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The Balance of Payment (BOP) of Bangladesh: A Comparative Study

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Abstract

This paper intends to examine the healthiness of the Balance of Payment of Bangladesh applying comparative indicators to achieve long term economic growth. To this end, analytical study was conducted based on the papers and relevant study materials conducted over time. In this study, four components of BOP have been analysed over last ten years period from the fiscal year (2007-08) to fiscal year (2016-17) using the World Bank data and other recognised journals and website. Data has been compared with the other regional countries to assess the healthiness of the indicator. The current account balance is considered as healthy as it has never been in deficit position in ten years except in FY (2010-11). However, financial account is considered as less healthy for higher debt dependency to short term and medium-term loan as external risk has been enhanced. Therefore, more improvement is required in debt management. However, FDI has been enhanced that contributed to boost the economic growth through exports. Overall balance of BOP is considered as healthy as the foreign exchange reserve has been increased and meets imports demands for more than six months. Cash account is moderately heathy as it has taken loan in time as adequate from IMF in BOP deficit. This is concluded from the analysis that the exchange rate is relatively consistent for the above BOP position which may increase economic growth in Bangladesh though appropriate fiscal and monetary policy formulation and implementation through attracting FDI in future.

Keywords: BOP**,** current account, export**,** FDI, GDP, GNI, IMF, import, remittance, reserve asset, trade balance, World Bank.

INTRODUCTION

The Balance of Payments (BOP) of a country is the record of all economic transactions between residents of a country and the rest of the world in a defined period generally a year. The BOP includes all external visible and non-visible monetary transactions of a country. It provides detailed information concerning the demand and supply of a country's currency (Chowdhury, 2013). Balance of payments data can be utilised to evaluate a country performance in international economic competition.

Bangladesh is a low-middle income country with constant economic growth rate of 6.5 over last ten years. Its foreign exchange reserve is USD 33 Billion which has been increased by export earnings and remittance. However, the overall trade capacity of Bangladesh can be assessed through analysis of the BOP. To this end, BOP of Bangladesh will be analysed critically through measuring comparative indicators: the current account, the financial account, the overall balance and the cash account. To reach this goal, ten-year comparative indicators data from Bangladesh Bank, ERD, The World Bank (WB) and International Monetary Fund (IMF) will be used to assess BOP healthiness and compare with other regional country position in relevant areas.

What is Healthy Balance of Payment (BOP)

Economic growth can be consistently achieved if a country has healthy BOP position. In addition, foreign exchange reserve might be increased in healthy BOP. This reserve can be used to meet import expenditure in emergency. Moreover, domestic currency is appreciated against foreign currency if heathy BOP is maintained over long time. The country with healthy BOP can lend from reserve to the other BOP deficit country to promote its export to that country. Furthermore, foreign direct investment is flowed to the heathy BOP positioned country as there is lower risk of foreign exchange fluctuation and higher potentiality of export earnings. Therefore, better quality goods and service are produced by that country.

Thirlwall (2011) argues that significance of a healthy balance of payments for growth can be specified concisely. "If a country faces problems in balance of payments as it demands increased before the short-term growth rate capacity is achieved, then demand must be shortened. Furthermore, supply is never fully exploited resulting investment is discouraged and technological advancement is decelerated. On the other hand, country's goods compared to foreign goods become less needed which worsen the balance of payments further." (Thirlwall ,2011)

Balance of Payment in Bangladesh context

Bangladesh Bank (BB) has been compiling, recording and publishing BOP data for Bangladesh since 1971. Since then, continuous progress has been made both globally as well as domestically. The current situation of Balance of payment in Bangladesh can be analysed below through assessing four major elements of BOP:

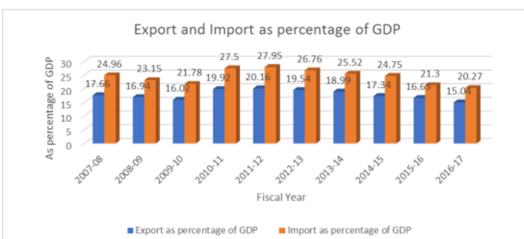
The Current Account

The current account (CA) is composed of goods and services, primary and secondary income between residents and non-residents, and current transfer. Export and Import reflects in trade balance, and profit and dividend from investments is reflected in primary and remittance is represented in secondary income (current transfer).

Export

Bangladesh has exported USD 34019 million in which readymade garments contributed 82.75% of total export in Fiscal Year (FY) 2017. In addition, the country's other export earnings came from footwears, manufacturing items, cements, chemical biproduct, pharmaceuticals, frozen fishes, frozen foods, leather goods, tea and tobacco. In recent years, its ship-building industry is flourishing. Its main exporting partner were States, Germany, United Kingdom, France, Spain, Canada, Japan, Belgium. The export was 14151 million USD in fiscal year 2007-08. Since then it gradually increased each year till 2016-17.

The graph demonstrates that the average export of Bangladesh is 17.83 as percentage of GDP since FY (2007-08). Since FY (2009-10) the export earning has been increased consistent till FY (2011-12). The export was highest worth 20.16% of GDP in FY (2011-12). However, the export gradually decreased to 15.04 % of GDP till FY (2016-17).



Source: World Bank (WB) data

Import

Bangladesh import has been substantially increased to promote its export since FY (2007-2008). In FY 2017, its total import was 43491 million USD. The main importing item is machineries and equipment's for industry. The other imported items are cotton, computers, electrical goods, mineral fuels, irons, vehicles, cereals. According to the above graphs, the average import was 24.39% of GDP in last ten year since FY (2017-08). The import was highest to 27.95% of GDP in FY (2011-12). Then, it gradually reduced each year and became lowest to 20.27% of GDP in FY (2016-17). Bangladesh mostly imports goods and equipment's from China, India, Japan, Singapure, Hongkong, Indonesia and Malaysia.

Trade Balance

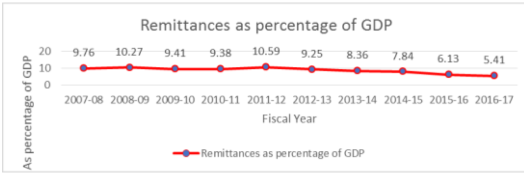
The trade balance for Bangladesh is determined as the difference between the exports and imports of goods and services. Trade surplus can be defined if export surpluses imports and trade deficit is reflected if import exceeds export in a year. According to the graph, there is always trade deficit in Bangladesh with an average of -6.57% of GDP since FY (2007-2008). However, the trade deficit was increased highest to -7.79% of GDP in FY (2011-12). However, since then the deficit is slowly reduced each year till FY (2016-17). The lowest trade deficit was -4.65% of GDP in FY (2015-2016). From the above graphs, it is observed that export is increasing gradually consistent with the substantial increasing in imports of Bangladesh over last ten years. This can be inferred that trade deficit has been gradually reduced in the last ten years and limited to around 5% of GDP which will reflect in the current account positively might contributed to favourable BOP in future.

Source: WB Data

Direct transfer of Income including Remittances

Remittance is an important element of income transfer in BOP of Bangladesh. Bangladeshi workers are mainly worked in Malaysia, Singapore, South Korea, Middle East countries. On the other hand, many foreigners also work in Bangladesh specially in garments sectors, Tele-communication industry, freight forward services and export processing zone who transfers their income to their home country. As a result, the income transfer (both inflow and outflow) has a significant impact in BOP of Bangladesh. The remittance inflow from worker has contributed to increase foreign exchange reserve in Bangladesh. In FY (2016-17), the foreign exchange reserve was USD 33493 Million which is 5.41% of GDP. The graph demonstrates that the average remittance as percentage of the GDP was 8.64 during last ten years. It was 9.76% of GDP in FY (2007-08). Then, it increased to 10.59% of GDP in FY (2011-12). But, then it gradually decreased to 5.41% of GDP as lowest in FY (2016-17) for the last ten years. After the Arab spring, many labour forces who worked in Egypt, Libya and Middle East returned home for political uprising. Moreover, the manpower transfer agreements to Malaysia and other

East Asian countries have been expired with the government. As a result, remittance inflow has been reduced drastically since 2014.

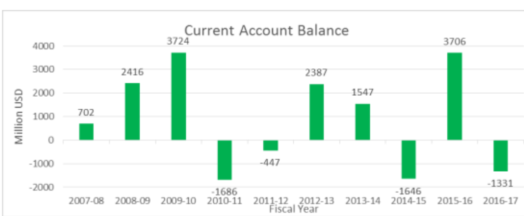


Source: WB and Ministry of Finance, Bangladesh

A. Current Account Balance

The current account balance (CAB) is the balance of trade in goods and services added to net rents, profit, dividends, interest and current transfers (The Economist,1997). Multi-national companies transfer their profit and dividends to native country. The investments are mostly in readymade garment, tele-communications, banking, insurance and export processing zone in Bangladesh.

Current account deficit is happened when a country's residents spend more on imports of goods than their export. According to the graph, current account balance is apparently surplus in most of the fiscal years in last ten years in Bangladesh. The highest CA surplus was 3724 million USD in FY (2009-10). The highest current account deficit was USD -1686 million in FY (2010-11). However, it gradually tends to current account deficit. In FY (2016-17), the current account deficit was USD 1331 million.

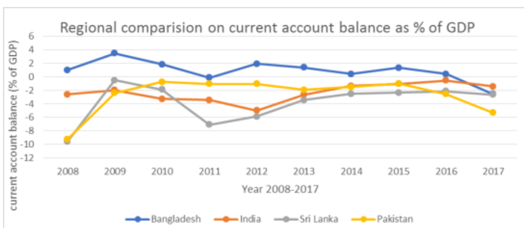


Source: WB Data

The CA deficit caused by reduction in exports and remittance inflow related to world crisis as oil price has been drastically increased to USD 113.30 per barrel in 2011 and political instability started in 2010 in the middle east. However, degree of external vulnerability of the economy can be assessed through current account balance as percentage of GDP.

Regional comparison on current account balance as percentage of GDP:

Bangladesh is a developing country in the south Asia where India, Pakistan and Sri Lanka are its neighbour Countries. The following graph demonstrates that current account balance as percentage of GDP in the regional comparison among Bangladesh, INDIA, Pakistan and Sri Lanka over last ten years. Among the four countries, CAB as percentage of GDP was positive in Bangladesh. The highest percentage was 3.47% of GDP in Bangladesh in 2009. However, its CAB is gradually decreasing, and CA deficit reached at -2.64% of GDP in 2017. On the other hand, Pakistan has always current account deficit in the last ten years and reached at -5.33 % of GDP in 2017. Though India has current account deficit in last ten years it is gradually improving and reached at -1.43% of GDP in 2017. Sri Lanka also has CA deficit in last ten years but gradually its deficits is reduced at -2.64% of GDP in 2017. It can be inferred that the CA deficit will lead to strong import demand for capital machinery and industrial raw materials and a temporary need for food import in longer term.



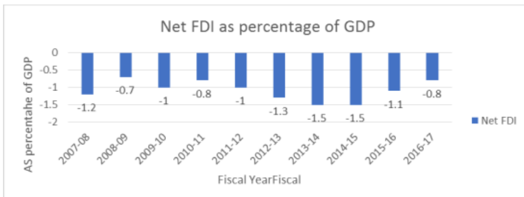
Source: WB Data

B. Financial Account

The financial account of BOP is the net acquisition and disposal of financial assets and liabilities during a period. The financial account keeps records in international capital flow and reflects utilization of current account surplus and financing for the current account deficit. All transactions related to changes of ownership in foreign financial assets and liabilities is recorded in the financial account. In BOP of Bangladesh, the financial account is composed of Direct Investment, portfolio investment, other investment and reserve assets. The financial account is directly linked to the exchange rates and the current account balance.

Foreign Direct Investment

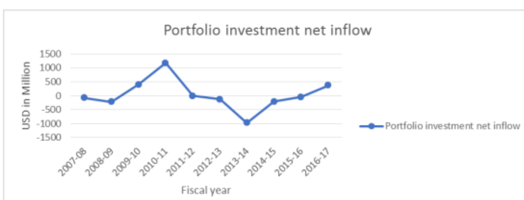
Foreign direct investment (FDI) refers to direct investment in industry, land and business in Bangladesh. According to the Bangladesh Bank, China, United Kingdom, Singapore, Netherlands, Hong Kong, USA has the most FDI net inflow which went to power sectors, textile, food, telecommunication, banking and leather industries. The FDI inflow is considered as liabilities whereas FDI outflow is as an asset of the country. In FY (2016-17), net FDI inflow was USD 1653 million. In the following graphs this is observed that there is always FDI outflow in the last ten years where it was -1.5% of GDP as highest in FY (2013-14) and FY (2014-15) result increased in liability. On the other hand, FDI inflow on that period led to boost private sector investment in Bangladesh facilitated to increase export as well as economic growth for the following years. Due to high inflow of FDI, foreign exchange especially USD rate against Bangladeshi currency was devaluated during this period. The lowest exchange rate was USD 1 to BDT 77.07 in FY (2013-14) led to slow growth of export in the following year.



Source: WB Data

Portfolio Investment

Portfolio investment refers to portfolio equity including shares, stocks, depository receipts, bonds and direct purchases of shares in local stock markets by foreign investors. In portfolio investment, the investor have not direct ownership of financial assets and the assets are relatively liquid based on the volatility of the market. In Bangladesh, the highest portfolio investment was made in 2014 worth USD 357.72 million in last ten years. Portfolio investment inflow is liability and portfolio investment outflow are considered asset for Bangladesh.

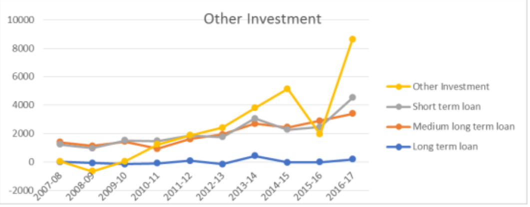


Source: IMF Data

According to the graph, the portfolio net inflow was USD -73.89 million in FY (2007-08). It gradually aroused to the peak worth USD 1179.68 million in FY (2010-11). Then it sharply dropped at lowest portfolio net investment worth USD -967.89 million in FY (2013-14). Portfolio investment was vulnerable as the local stock market was not stable caused by liquidity crisis in FY (2013-14). However, it again aroused next year and reached in FY (2017-18) worth USD 367.07 million.

Other Investment:

In the BOP of Bangladesh, other investment includes long-term (LT), medium and long-term (MLT) and short-term (ST) loan. The long-term loans are mostly taken from The WB, ADB for development projects in Bangladesh. In addition, long term and medium-term loan are also taken for development projects through bilateral agreement between countries especially from Japan, China and India.



Source: Bangladesh Economic Review, 2017

The above graph depicts that dependency on long term loan has been reduced over time while short term and medium long-term loan increased in Bangladesh for the period. In consequence, other investment has been increased to highest worth USD 4116 million in FY (2016-17) within last ten years which is alarming. The continuous dependency to MLT loan and ST loan have been gradually increased and reached at USD 3220 million and USD 1120 million in FY (2016-17) which required precaution as interest repayment risk has been increased. In consequence, the country might be challenged in long term capital project if consumer goods imports increased. LT loan is generally investment in capital asset while ST and MLT loan are invested in operating business and imports of goods. Moreover, LT loan are generally less risky as cost of capital is lower than ST loans. However, though other investment has increased liability in BOP of Bangladesh the debt to Percentage of GDP has been improved during this period.

Debt to Percentage of GDP, External Debt to Percentage of GNI and Reserve to short term debt ratio

Debt sustainability has been identified through debt to percentage of GDP of a country. This is observed in the following table that total debt has been increased in last ten years in Bangladesh.

Date	Debt in USD MN	Debt to (%GDP)	External Debt to GNI	Reserve to Short-term Debt Ratio
2016-17	79,627	32.48%	18.10%	32.21
2015-16	73,411	33.33%	16.60%	24.27
2014-15	65,469	33.68%	17.50%	24.13
2013-14	60,985	35.27%	17.90%	18.61
2012-13	54,485	35.82%	19.60%	20.65
2011-12	48,025	36.22%	19.70%	15.36
2010-11	44,630	36.62%	19.60%	22.95
2009-10	40,284	35.49%	21.60%	26.39
2008-09	40,469	39.54%	23.00%	18.7
2007-08	37,103	40.57%	23.70%	32.73

Source: WB Data

In FY (2007-08), the total debt was USD 37103 million which has been doubled worth USD 79627 million in FY (2016-17). On the other hand, total debt to percentage of GDP has been reduced in last ten years from 40.57% of GDP to 32.48% of GDP. So, external risk of debt has gradually been reduced in last ten years with improved debt sustainability in Bangladesh. In addition, external debt to percentage of GNI has also been improved from 23.70% to 18.10% of GNI from FY (2007-08) to FY (2016-17). The foreign exchange reserve to short-term debt ratio is 32.21 in FY (2016-17). So, external vulnerability to debt repayment also reduced and self-financing capacity has been improved in Bangladesh.

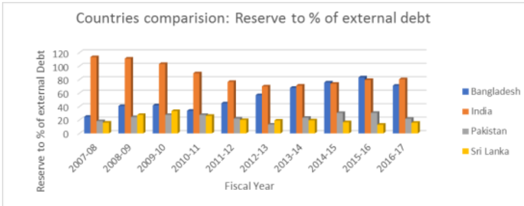
Reserve Asset:

Reserve asset is the strength of a country to repay its loan repayment and payment for imports from foreign countries. Bangladesh had net reserve worth USD 33.43 billion in FY (2016-17). A country should have adequate foreign exchange reserve to meet import expenditure for three months. Bangladesh has been acquired enough reserve to meet import bill for more than six months. The graphs show that reserve has been gradually increased from USD 5.79 billion to USD 33.43 billion in FY (2016-17) as remittance inflow and export earnings increased during this period. But, another cause might be reduction in import of capital goods and machineries. However, the increasing reserve contributed to favourable BOP balance during this period.

Source: WB Data

Regional comparison on reserve:

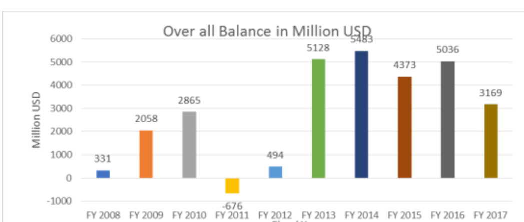
Reserve to percentage of external debt is an important indicator to show a countries external vulnerability to debt repayment. The following graphs depicts comparison of reserve to percentage of external debt in Bangladesh, India, Pakistan and Sri Lanka. The reserve to % of external debt is comparatively better in India and Bangladesh than Pakistan and Sri Lanka during last ten years. While India’s had 113.3% in reserve to external GDP, Bangladesh had only 24% in FY (2007-08). But the reserve to external debt ratio has been gradually increase over ten years and reached at 79.9% for Bangladesh and 80.4% for India in FY (2016-17). On that year the reserve ratio percentage were 21.8% and 15.9% for Pakistan and Sri Lanka respectively. So, it can be inferred that Bangladesh is in less vulnerable opposition to external debt repayment risk at present.



Source: WB Data

C. The Overall Balance

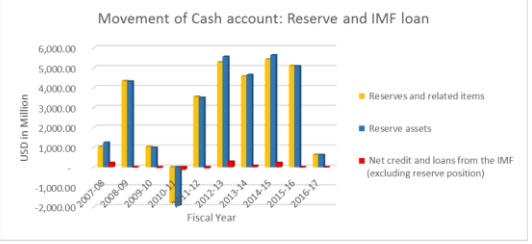
The overall BOP balance reflects the summation of the current account balance, the non-reserve portion of the capital and financial account added to net errors and omissions. The overall BOP balance also reflects the changes in transaction of foreign exchange reserve assets. The graph demonstrates the overall BOP balance of Bangladesh over the last ten years. The overall balance was USD 331 million in FY (2007-2008) which gradually increased till FY (2009-2010). The balance sharply falls to deficit balance of USD -676 million in FY (2010-11). Since FY (2011-12), the BOP overall balance is increasing till FY (2016-17) with the highest BOP overall balance of USD 5483 million in FY (2013-14). The positive overall balance of BOP in Bangladesh illustrates the healthiness of BOP position during this period. The impact of positive overall balance is Bangladeshi currency has been appreciated against USD during this period. FDI has been increased as exchange rate risk has been reduced. This picture also reflects that fiscal deficit of Bangladesh has been reduced to around 5% each year.



Source: Bangladesh Bank Report, 2017

D. The Cash Account

Cash account refers to the assessment of the strength of financial liquidity of a country. The cash account shows movement of reserve asset and borrowing from IMF if the overall Balance is deficit. The following graph represents movement of foreign exchange reserve and net loan from IMF in BOP of Bangladesh. BOP overall balance in Bangladesh has been adjusted from movement of reserve except in the FY (2010-11) when the overall balance was deficit. However, IMF loan has been taken in FY (2007-08), (2012-13) and (2013-14) to adjust overall balance worth USD 210.62, USD 277.08 and USD 209.83 in million respectively. The reserve has been utilised to made repayment of IMF loan in other years.



Source: IMF Data

CONCLUSION

BOP is essential for international business transaction for Bangladesh. To evaluate BOP healthiness, four components of BOP have been analysed over last ten year (FY 2008-17). The current account balance can be considered as healthy as it has never been in deficit position in ten years except in FY (2010-11). However, financial account was less healthy for higher debt dependency to short term and medium-term loan as external risk has been enhanced. Therefore, debt management requires more improvement. On the other hand, FDI has been increased which contributed to boost the economic growth through exports. Overall balance of BOP can be considered as healthy as the foreign exchange reserve has been increased and meet imports demands for more than six months. Cash account is moderately heathy as it has taken loan from IMF in BOP deficit. We may conclude that the exchange rate is consistent for the above BOP position which may increase economic growth in Bangladesh though appropriate fiscal and monetary policy formulation and implementation through attracting FDI in future.

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