

# Turning Point

## Bank Job Aid

### Focus Writing Module - 7



**Developed & Presented by**

*Aashfak Dipu*  
**Turning Point**

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**A Complete Preparatory Package for Bank Job Written Part**

## Session Content

1. Major IMF conditionalities related to the economy and financial sector.
2. Some experts are saying that only *“a USD 4.7 billion IMF loan is not a panacea for Bangladesh economic crisis and this loan will not resolve our reserve crisis. Overnight”* – Do, you agree? Explain, your stance,
3. Major conditionalities of IMF loan and their expected impacts on the financial sector/economy of Bangladesh.

### IMF Loan Facts

- On January 30, the board meeting of the International Monetary Fund (IMF) approved a loan of \$4.7 billion for Bangladesh. Entire loan will be given in seven installments over 42 months till 2026. The average interest rate of this loan is 2.2%.
- \$3.3 billion under the Extended Credit Facility (ECF) and Extended Fund Facility (EFF) arrangements and \$1.4 billion under the new Resilience and Sustainability Facility (RSF). Generally, the IMF offers help through the ECF/EFF and RSF when a country suffers from balance of payment volatility and needs to set a policy direction.
- The IMF announcement noted that “Bangladesh is the first Asian country to access the RSF.”
- Bangladesh received \$470.62 million last February as the first installment of the IMF's loan. Bangladesh is expected to receive the second installment of the \$4.7 billion loan from the IMF by November, 2023.

### Why the ECF/EFF and RSF facilities are provided?

Generally, the IMF offers help through the ECF/EFF and RSF when a country suffers from balance of payment volatility and needs to set a policy direction. In essence, the IMF offers a country short- to medium-term funding, while allowing the borrower to return the funds over a longer duration. For instance, an ECF has a zero-interest rate, a 5-and-a-half-year grace period, and final maturity at 10 years. Therefore, a country can obtain these funds without incurring any costs, use the money to implement structural changes that would boost its economy, and then repay the loan with zero interest after 10 years, when the country will be able to benefit from the reforms. With this deferred repayment schedule, such funds not only lessen strain on the BOP, but also allow the government to return with a better financial foundation for a thriving economy.

## **Why Bangladesh took the IMF loan:**

Bangladesh has not asked for a “bailout” package from IMF like Sri Lanka and Pakistan but rather for a stabilization package. Giving financial support to a country or firm that faces insolvency is referred to as a “bailout,” whereas an EFF package is granted to fund structural reform, an RSF to ensure balance of payment (BOP) stability, and an ECF for a stable and sustainable economic position. As the IMF put it, the loan will help preserve macroeconomic stability and prevent disruptive adjustments to protect the vulnerable.

According to IMF statistics, Bangladesh being the 35<sup>th</sup> largest in the world has done well during the corona pandemic and post-pandemic economic recovery. But since February 2022, the economy of Bangladesh has also been under pressure due to the Russia-Ukraine war and global inflation, recession and energy crisis.

- In FY 2021-22, exports increased to a record amount (\$52bn), but imports also increased at a comparatively higher rate (\$89bn). On the other hand, remittance inflow has not increased much. As a result, there were a deficit in the balance of trade and transactions. The country's foreign exchange reserves continued to decline rapidly. Actual reserves fell to around \$48bn in August 2021 and stood at \$24bn in December 2022. Therefore, IMF assistance was needed for Bangladesh to maintain trade deficit and economic stability.
- Therefore, the annual loan repayment amount is increasing every year. It is estimated that by the end of 2023, the foreign debt will stand at about \$100bn. By the end of 2024, this debt may reach \$120bn. In 2021, the government repaid foreign debt of \$2bn with interest. In 2022, foreign debt repayment was almost double of the previous year. The repayment amount in 2024 may exceed three times of the previous year. Therefore, IMF assistance was needed for Bangladesh to avoid nonpayment risk.

According to the IMF, this loan will help to protect the stability of Bangladesh's overall economy, make necessary reforms to create more capacity for social and development spending, strengthen the financial sector, modernize the policy framework, and make people more resilient to the impact of climate change.

Some experts are saying that only '***a USD 4.7 billion IMF loan is not a panacea for Bangladesh economic crisis and this loan will not resolve our reserve crisis overnight***' – Do you agree? Explain your stance.

Though USD 4.7 billion is less than one month of import costs (roughly \$7 billion) of Bangladesh, we are going to have the loan amount in seven installments within 42 months accepting 30 conditions. \$1.4 billion for the new Resilience and Sustainability Facility (RSF) to ensure balance of payment (BOP) stability is not adequate to make major impact when current account deficit is at pick. Another \$3.3 billion under the Extended Credit Facility (ECF) and Extended Fund Facility (EFF) is trivial against the demand for Bangladesh.

The IMF loan seeks attention in two different aspects; the loan amount is inadequate but the set of reformation offers are too many. However, withdrawing subsidy in fuel, gas and fertilizer as well as mandatory increase of tax-GDP ratio will strengthen internal capacity of the state that may regain lost momentum of the economy in near future. The government is advised to withdraw or gradually reduce selling of savings certificates, reduce NPL and capital shortfalls to lessen budget deficit which shall have many positive impacts in creating fiscal space. The minimalist subsidy strategy accompanied by a set of reformation in monetary and fiscal policy regime will reduce the dependency on foreign loan which will ultimately work as safeguard against depleting foreign currency reserve as well as stabilizing BOP. Structural reformation will result in cementing the macro-financial base of the country.

The rate of reserve depletion is alarming, and the IMF loan will not be enough to fend off the hemorrhage. But the conditionalities attached to the loan, if properly implemented, will be good enough to reverse the trend of current account deficit – and thus the atrophy of reserves. I do agree that problems won't solve overnight; however, I also see silver lining on the horizon for the financial sector as well.

Regardless of where the money comes from, the ultimate solution to today's economic volatility is production. There is simply no alternative to increasing domestic production to ensure economic health. So Bangladesh must ensure that it is disbursing funds to boost up production, which will bring foreign exchanges in and improve the BOP. The decision to take out a loan from the IMF can only be judged successful if the economy is stronger in 10 years than it is today.

## **What are the major conditionalities of IMF loan and their expected impacts on the financial sector of Bangladesh?**

Though USD 4.7 billion is less than one month of import costs (roughly \$7 billion) of Bangladesh, we are going to have the loan amount in seven installments within 42 months accepting 30 conditions. Bangladesh has accepted all conditions of IMF without any contest so far and has to be fulfilled within targeted timeframe. Major conditions are:

- A.** The IMF wants Bangladesh to eliminate all structural subsidies and to adopt a periodic formula-based price adjustment mechanism for petroleum products by December, 2023. It also suggests curtailing or no subsidies to electricity and gas and recommended to adjust the price of these products every month in line with market prices. As part of IMF conditions, beside government, the private sector will get permission for LNG import.
- B.** Instead of offering different exchange rates and managed rates for export, import and remittance, IMF insists to use market-determined exchange rate for official forex transactions by June, 2023. The net forex reserve also must not drop below \$26.8 billion by the end of this year. It also wants the Bangladesh Bank to compile and report official reserve assets as per the BPM6 definition – IMF's balance of payment guideline.
- C.** The agreed MoUs between Bangladesh and the IMF will target a reduction of the average non-performing loan ratios to below 10% for state-owned commercial banks and below 5% for private commercial banks, while increasing the banks' capital adequacy ratios and provisioning coverage to statutory minimum by 2026 and also given directives to modification of bank company act. The creation of an asset management business to recover and dispose of defaulted loans is one of the reforms the IMF has suggested for Bangladesh.
- D.** IMF also recommends withdrawing the Cap of 6 and 9 percent deposit and interest rate of banks. Rather they urge that the market will determine the deposit and lending interest rate of bank. IMF has given condition that government dependence on savings certificates for meeting its budget deficit should gradually reduce to below one-fourth of total net domestic financing by FY26.
- E.** The IMF wants Bangladesh to take up measures reformation of tax laws and to increase the tax-GDP ratio by 0.5% by June, 2023. The government is pledged to continue efforts to increase the number of registered taxpayers to 10 million by 2026 and also pledged to combat corruption by safeguarding the independence of the Anti Corruption Commission.

## **Impacts of IMF Conditionalities:**

- A.** Bangladesh is no longer able to independently determine economic policy. Whenever the government designs a policy, it must guarantee that it does not contravene any of the IMF's conditions.
- B.** The main condition of the IMF loan is the reduction of subsidies. In order to reduce the subsidy, the government has already revised and adjusted price of electricity and gas twice recently. All these stances are affecting the hardcore to the hardest by raising inflation rate.
- C.** The Bangladesh Bank has declared a shift from a Keynesian to a monetarist economy and chose to let the economy operate as a free market. BB has started relaxing lending interest rate restrictions and is committed to removing all caps over the program period.
- D.** Bangladesh's tax to GDP ratio is only 7.5 percent, whereas World Bank suggests the ideal ratio would be 15 percent. Thus, Bangladesh has a wide scope to raise VAT and tax revenue. Tax thirst from fiscal authority will squeeze real income of the middle and lower income people when the inflation rate is at pick.
- E.** The creation of an asset management business to recover and dispose of defaulted loans is one of the reforms that the IMF has suggested for Bangladesh. This reform is desperately needed though many comprehend that another threshold of red-tapism may result for this AMB.

## **Review before 2<sup>nd</sup> Installment:**

The government has met all six of the Structural Benchmarks (SBs) for June 2023, except the following two:

- The government has failed to maintain minimum net international reserves (NIR) of \$24.46 billion at the end of June.
- The government needed to collect at least Tk 345,630 crore in tax revenue in fiscal 2022-23. That target will be missed by about Tk 15,000 crore as collections slowed down.

The SBs for June include the adoption of an interest rate corridor system, reporting official reserve assets as per the IMF's BPM6 definition and introduction of a market-determined exchange rate. Beside these, the central bank was supposed to complete the pilot risk-based supervision action plan and publish banks' distressed assets in the annual financial stability report as well.