in Risk-Weighted Assets (RWA). The Financial Stress Index (FSI) showed increased stress levels by July 2024, but positive developments in the foreign exchange market helped mitigate this. Financial intermediation is recovering slowly, with gradual credit and deposit growth. The Credit to Deposit Ratio (CDR) indicates improvement, with increased willingness to lend and demand for loans. Exposure to the public sector is decreasing, with the share of exposure towards the Sovereign down to 49.8% in June 2024. The private sector credit-to-GDP gap has entered an expansionary phase, reflecting economic recovery. The default risk, indicated by the Stage 3 Loans Ratio, slightly declined to 12.8%, showing stabilization in credit quality. The Central Bank of Sri Lanka (CBSL) further

strengthened its legal and regulatory framework pertaining to licensed banks in Sri Lanka through the Banking (Amendment) Act No.24 of 2024 which came into operation on June 15, 2024 and issued necessary directions to licensed banks with a view to facilitating the effective implementation of the new Act. The CBSL also issued new corporate governance directions in September 2024 which will be effective from January 01, 2025. These aim to enhance the responsibility and accountability of boards of directors and senior management, promote board independence, reinforce sound corporate culture and values, and establish a strong risk governance framework. These measures are designed to create a resilient banking sector in Sri Lanka, aligning with international standards and addressing recent governance failures and market developments.

Bangladesh

GDP Growth

22. Prudent economic policies and their implementation consistently over the years during the past few decades resulted in sustained growth in Bangladesh. The economy gained significant momentum which is evident from the fact that the average GDP growth rate during the period FY12 to FY23 has been 6.74 percent which is significantly higher than the average growth of the emerging markets and developing economies. Owing to the outbreak of COVID-19 in 2020, the global economy was hit with abrupt slowdown and consequently many countries including the developed ones had to endure negative growth rates. However, Bangladesh was one of few countries that managed to remain in the positive growth quadrant. The GDP growth rate in FY20 fell to 3.45 percent from 7.88 percent in FY19. Yet, in FY21 the growth rate again surged to 6.94 percent followed by 7.10 percent in FY22. This V-shaped recovery indicates the inherent resilience of the economy and explains why the country defied numerous odds and moving forward. However, owing to high inflation and depleting foreign exchange reserves, the country is currently pursuing a tight fiscal and monetary stance which may cause a temporary slowdown during coming months. The Medium-term Macro Framework (MTMF) used by the Finance Division had projected last year that the country would gradually recover from the current state and would post a 7.25 percent GDP growth rate by the end of FY27.

Inflation and Exchange Rate

23. Domestic inflation was under control until the Russia-Ukraine war broke out in February 2022. Owing to the uncertainty of supply of key commodities such as wheat, fertilizer, and gas, in the global commodity market, prices rose sharply. This affected adversely almost all the countries including Bangladesh. Although, point- to-point inflation gradually fell since FY13 and stabilized around 6 percent during the FY13-FY21 period, it is now above 10 percent despite the authorities kept pursuing tight policies. However, as the global inflation started to rise in the beginning of 2022, most of the countries and regions including the US and the EU adopted tight monetary policy and raised interest rates. Because of this, Bangladeshi Taka, like many other currencies, started to depreciate against the US dollar. Calculations show that Taka depreciated against the US dollar by almost 25 percent during the FY21-FY23 period. This further added push for inflation to go up. Currently, the exchange rate stands at Taka 120 per USD (August 2024) and point-to-point inflation stands at 10.49 percent (end-August 2024). To contain a further rise in inflation, the government has increased policy rates and started to monitor import prices stringently. The government has also adopted various austerity measures to support the monetary policy in containing inflation. The tightening monetary policies generally takes some time to take effect and hence it is expected that inflation will start to come down within a few months.

External Sector

24. All key external sector variables showed robust growth during the FY12-FY22 period. The growth of these variables, however, slowed down when COVID-19 broke out globally. In FY12, the volume of exports (f.o.b) and imports (f.o.b) were USD 24.3 billion and USD 35.5 billion respectively. This grew to USD 43.46 billion and USD 69.5 billion respectively by the end of FY23. This reveals that during the FY12-FY22 period both the volume of exports and the volume of imports almost doubled.

25. During the COVID-19 peak period (FY20-21), global trade slowed down because of lockdown imposed by all the countries. When the vaccine arrived and situation started to normalize, a surge in both export and import was observed in FY22. In that year, imports grew by more than 35 percent to USD 82.5 billion and exports grew by more than 33 percent to USD 49.2 billion. However, as the base of the imports was almost 1.7 times than that of the exports, the trade deficit grew by almost 40 percent to USD 33.3 billion. The sudden surge of imports in FY22 resulted in the highest trade deficits in the history of Bangladesh and this put pressure on the foreign exchange reserves.

26. The Foreign Exchange reserves grew steadily from USD 10.37 billion in FY12 to USD 46.39 billion in FY21. However, as the trade deficit had a sudden surge in FY22, it started to decline. By the end of FY23, gross foreign exchange reserves stood at USD 31.2 billion. The decline continued in FY24 and at the end of August 2024 stood at USD 25.57 billion, which is equivalent to about 4.6 months of imports. Foreign exchange reserves equivalent to 3 months of imports are considered safe and hence the foreign exchange reserve now, although declined significantly since FY21, is adequate.

27. Remittance has been a key stabilizing factor for the economy. The inflow of remittances has remained stable and during the period FY12-FY23 grew at an average of 6.1 percent per annum. Yearly remittance inflow in FY2000 was only USD 1.95 billion, which grew to USD 21.6 billion by the end of FY23. When combined with the net export, figures for several years were found to be positive, and this has helped to build the foreign exchange reserves. However, the growth rate of remittance inflow has remained quite volatile and during the period FY2000-FY23, it ranged from -15.1 percent to 36.1 percent.

Foreign Direct Investment

28. The flow of foreign direct investments into Bangladesh is gradually picking up. During the FY10-FY22 period, on an average, USD 2.09 billion FDI entered Bangladesh per annum. In FY 22, total FDI inflow into the country was 3.44 billion. Data for the first three quarter shows that at an annualized rate about USD 3 billion FDI came to Bangladesh in FY24 as well. Total stock of FDI at the end of FY23 stood at USD 21.82 billion. One notable trend is that inflow of fresh capital gradually decreased its share in total FDI inflow while reinvested earnings took the dominant role for the increase in the flow of FDI.

Development Expenditure

29. Realizing that investment in physical and social infrastructures is key to unlocking the true potential of Bangladesh, highest priority has been given to building large infrastructure projects. Construction of Padma Bridge, MRT line-6, Tunnel under the river Karnaphuli, constructions of Matarbari coal fired power plants, Rooppur nuclear power plant and Terminal-3 of the Hazrat Shahjalal International Airport have been completed, elevated expressway connecting the north and south of Dhaka city has been opened. To ensure a business and investment friendly climate in the country, initiatives to build 100 economic zones have been undertaken and 100 percent of the population have been brought under electricity coverage. Implementation of these projects has been possible as the rate of implementation against the allocation of the Annual

Development Program (ADP) has been about 90 percent on average during the FY13-FY23 period.

Revenue Collection

30. Tax-GDP ratio in FY13 was 7.70 percent and in FY22 the ratio has been estimated as 7.54 percent. Recent data showed that the ratio has further dipped to 7.32 percent in FY24. Compared to India and Vietnam (17.7 percent[1] and 18.2 percent[2] respectively) this is quite low. During the period FY13-FY23, shares of tax and non- tax revenue in total revenue have been 86.78 percent and 13.22 percent respectively. However, a declining trend in the share of non-tax revenue and an increasing trend in the share of tax revenue is observed. To boost revenue collection, the government has taken a three-pronged approach- (1) digital transformation, (2) expansion of tax net, and (3) strengthening administrative capacity. Keeping this strategy in mind various measures such as online tax payment system, enhanced use of electronic fiscal device and approval of additional 4500 posts to expand tax offices across the country are being implemented. According to the National Board of Revenue (NBR), the measures are expected to generate additional revenue equivalent to 0.5 percent of GDP in the next two fiscal years.

Deficit Financing and Debt Management

31. Bangladesh has always been prudent in maintaining a sustainable level of budget deficit. According to the accepted thumb rule 5 percent of budget deficit is considered sustainable. However, the average budget deficit (including grants) during the period FY12-FY23 has been only 3.83 percent of GDP. This trend is expected to continue in the medium-term and the deficit will be kept within the 5 percent level. The latest debt sustainability analysis (DSA) done by the IMF in 2023 reported that external debt to GDP for Bangladesh for FY23 was 15.7 percent, while the approved ceiling for this indicator is 40 percent. Therefore, IMF categorized Bangladesh as "low risk" country with respect to the risk of facing debt distress. IMF has also projected that by FY28 this ratio will further fall to 13.9 percent.
32. It may also be noted that according to the external debt redemption profile estimated by the Economic Relations Division (ERD) the largest amount of external debt (principal plus interest) will be due in FY27. In that year the total amount of external debt (principal plus interest) will be approximately USD 5.3 billion (based on June 2024 debt stock). Considering the average monthly inflow of remittance during the FY19-FY23 period, which is about USD 1.70 billion, it is safe to assume that with approximately 3 months of remittance inflow, the country will be able to repay all its external debt liabilities of the whole year even during the peak. So far, outstanding stock of external general government debt including public guarantees (USD 77.3 billion as of June

2024) has been sourced mostly from long-term concessional loans from multilateral and bilateral creditors.

What lies ahead?

33. Inflation in Bangladesh has remained somewhat sticky. Although monetary and fiscal measures have been deployed to control it, fresh exogenous external events are developing that may thwart the efforts of the domestic policy makers. Oil price in the global market, which sharply went up after the Russia- Ukraine war had broken out, came down again after June 2022. The decline in the oil price continued for a full one year until recently, at the end of June 2023, it started to rise again. This rise continued until April 2024 and then started to fall again. As of 03 October 2024, price of Brent crude stands at USD 74.71per barrel. Considering the volatile situation in the Middle-east, it is now expected that oil prices may rise in the coming months if situation further deteriorates. If this expectation is realized, efforts to fight inflation may require further tightening.
34. To fight inflation that surged in early 2022, most of the central banks around the world increased their policy rates. In the USA, the Federal Reserve Bank raised the Effective Federal Fund Rate (EFFR) from 0.08 percent on 16 March 2022 to 5.33 percent on 6 September 2023. With this, the EFFR reached the same level that prevailed immediately before the global financial crisis of 2007-08. This huge rise in interest rate has deep implications for developing countries like Bangladesh. High interest rates in developed markets tend to drive foreign investments towards that market and hence a foreign currency shortage may emanate in other countries. This shortage in supply of foreign currency then may drive the value of the local currency to depreciate against the foreign currency. Finally, the depreciated local currency may result in rising import prices which then fuels inflation. This cycle may further aggravate if the central bank does not have adequate foreign currency reserves needed to stabilize the market. Recently, the Federal Reserve Bank of the USA has reduced the EFFR by 50 basis points signalling that there might be further rate cuts in the coming months if inflation remains subdued. If the rate cut in the USA continues, it may help ease the pressure on the balance of payments (BOP) that Bangladesh is facing now.
35. Food security is another concern that many countries are now wondering how to tackle should the Russia- Ukraine war reaches more devastating state in the coming months. After the war had started in 2022, price of wheat sharply rose from USD 243.63 per metric ton on 01 July 2021 to USD 444.16 per metric ton on 01 May 2022. After the grain deal was reached between Russia and other countries, price of wheat gradually fell and now stands at around USD 269.69 per metric ton at the end of September 2024.

Bhutan

36. The GDP for 2023 recorded a growth of 4.88 percent, reaching an economic size of Nu 249.38 billion (equivalent to USD 3.02 billion). The growth was predominantly driven by the service sector, underscoring its growth potential and growing importance in our economy. Among the three broad economic sectors, the tertiary sector recorded the highest share at 55.49 percent, followed by the secondary sector at 29.55 percent. The primary sector also showed resilience with a modest growth rate. The significant growth in the service sector was contributed by hotels and restaurants at 50.64 percent followed by finance and insurance at 13.42 percent. This growth is, by and large, attributed to tourism and its related industries.
37. Bhutan's economy is projected to grow by 6.1% in 2024 and accelerate to 9.6% in 2025. This growth projection is supported by domestic demand fueled by the government's expansionary fiscal policy, hydropower investments, credit growth on account of the Economic Stimulus Program (ESP), and a gradual recovery in the tourism sector.
38. The agriculture sector is estimated to witness a marginal growth of 1.5% in 2024 and 2025 due to the anticipated growth in livestock production and forestry & logging. The industry sector is predicted to experience significant growth, with a projected increase of 7.7% in 2024 and 20% in 2025. This growth will be driven by the anticipated hydropower commissioning of the Punatsangchu-II and the lifting of loan moratoriums, which will boost activities in mining & quarrying, manufacturing, electricity, and construction. Finally, the service sector is assumed to grow by 5.4% in 2024 and 4.6% in 2025 propelled by a rebound in tourism and related industries such as hotels & restaurants, transport, and communications.
39. From June 2023 to April 2024, inflation rates ranged between 3.83% and 5.07%, indicating steady inflationary pressures due to factors like rising demand, supply constraints, and cost-push inflation. However, with the rebasing of consumption baskets in May 2024, inflation dropped sharply to 2.17%. Following the recent rebasing, the month-on-month inflation rate for June 2024, relative to May 2024, decreased by 0.33 percentage points, due to the reduction in the non-food index (observed in transport, housing, and utilities). The price level will hover around 3.8% for the FY 2024/25.
40. As of June 30, 2024, total revenue collection amounted to Nu 56,014 million, with the increase in domestic revenue from higher non-tax revenue, including profit transfers from the Royal Monetary Authority of Bhutan and dividends from Druk Holding and Investments. In the medium term, tax revenue performance is expected to improve with

the implementation of GST. Similarly in the same review period, total expenditure utilization reached Nu 70,465 million including advance of Nu 406 million. The recurrent expenditure utilization accounted for nearly 61% of the total expenditure.

41. The overall fiscal deficit for FY 2023/24 was Nu 653 million, accounting for 0.24% of GDP. This improvement is largely due to the release of ESP grants towards the end of the fiscal year, coupled with higher domestic revenue and reduced government spending. The estimated fiscal deficit for FY 2024/25 has been revised down to 4.5% of GDP from the 5.2% projected with the increase in tax and non-tax revenue, along with the mobilization of external grants, giving a positive fiscal outlook in the medium term.
42. The total public debt stood at Nu 285,179 million, accounting for 106.9% of GDP as of June 2024, a decrease of 2.6% from the previous projection. The redemption of Treasury Bills and the repayment of government bonds enabled this moderation. Of the total public debt, 7.5% is domestic, while 92.5% is external in FY 2023/24. However, public debt is projected to increase by Nu 28,300 million in FY 2024/25 to finance budgetary deficits and meet borrowing needs for hydropower projects.
43. On the external front, Bhutan's balance of payments in FY 2024/25 is expected to improve with increased development assistance tied to the 13th FYP as well as anticipated growth in hydropower exports. As of June 2024, the Current Account Balance (CAB) stood at Nu 56,859 million accounting for 22.6% of the GDP. This is a significant improvement in the CAB as compared to Nu 81,198 million (33.5% of the GDP) in FY 2022/23. The gross international reserves at the end of FY 2023/24 stand at USD 681.44 million, sufficient to cover 14.3 months of essential imports. The reserve position is expected to strengthen further due to expected increases in capital inflows, service earnings from tourism, and continued growth in non-hydro merchandise exports.
44. On the domestic credit front, it continues to serve as a key source of private investment in the county and as of June 2024, the total loan outstanding in the financial sector amounted to Nu 220,473 million against a Non-Performing Loan (NPL) of Nu 7,333 million (NPL ratio of 3.3%). The five commercial banks in the country contributed to 82% of the total portfolio and the remaining 18% by the three NBFIs. From the total NPL, the share of commercial banks and NBFIs stood at 84% and 16% respectively.