

RAGS FIRST BUT RICHES TO FOLLOW

Bangladesh Apparel Sector Report
January 2023

Executive Summary

1. Global Apparel Outlook: Empty Pockets

Global apparel export is expected to rebound following a dip in 2023E

- I. Monetary tightening to induce a global economic slowdown*
- II. Energy shock to hit EU harder*
- III. Central banks to step in to revive growth*

2. Short-term Outlook: Time to Tighten the Belt

- I. A slowdown in the major apparel markets will weigh down local apparel export in 2023E*
- II. Inflation will push wage rates higher, and gas shortage to increase production costs, squeezing margins*
- III. A decline in cotton prices stemming from waning global cotton consumption to help ease price pressures*
- IV. With high local value addition, currency depreciation will benefit apparel exporters*

V. What does this mean for companies operating in the sector in 2023?

- I. Apparel exporters with higher exposure to European markets will experience a significant dip in revenue than those with higher exposure to the US markets*
- II. Companies with high fixed-cost structures will experience a substantial reduction in their bottom line*
- III. Companies with high debt exposure and high inventory will struggle in 2023*

3. Mid-term Outlook: Knitting the Next Phase of Growth

Despite a dip in 2023E, CAL expects Bangladesh apparel export to grow at c. 5.3% CAGR and reach USD 56 Bn by 2026E

- I. With dominance in cotton-based apparel, Bangladesh is increasingly focusing on MMF to ride on a stronger global growth outlook*
- II. Migration of global fashion retailers' order flow from China will drive market share expansion for Bangladesh apparel*
- III. CAL expects market share in major non-traditional markets to increase to c.10% in 2026E from the existing share of 8%. Also, moving up the value chain through a gradual shift towards higher-margin products will facilitate enhanced top-line growth*

IV. What does this mean for companies operating in the sector?

- I. Companies investing in the MMF segment are likely to witness faster growth*
- II. Companies expanding their portfolios with higher-margin product categories will perform better*
- III. Companies expanding into nontraditional markets to consolidate market share*

Executive Summary (Continued)

4. Graduation from LDC: A Few Cards up the Sleeve

Preferential trade deals and strong backward linkage could ensure a smooth transition for the apparel sector toward LDC graduation

- I. Export growth picked up after the initial transition phase in Sri Lanka following the removal of GSP facilitation*
- II. After LDC graduation, 18% of the total export is likely to be affected in 2026 resulting in a significant increase in tariff rates*
- III. Securing preferential trade agreements, focusing on sustainability, and enhancing competitiveness would help to smoothen the transition path of LDG graduation*

IV. What does LDC graduation mean for companies operating in the sector?

- I. We expect well-established apparel exporters to consolidate their market share further*
- II. Product portfolio to have a greater share in higher margin products*
- III. Well-established companies to move lower margin manufacturing to countries that still enjoy duty benefits*

1 | GLOBAL APPAREL OUTLOOK

EMPTY POCKETS

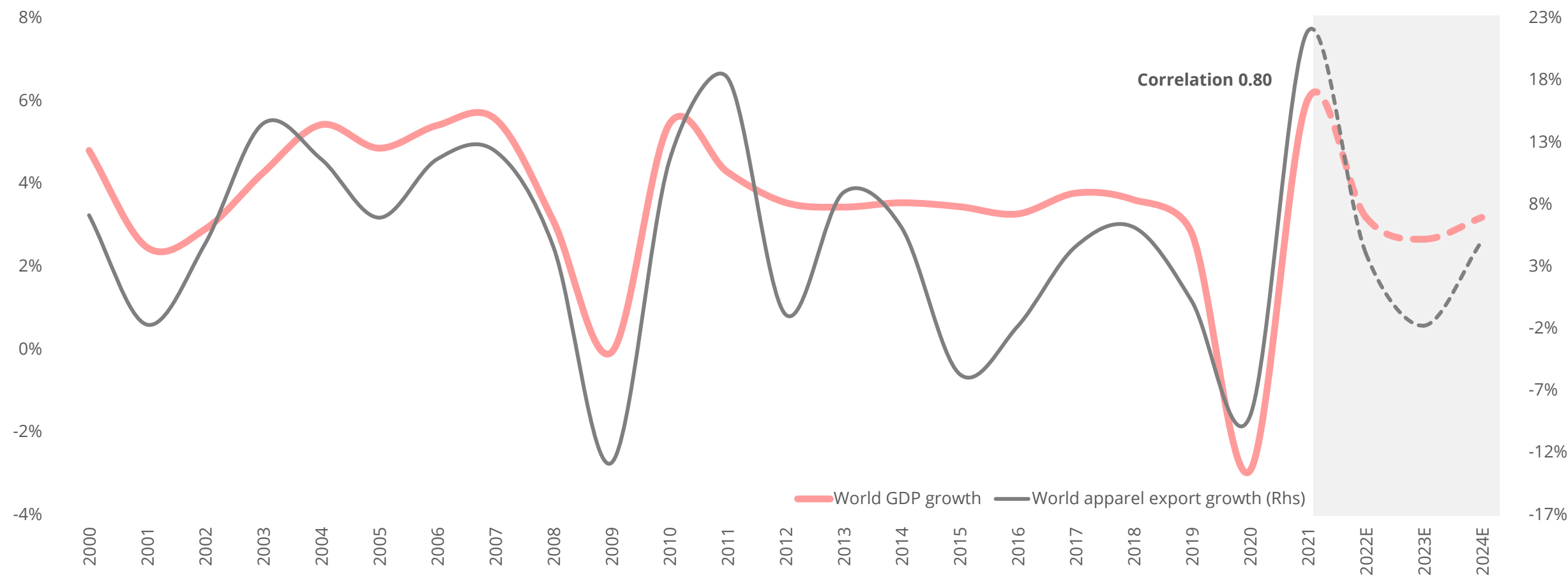
World apparel export growth is expected to dip in 2023 in line with the global economy stemming from the amplified pace of monetary tightening to curb heightened inflation on the back of deteriorating geopolitical conditions. Among major apparel markets, the US is expected to be less impacted than the EU regions, as soaring energy bills dent discretionary spending. However, we expect a rebound in the global economy by 2024 as central banks swiftly shift to expansionary measures following early signs of a recession and a slowdown in inflation.



Global apparel export growth is expected to dip in 2023E in line with the global economy followed by a rebound thereafter...

Historically, apparel demand has been strongly correlated with global output. We expect a dip in global output will dent the global apparel demand in 2023E, followed by a rebound in 2024E.

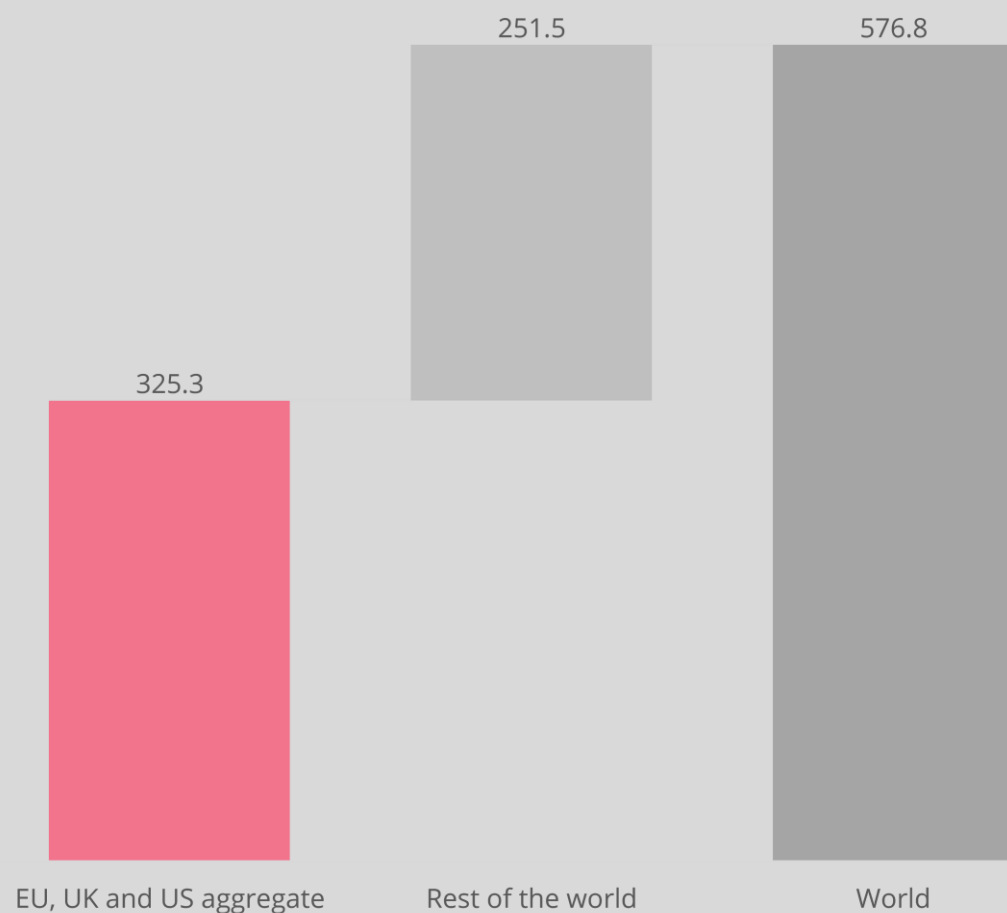
World output growth (%) vs world apparel export growth (%)



...as the economic outlook for the major apparel markets is expected to remain subdued in the short run.

EU, UK, and US aggregately account for 44.7% of the global output and contribute to 56.4% of the global apparel imports.

Global apparel imports (USD Bn)



What factors will influence the global economic outlook?

Response to Inflation

Slowdown led by monetary tightening

Although both US and Europe faced common headwinds owing to prolonged inflationary pressures, the regions' challenges differ in degree and kind. In response to inflation, the extent of tightening adopted by central banks has varied between US and EU regions. Growth in output among EU countries is projected to fall to 0.7% in 2023 compared to 1% in the US.

Energy Shock

Energy shock to hit EU harder

The Russia-Ukraine conflict led to a severe energy crisis in Europe, increasing the cost of living and hampering economic growth. An 80% gas supply cut by Russia from 2021 levels has raised the prospect of energy shortage in the EU region in 2022 and beyond.

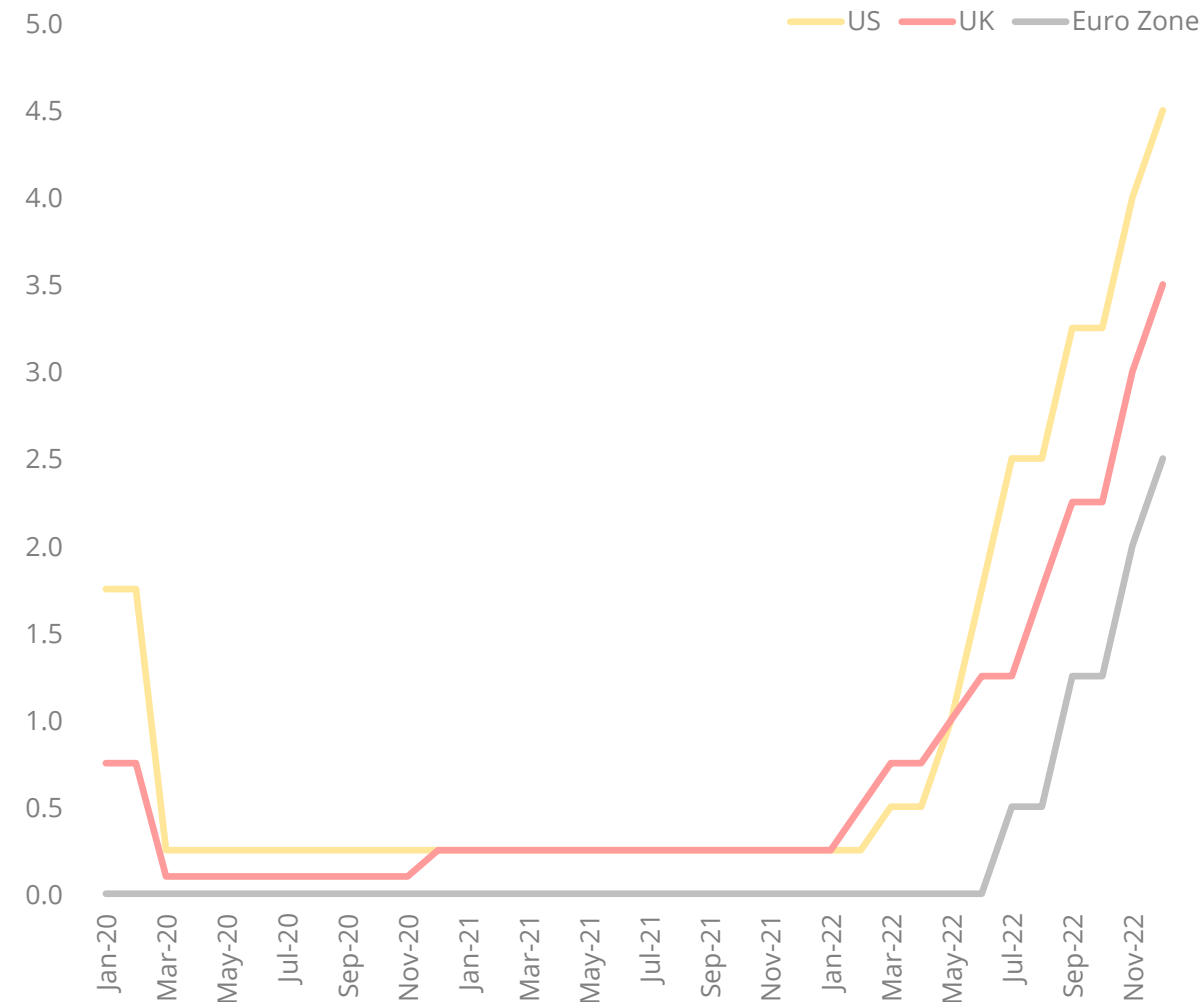
Monetary Policy Path

Central banks to step in to revive growth

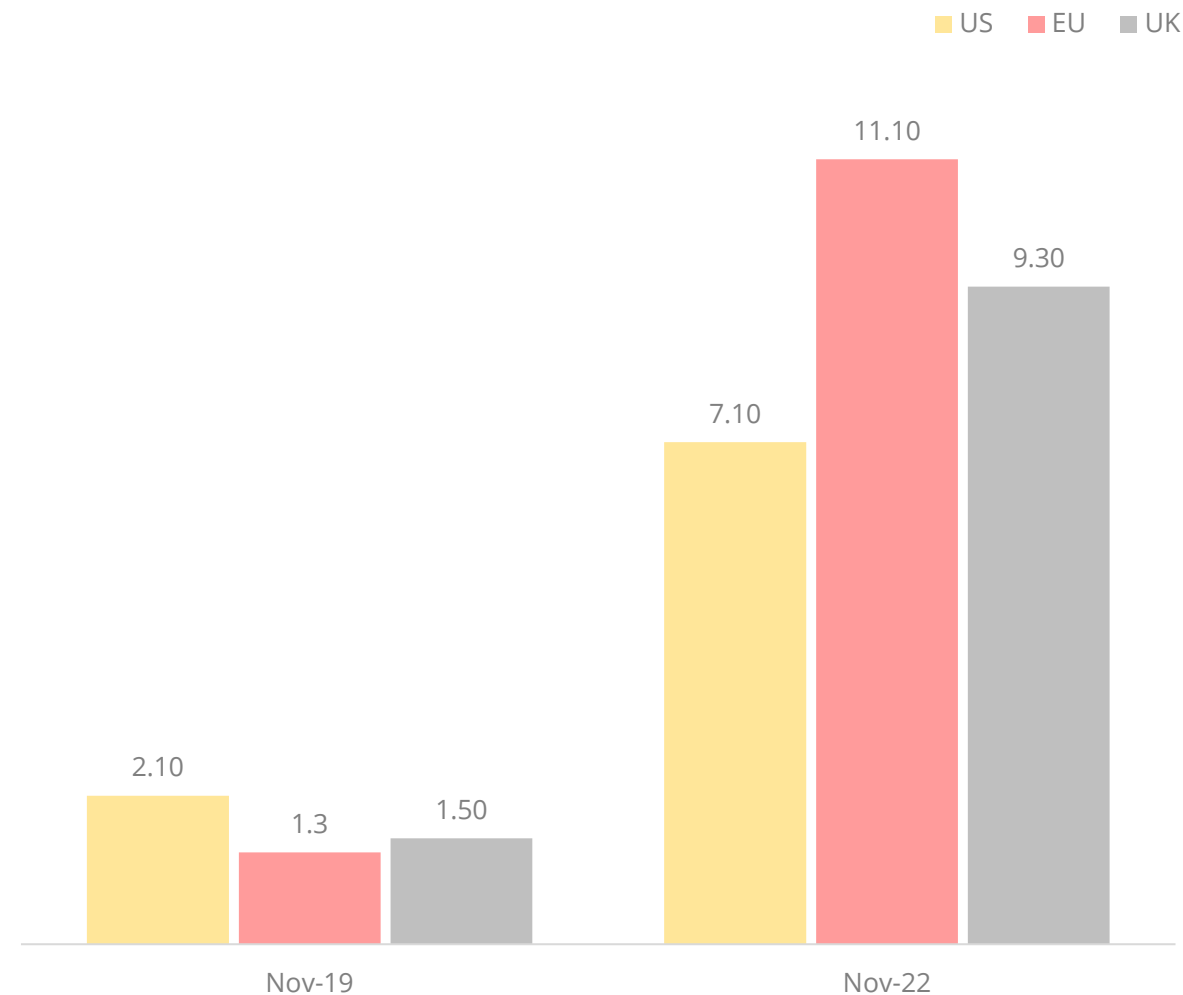
During the COVID-led economic crisis, central banks in the US and EU stepped in with expansionary measures to stimulate the economy. With early signs of recession, central banks across the developed markets are likely to shift towards expansionary move in line with historical precedents resulting in a rebound in demand.

Monetary tightening by global central banks to rein in inflation will lead to a slowdown in global output in 2023E.

Policy rate (%)



Inflation rate (%)

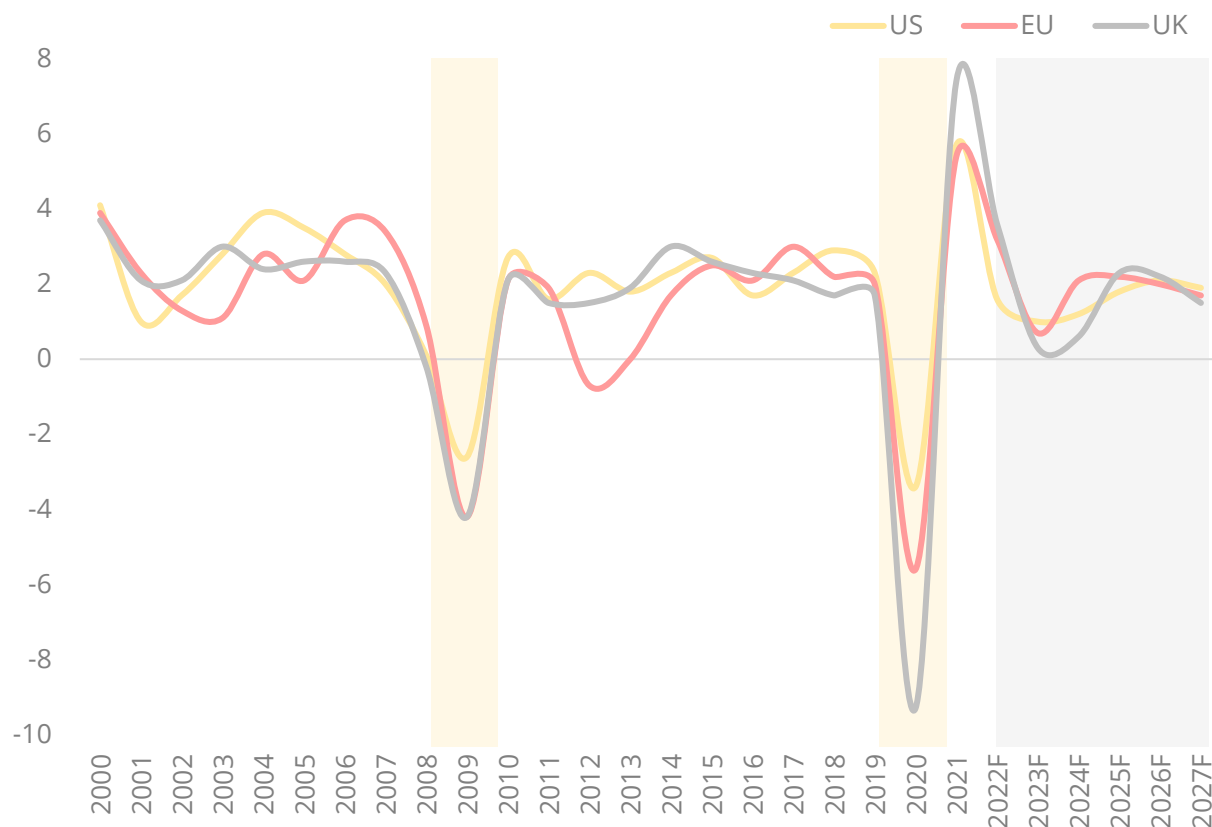


However, the US economy will be less impacted due to lower oil import dependence.

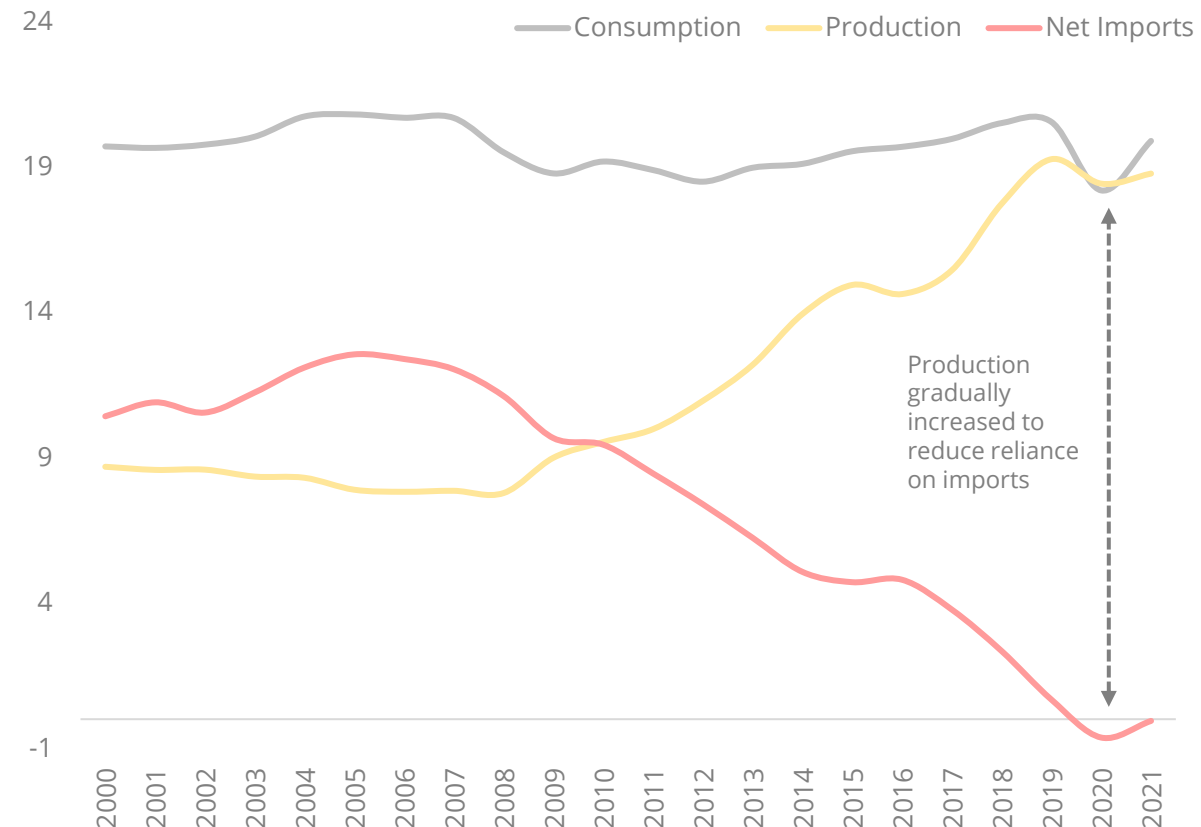
US output growth is forecasted to remain comparatively resilient, with a 1% output growth in 2023. While the conflict between Russia and Ukraine continues to take an increasing toll on European economies. Output growth in EU countries is projected to fall to 0.7% in 2023 from c. 3.2% in 2022.

The US economy will also be insulated from the energy crisis as increases in domestic petroleum production, and petroleum exports have helped the country reduce annual total petroleum net imports. Since 2020, total yearly petroleum net imports have been negative.

Real GDP growth outlook (%)



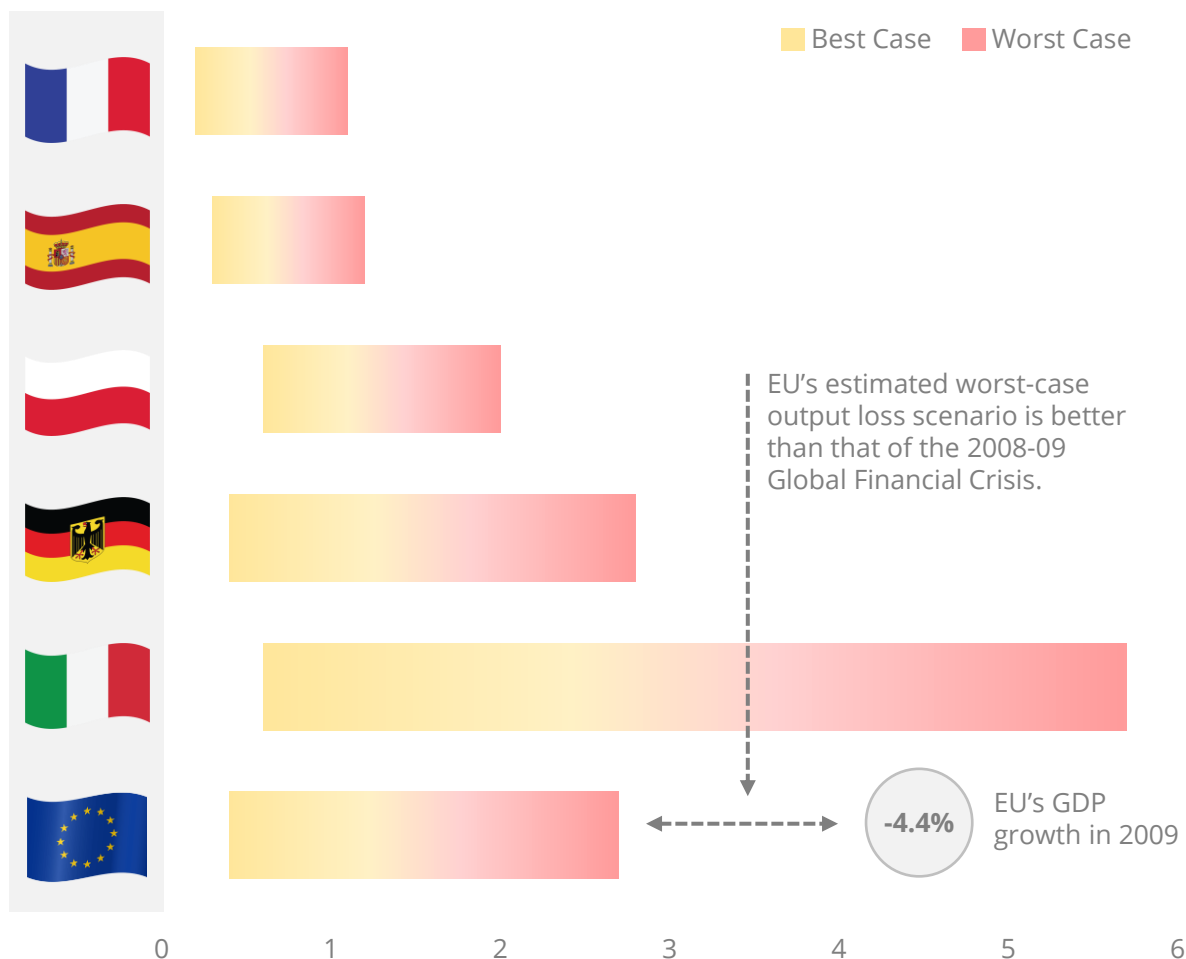
U.S. petroleum consumption, production and net imports (mn barrels/day)



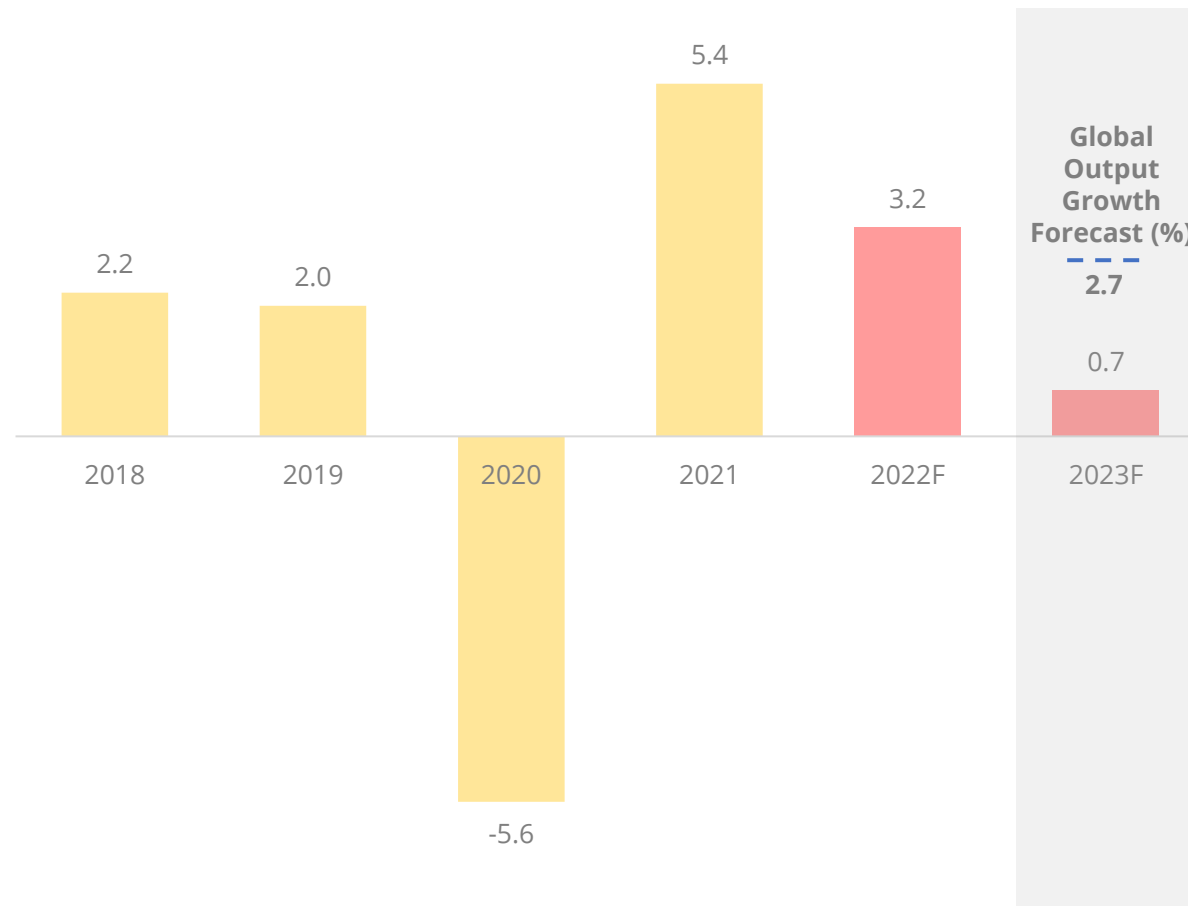
GDP growth in the EU might experience a steeper fall...

Dampening economic activity led by monetary tightening and heightened inflation has set the EU on a path of lower but positive growth in 2023E. However, the economic slowdown is unlikely to be as bad as the 2008-09 global financial crisis.

Estimated GDP output losses 12 months after a Russian supply shut-off (%)



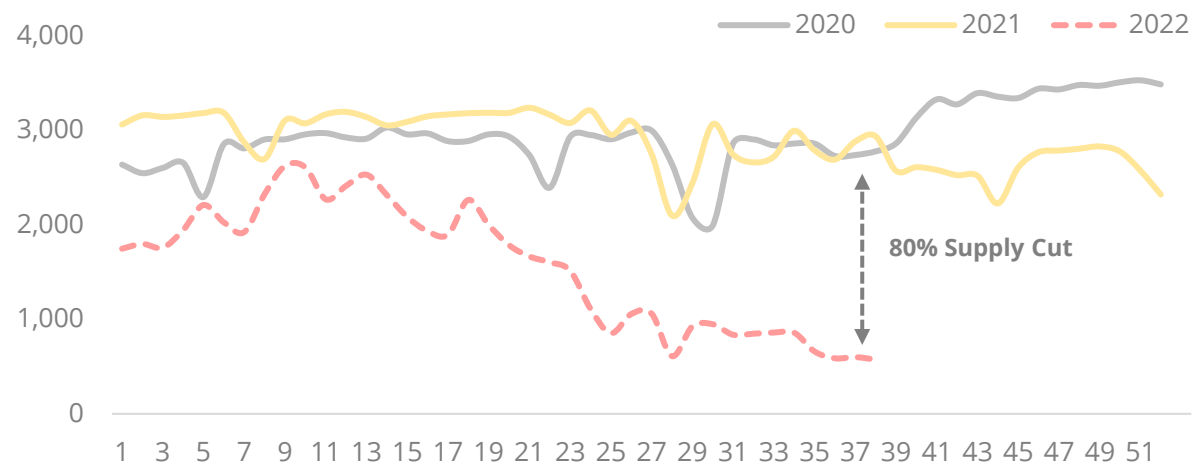
EU real GDP growth (%), forecasts by IMF



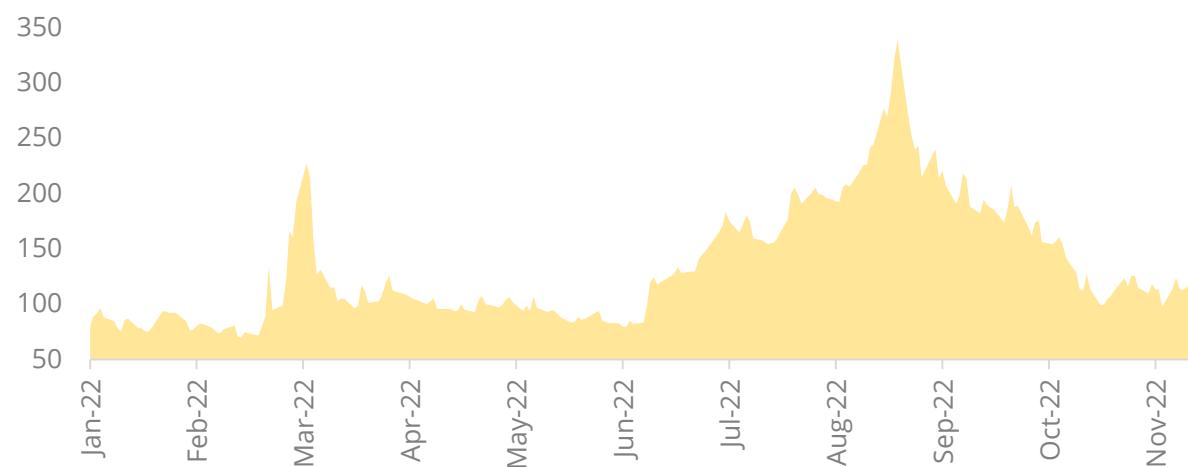
...owing to the gas supply crunch exacerbating the situation further.

The gas supply crunch following the Russia-Ukraine conflict has led to higher electricity costs stoking inflation. This inflationary pressure will dampen consumption.

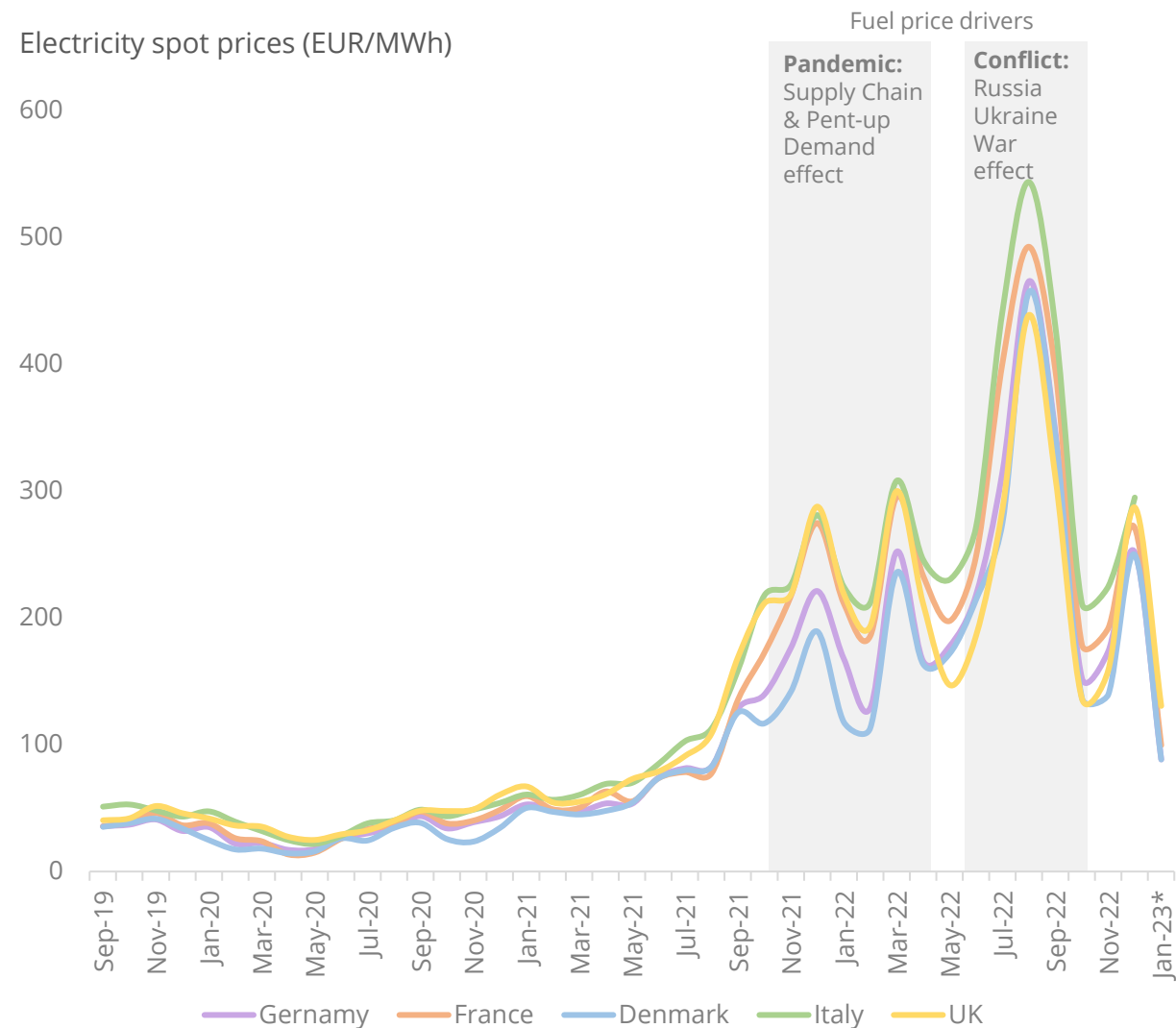
EU natural gas import from Russia (Mn cubic meters/week)



Natural Gas EU Dutch TTF Futures (EUR/MWh)



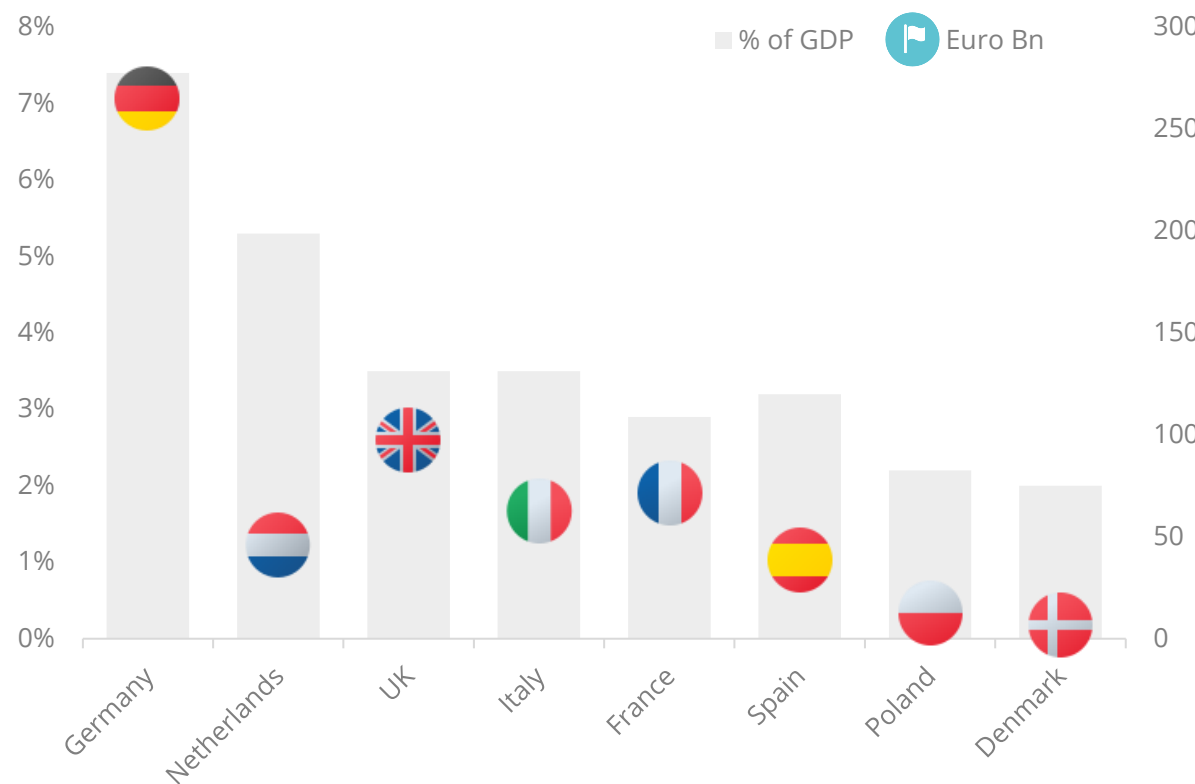
Electricity spot prices (EUR/MWh)



*UK in GBP

Unlike the 2008 economic crisis, looming recessionary conditions may be short-lived as governments steps in with incentives to ease the supply-led economic pressures.

Government incentives for households and businesses to address the energy crisis



EU emergency package



Energy Savings: 5% during peak hours including a 10% overall reduction



Revenue Cap: set at €180 per megawatt-hour for non-gas power plants



Solidarity contribution: 33% levy on extraordinary profits by fossil fuel companies in FY-22

Measures taken to address the energy crisis

Measure	France	Spain	Germany	UK	Italy	Netherlands	Poland	Denmark
Reduced energy tax / VAT	✓	✓	✓	✓	✓	✓	✓	✓
Retail price regulation	✓	✓	✓	✓	-	A	✓	✓
Wholesale price regulation	✓	✓	-	-	-	-	-	-
Transfers to vulnerable groups	✓	✓	✓	✓	✓	✓	✓	✓
Mandate to State-owned firms	✓	-	-	-	-	-	-	-
Windfall profits tax / regulation	-	✓	A	✓	✓	A	✓	-
Business support	✓	✓	✓	✓	✓	-	-	-
Other	✓	-	A	-	-	-	-	A

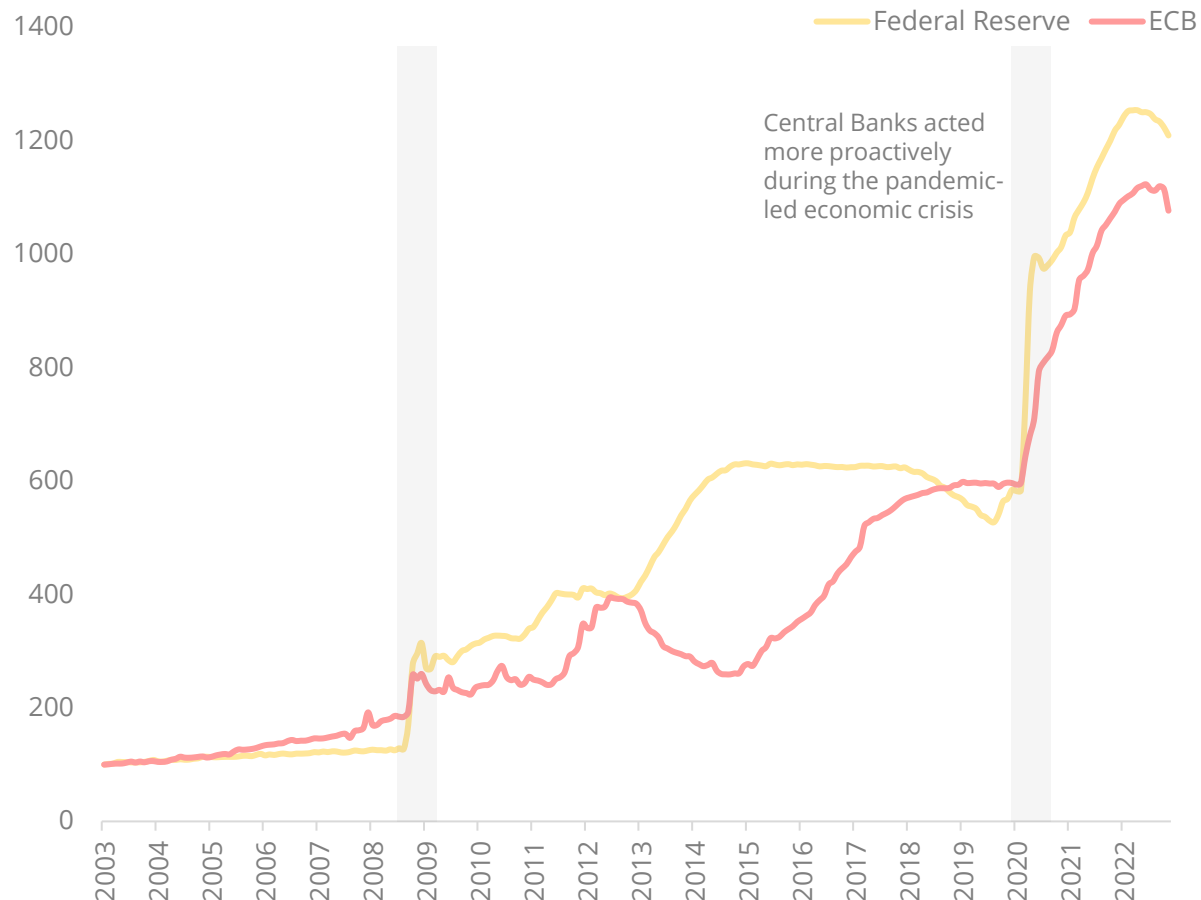


A = Measures announced publicly

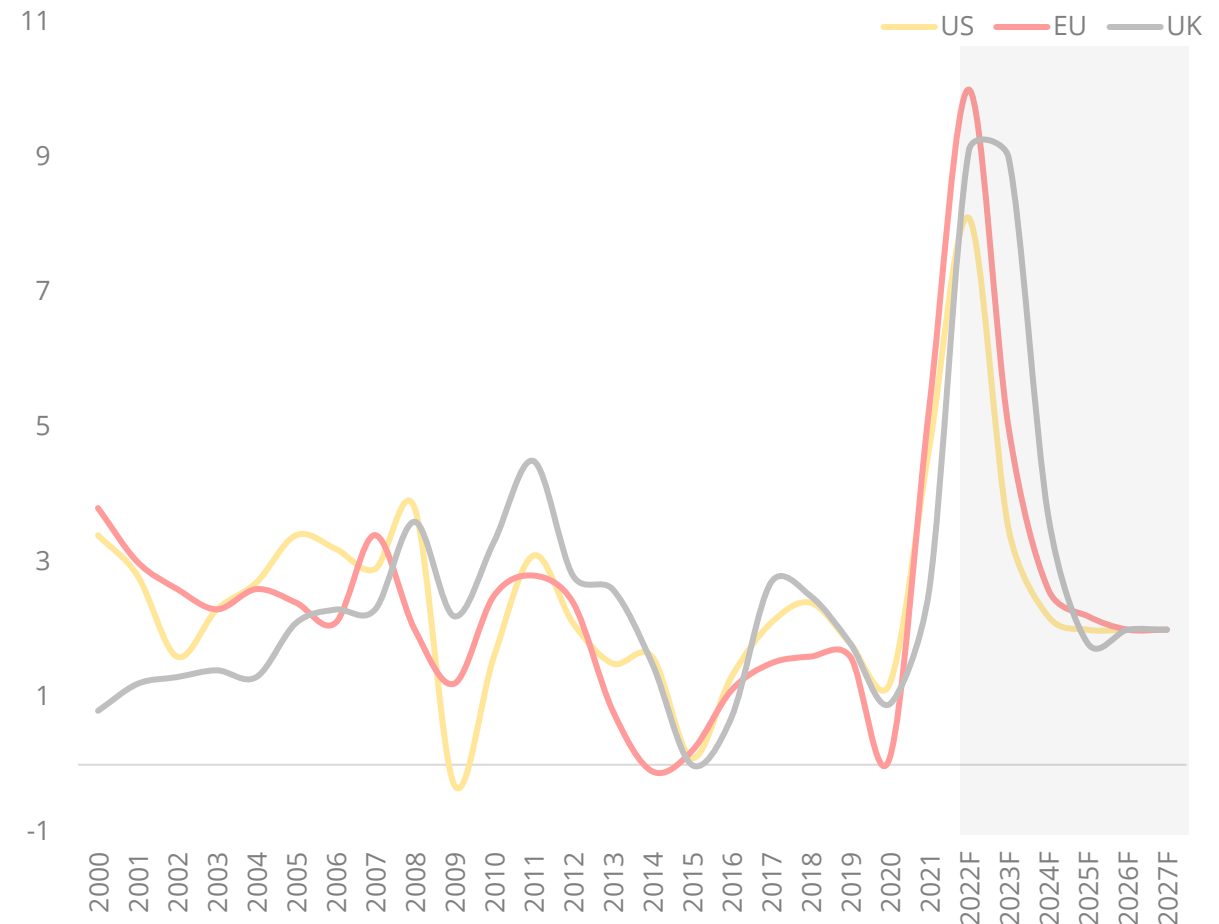
With early signs of recession, central banks may step in with expansionary measures to revive economic growth no sooner they see a slowdown in inflation.

Central banks have become more proactive and stepped in during economic downturns. Inflation is expected to ease in 2023, creating room for the central banks to take expansionary measures to stimulate the economy.

Central bank assets (January 2007 = 100)



Inflation, average consumer prices (%), forecasts by IMF



2 | SHORT-TERM OUTLOOK

TIME TO TIGHTEN THE BELT

CAL expects the sober global apparel outlook in 2023E will have a spillover effect and push Bangladesh's apparel export growth into negative territory. High inflation and increased energy prices will exert upward pressure on wage rates while production costs will remain at elevated levels. Difficulty in opening LCs on the backdrop of dollar shortage will also hamper production output. However, a sharp fall in cotton prices and currency depreciation will help ease pressure on the margins.



CAL expects Bangladesh apparel exports to witness marginal de-growth in 2023E; however, declining cotton prices and currency depreciation will help ease pressure on margins.

Headline Inflation (%)



Cotton A Index (USD/Kg)



Exchange Rate (BDT/USD)



What factors will influence the short-term outlook?

Demand Dip

Apparel export globally is expected to dip in 2023, stemming from a slowdown in global output. However, the apparel export of Bangladesh has been comparatively resilient during global economic downturns. CAL expects a marginal de-growth in the apparel export of Bangladesh in 2023E.

Price Pressures

As global price pressures spilled over onto domestic fronts, industries are feeling the cost pinch, with inflation staying elevated at 8.71% in December 2022, compared to 6.1% during the same period in the previous year. A 68% diesel price hike in two phases since November 2021 and a 116.6% hike in the gas price for captive power since June 2022 have increased the cost of production significantly.

Softer Fiber

The cotton rally fueled by the post-pandemic pent-up demand is losing steam over the demand worries. Till December 2022, the cotton price has declined 39% from its peak in May 2022. A 76% annual decline in the freight rates will also reduce the import cost of raw materials, further easing pressure on the margins.

Depreciation Drive

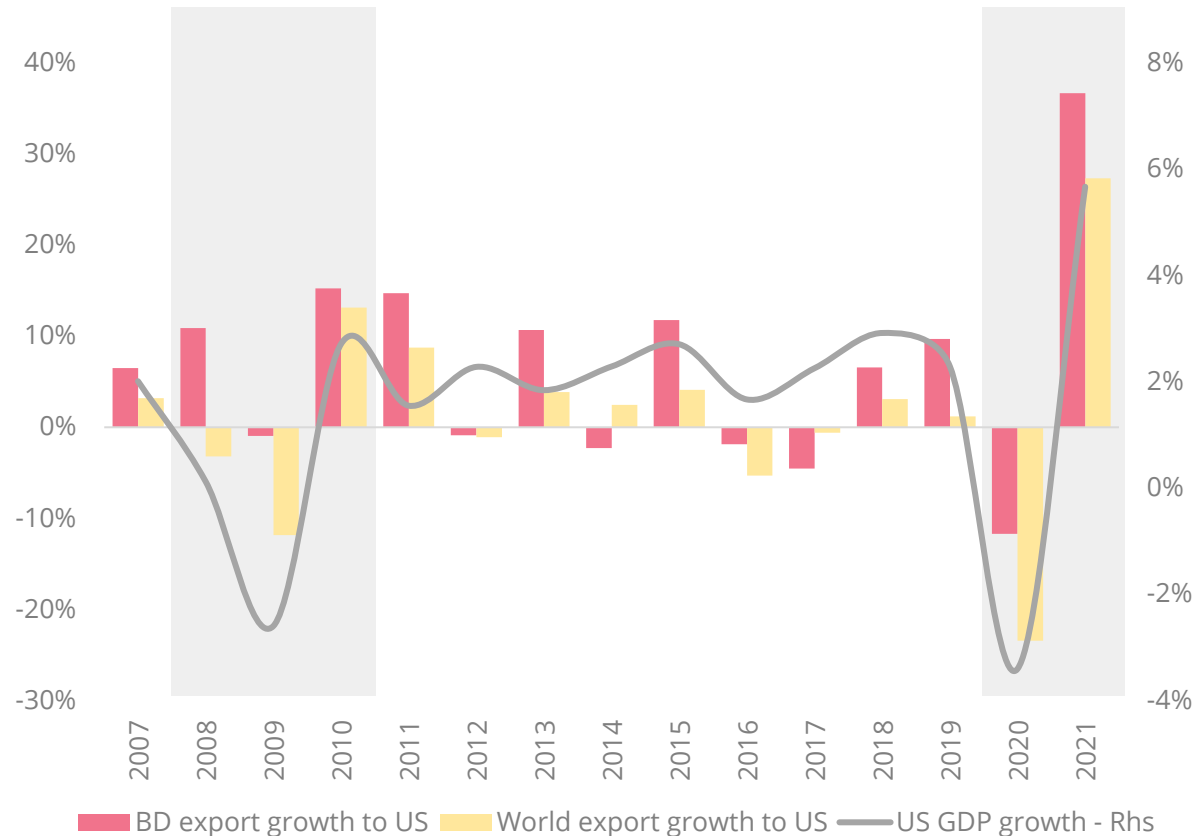
The annual currency depreciation of 20% in 2022 is expected to increase revenue and relieve pressures arising from increased input costs. As the RMG sector has a 54% local value addition, the sharp depreciation in the currency will positively impact the overall sector. However, owing to multiple exchange rate regimes for import payments and export proceeds conversion, the sector is yet to reap the total benefit of currency depreciation.

Demand Dip: A slowdown in the major apparel markets will weigh down local apparel export in 2023E.

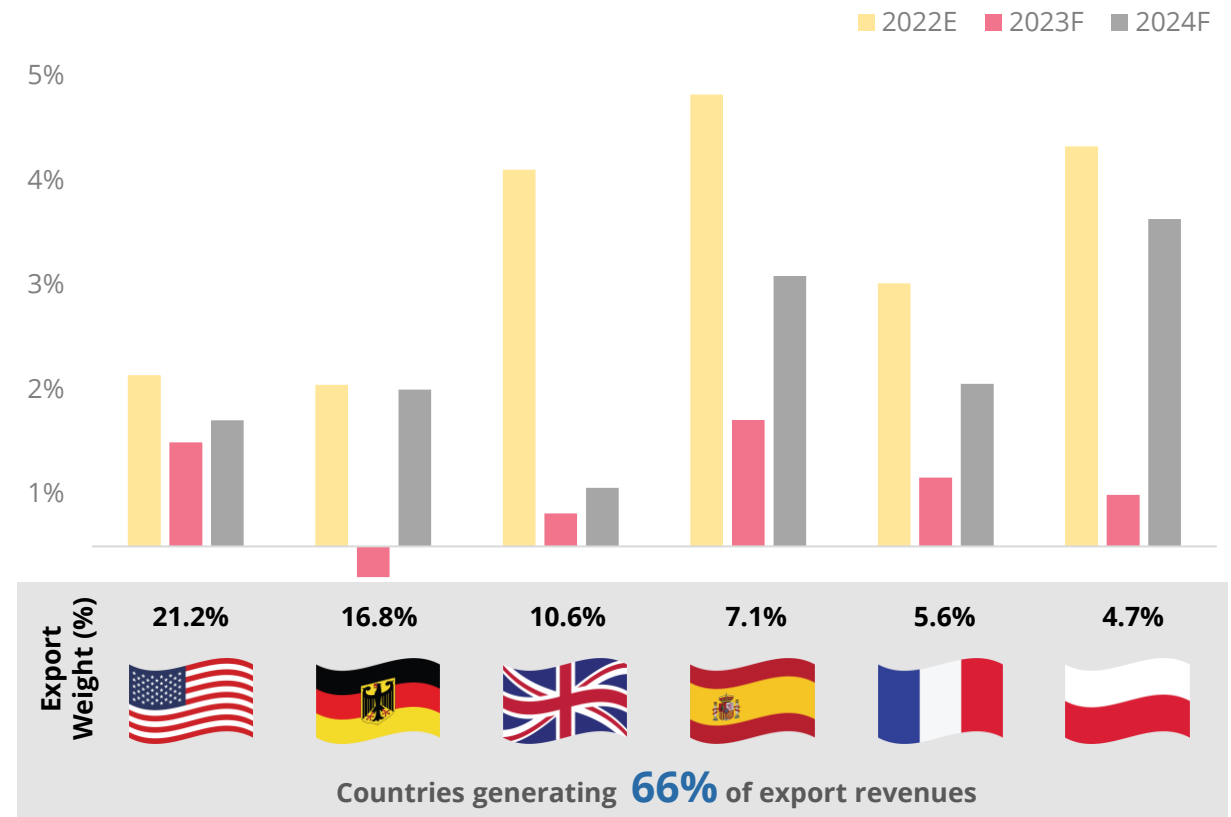
Historically, Bangladesh's apparel exports have proven to be comparatively more resilient during recessionary periods, with smaller decreases followed by stronger rebounds during economic recoveries. In 2023, it is expected that the decline in apparel export will be smaller compared to the decline in the global apparel market growth.

A tepid growth outlook on the developed markets is expected to squeeze apparel export in 2023 while raising the possibility of a strong rebound in 2024.

Apparel export to the US (a proxy for developed markets) during economic cycles



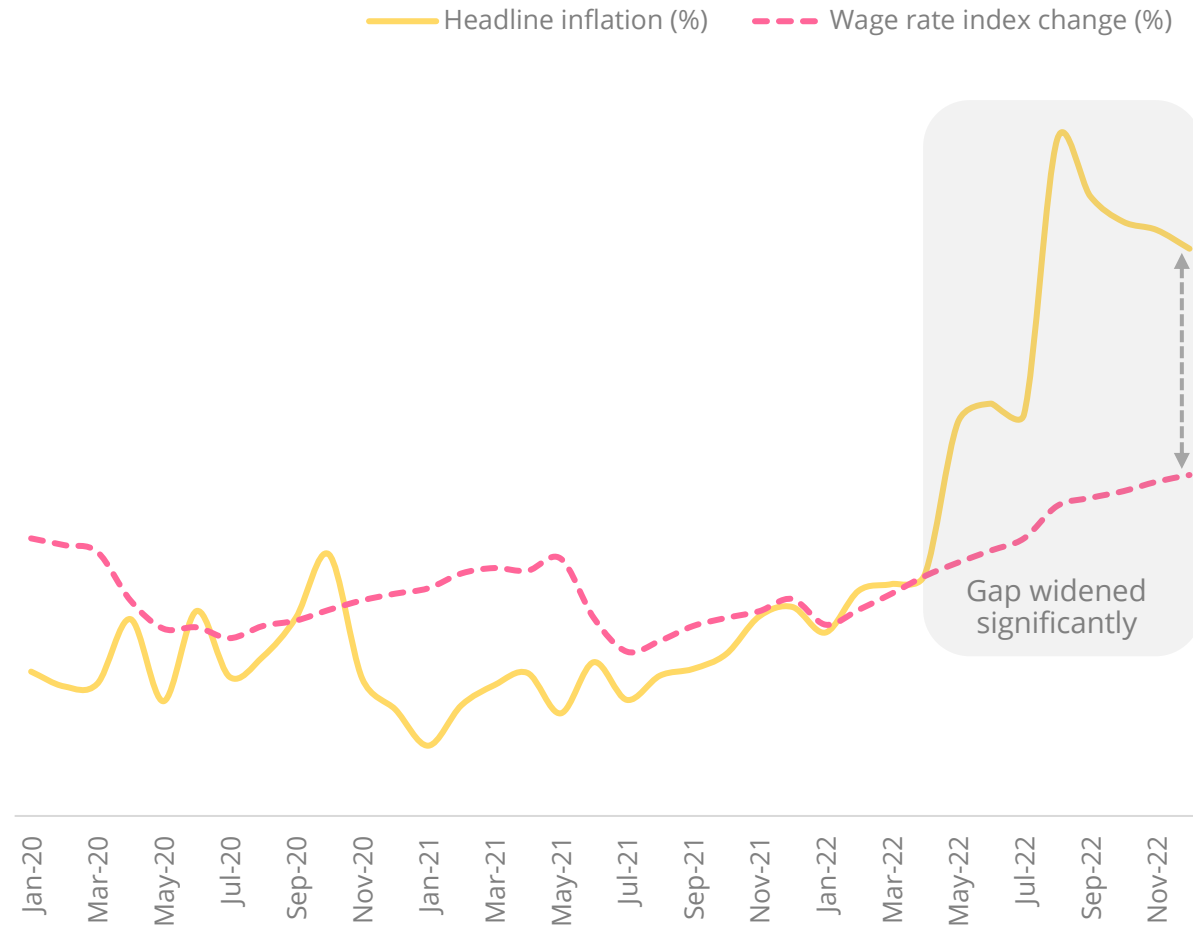
Growth outlook on the key apparel markets of Bangladesh (%)



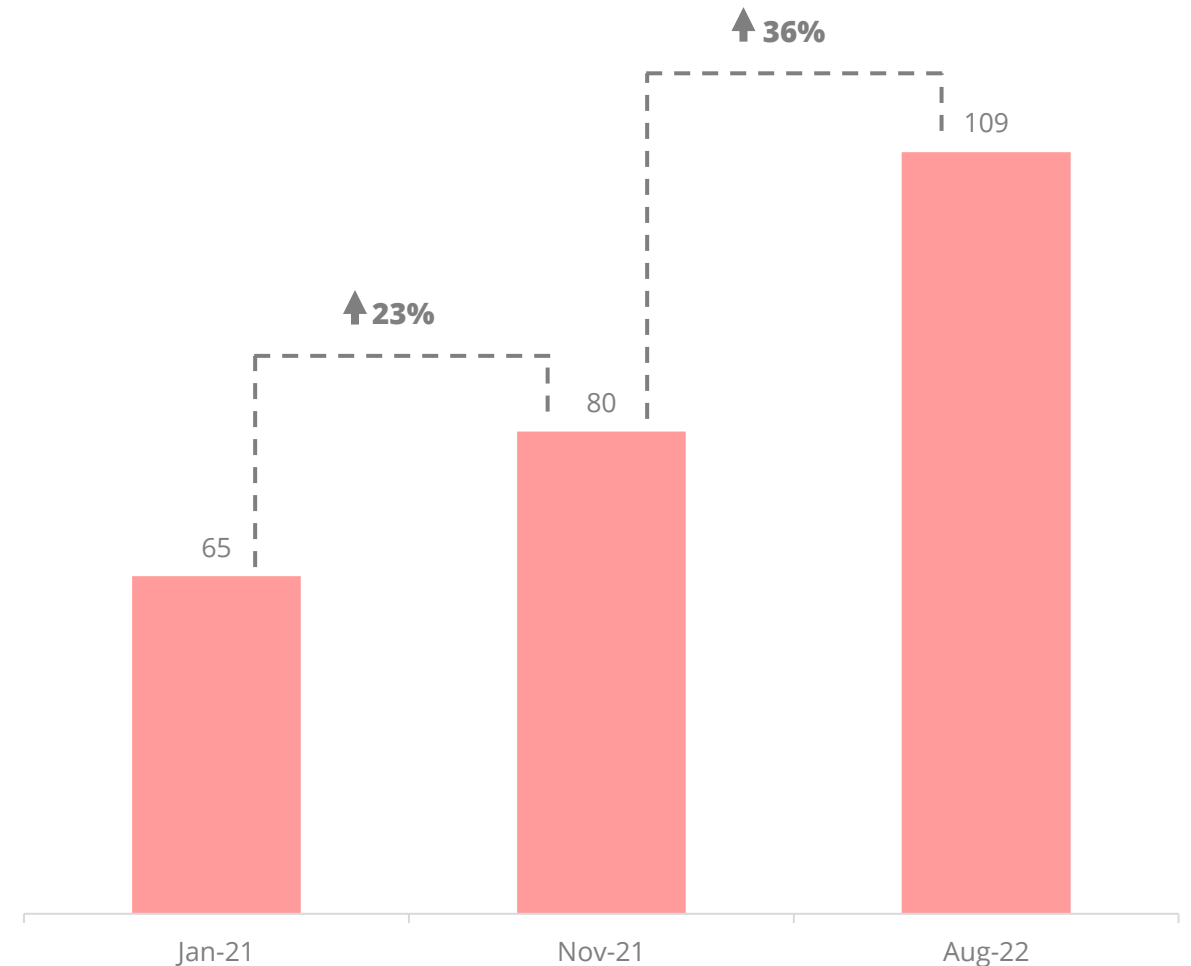
Price Pressures: Inflation will push wage rates higher, squeezing margins

Historically, an increase in inflation has eventually resulted in an increase in the wage rate. The wage rate is expected to go up as inflation remains elevated at 8.85% in November 2022 while the YoY change in the wage rate is at 6.98% during the same period creating a large gap. An increase in the wage rate will have an impact on the profit margins.

Headline inflation and wage rate



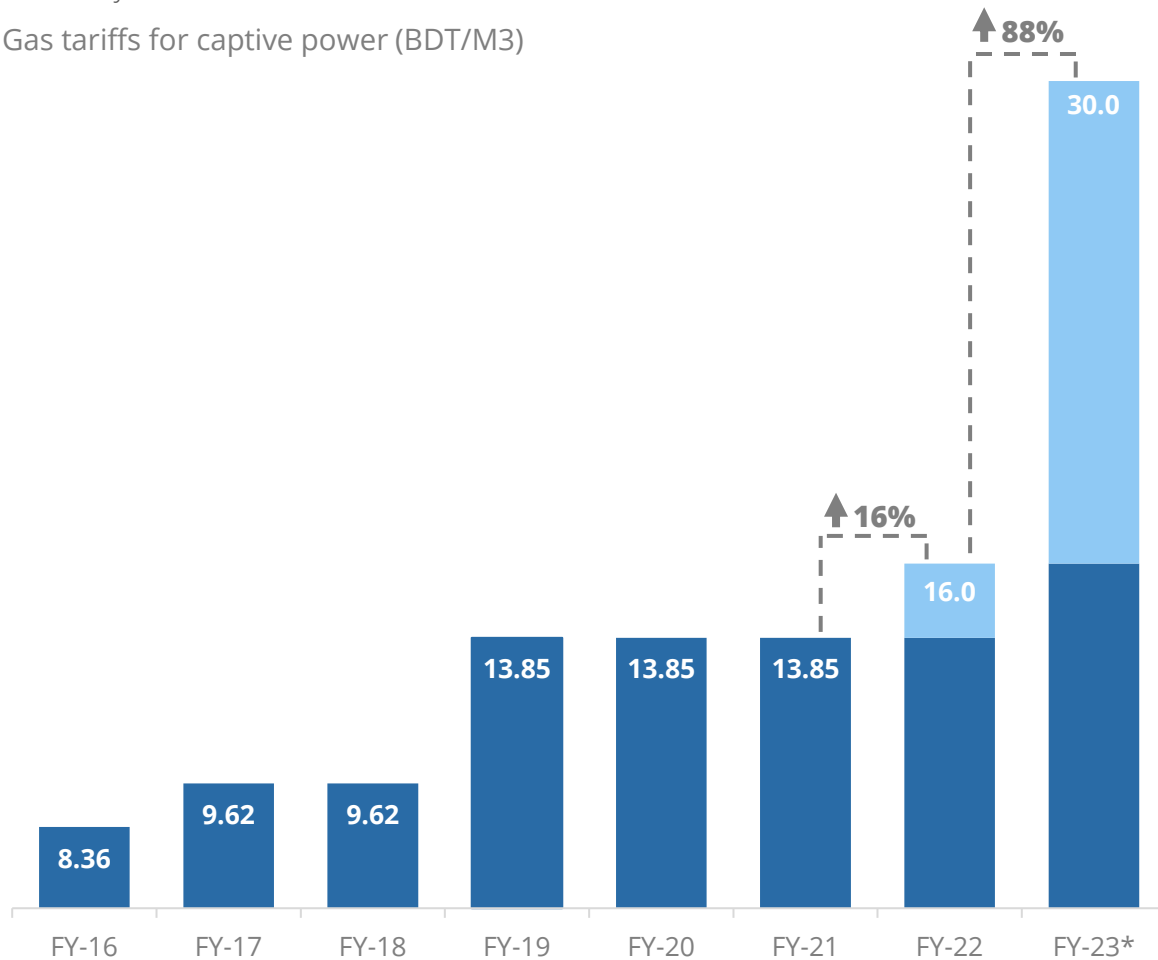
Diesel price (BDT/Litre)



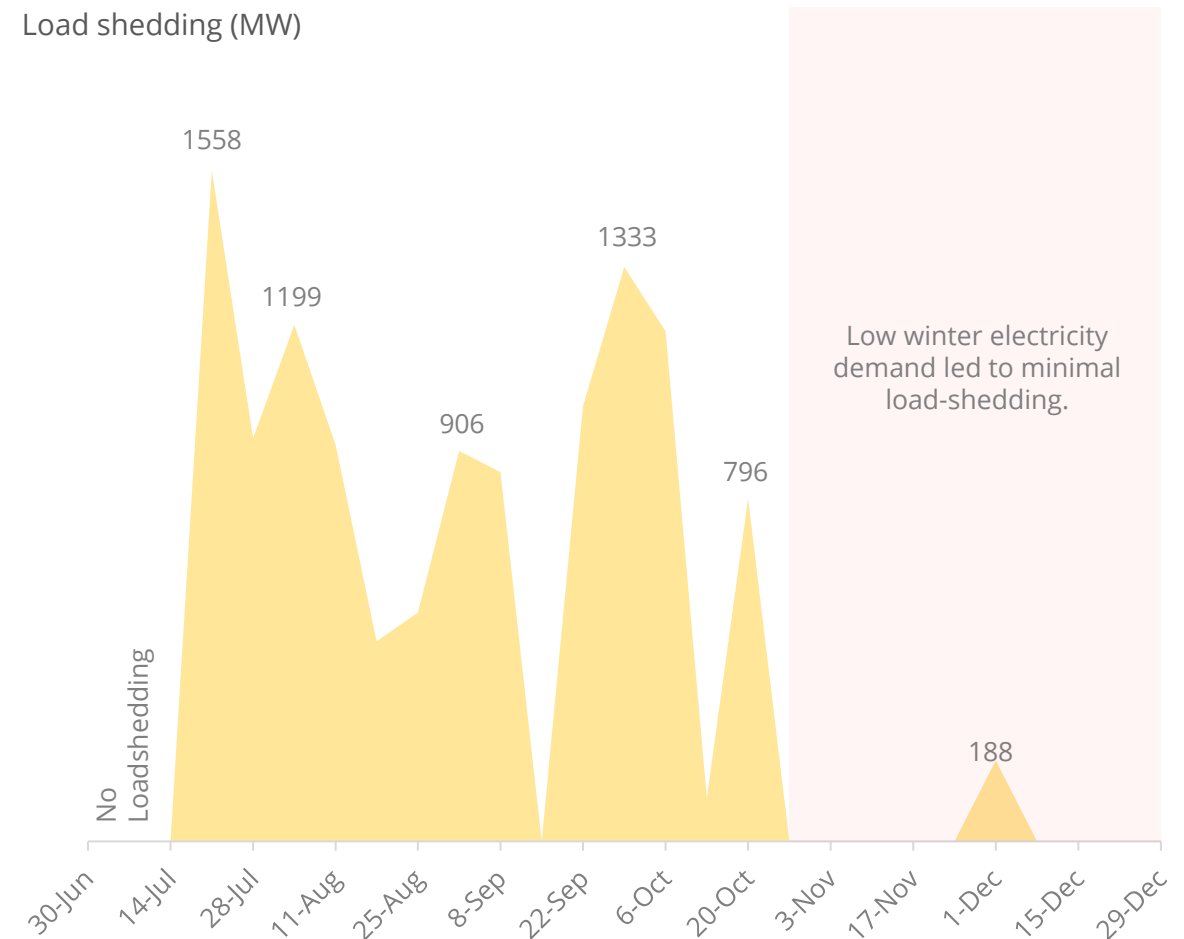
Production costs will increase due to a gas tariff hike while energy shortage will hamper productivity.

The apparel sector is expected to face increased production costs due to the 87.5% gas tariff hike set to take effect in February 2023. Load shedding caused by gas shortages from July to October 2022 greatly hindered production. If the underlying supply-side issues are not resolved, there is a risk of a repeat of a similar crisis in the summer of 2023 due to a spike in Electricity demand.

Gas tariffs for captive power (BDT/M3)



Load shedding (MW)

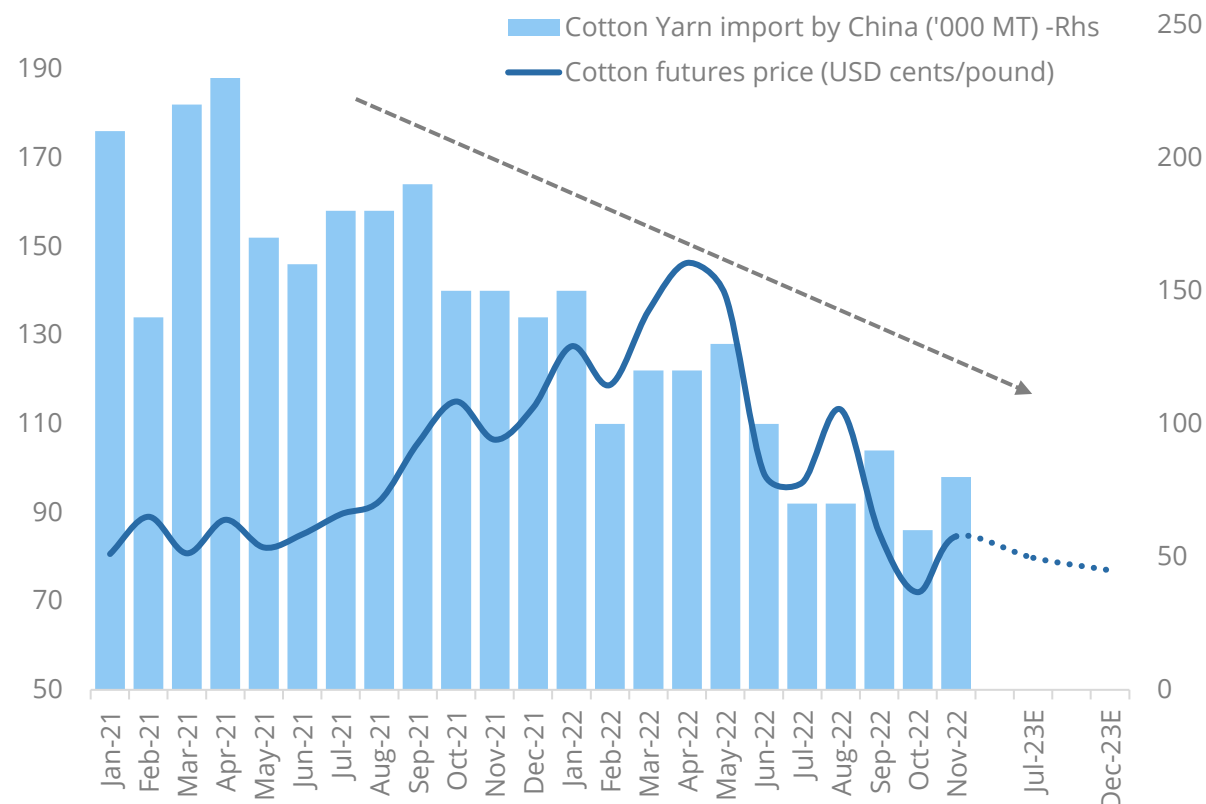


Softer Fiber: A decline in cotton prices stemming from waning global cotton consumption to help ease price pressures...

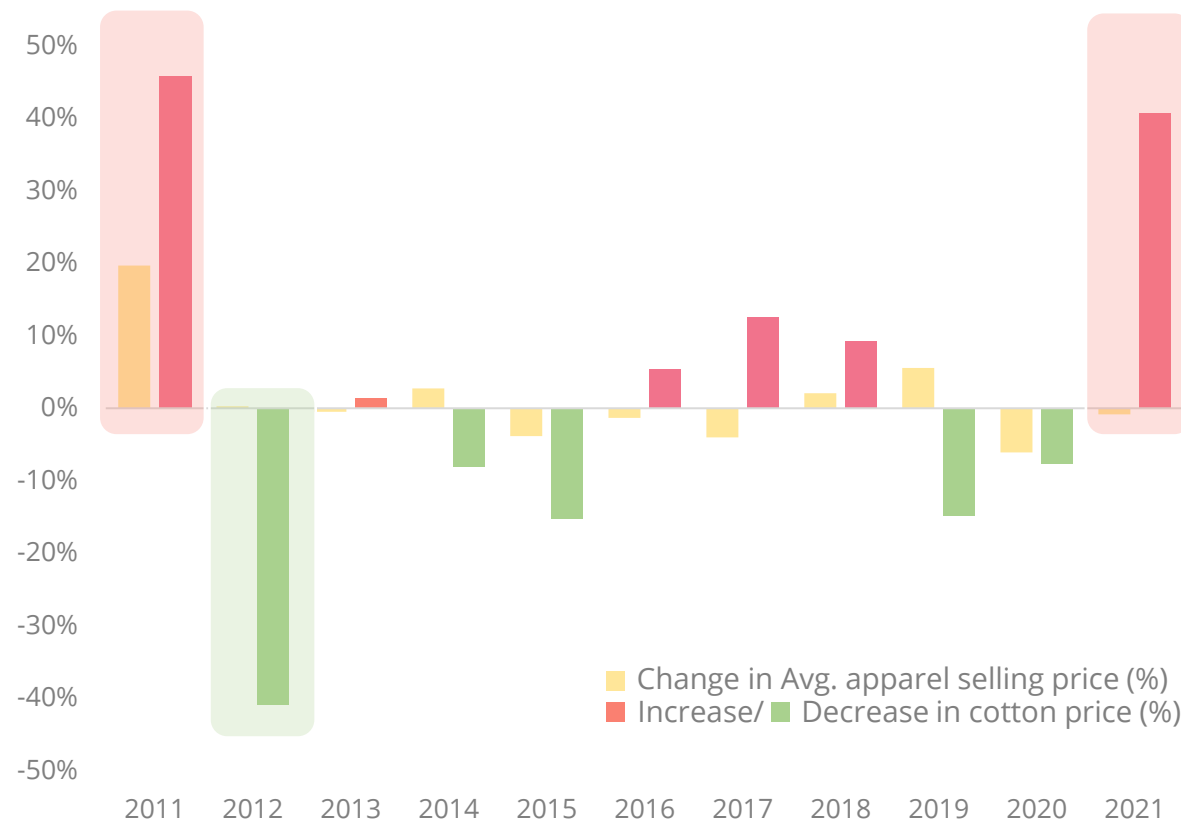
Reduced demand stemming from foreign trade policies barring imports of cotton products from China, and a global demand slowdown for apparel resulted in plunged yarn imports by China. The decline in yarn import by China and a global demand slowdown have reduced cotton consumption in the major yarn-exporting countries, resulting in a sharp fall in cotton prices.

Historically, the apparel industry has maintained its prices despite decreases in cotton prices, resulting in higher profit margins. The recent 39% drop in cotton prices since May 2022 will likely benefit apparel producers to expand their profit margins.

Cotton price and demand



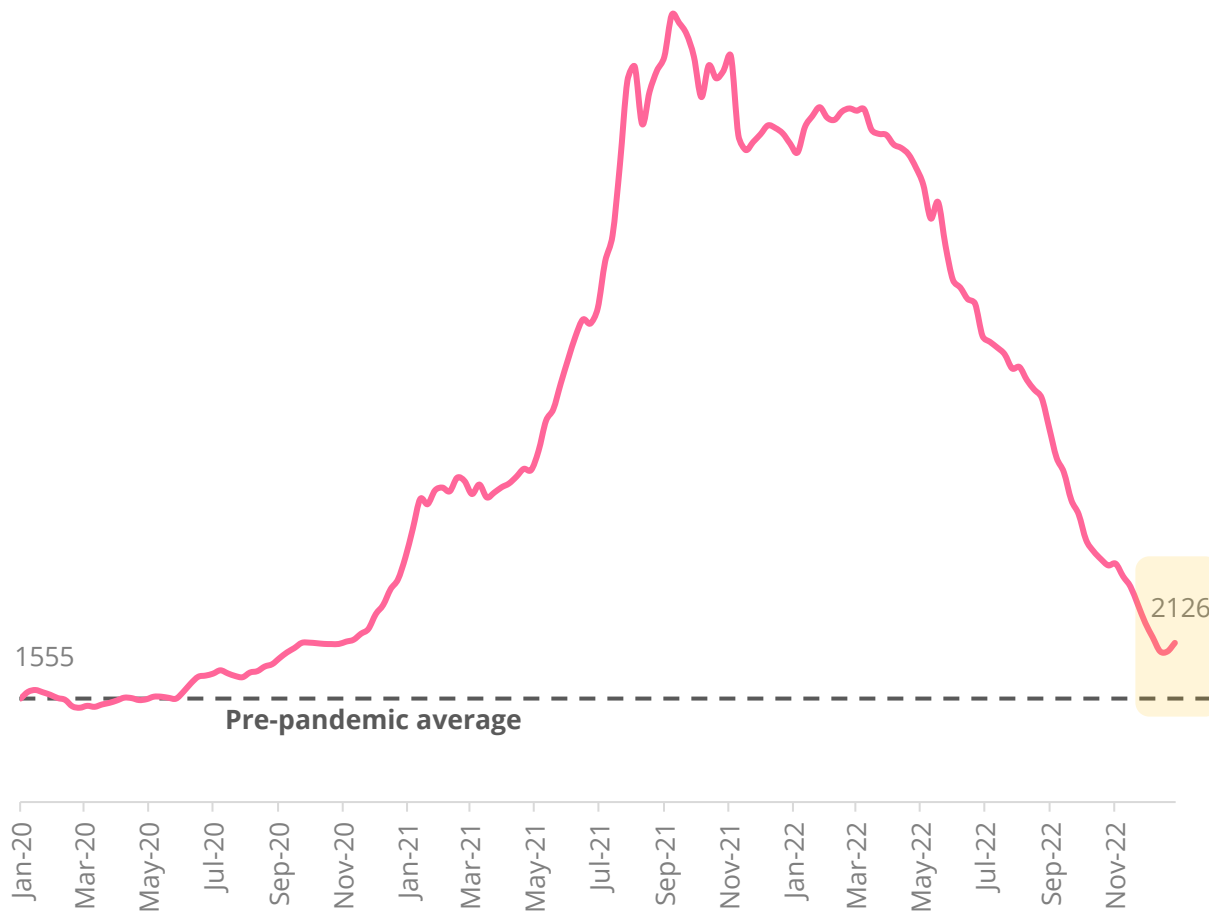
Movement in cotton price Vs apparel selling price (%)



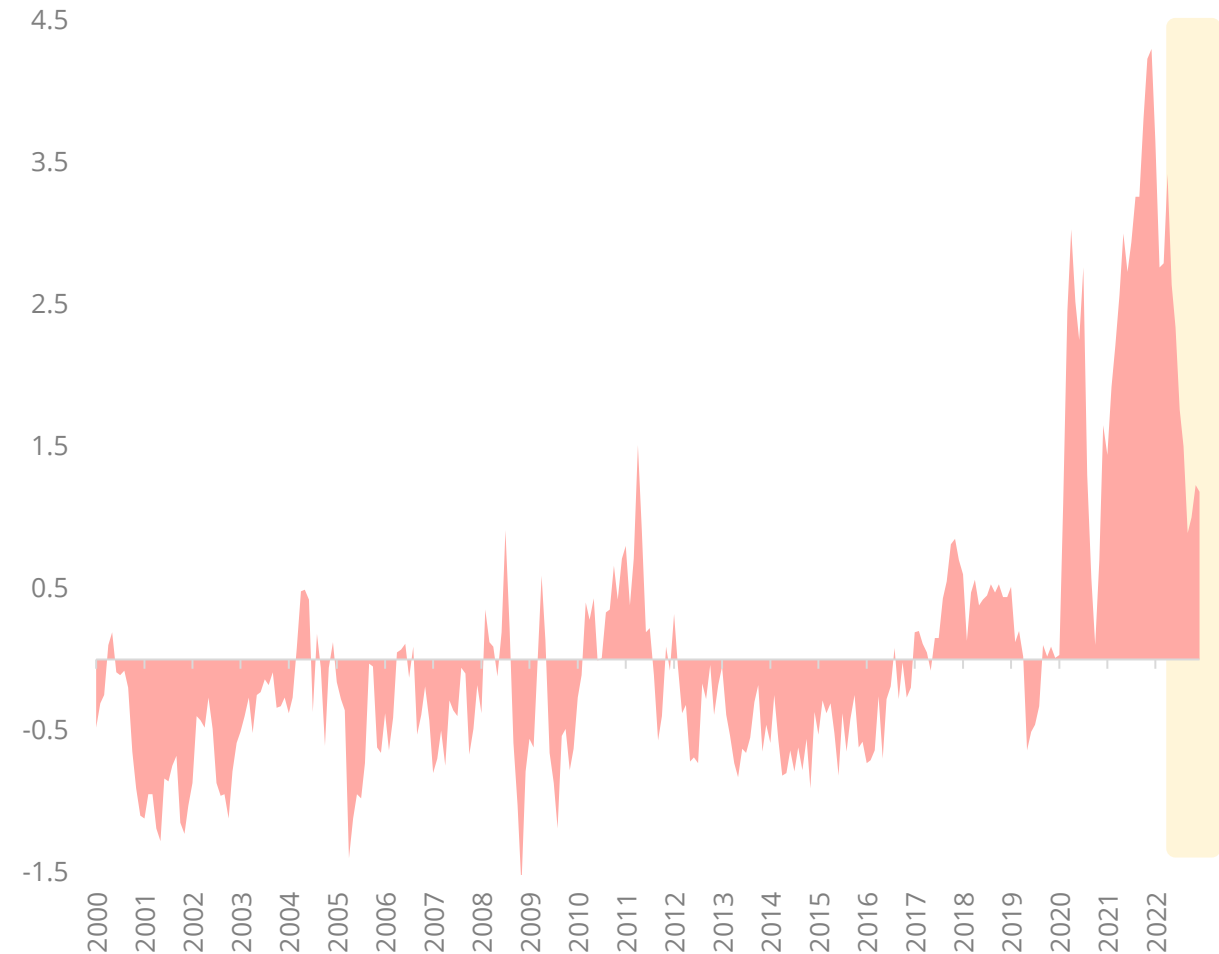
... and a steep correction in the freight rates will help reduce raw material import costs.

The easing of pressure on global supply chains has led to a decrease in shipping costs. In 2022, a 76% annual decline in the container freight rate will significantly reduce the import cost of cotton and other related raw materials.

Global container freight Index : FBX (\$)



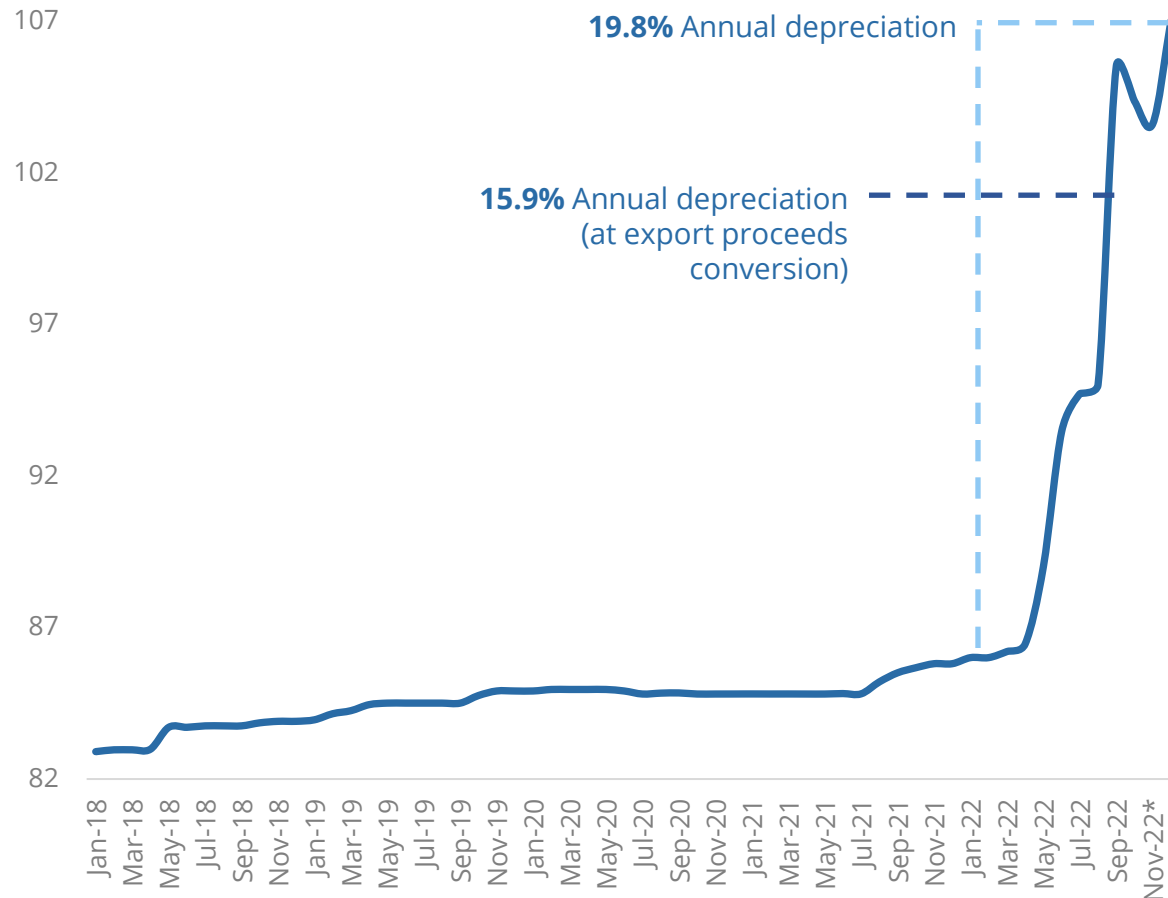
Global supply chain pressure index (GSCPI)



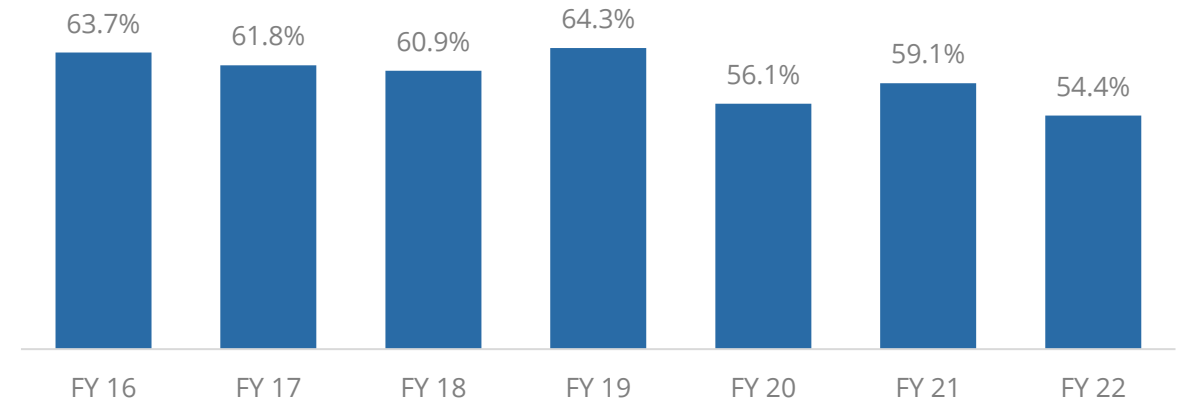
Depreciation Drive: With high local value addition, currency depreciation will benefit apparel exporters, however, multiple exchange rates will dent the benefit...

The 19.8% annual currency depreciation in 2022 will benefit the sector due to the 54.4% of local value addition. However, margins will also be negatively affected as export proceeds are converted at BDT 102, and a higher exchange rate is required for L/C settlements to purchase raw materials.

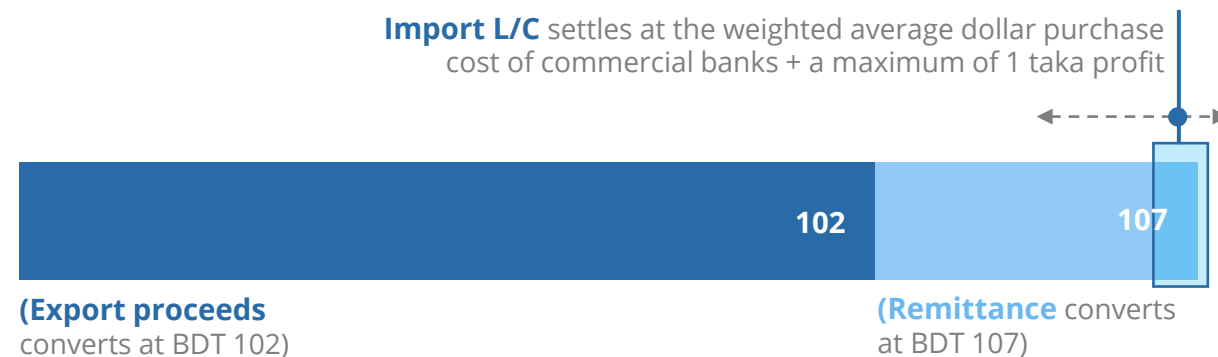
Inter bank exchange rate (BDT/USD)



Value addition from RMG export in context of raw materials import



Transaction wise exchange rate (BDT/USD)



...along with additional challenges arising from LC opening hurdles stemming from declining dollar balance in the economy.

The shortage of dollars has presented a challenge for the textile industry in sourcing raw materials. Additionally, due to current import control measures, there has been a decline in the opening of letters of credit for capital machinery imports. If industry capital expenditures continue to decrease, it will have a long-term effect on exports.

Media coverage of LC opening difficulties for the raw material imports

The Financial Express

Dollar shortage fallout

Most banks cold-shoulder LC opening

Spinners fear exhausting basic raw materials for apparel

"Declining stocks of raw materials amid commercial banks' unwillingness to open LCs might severely hamper production and exports of textile and apparel items," Mr Khokon says in the letter.

THE BUSINESS STANDARD

ECONOMY

TBS Report

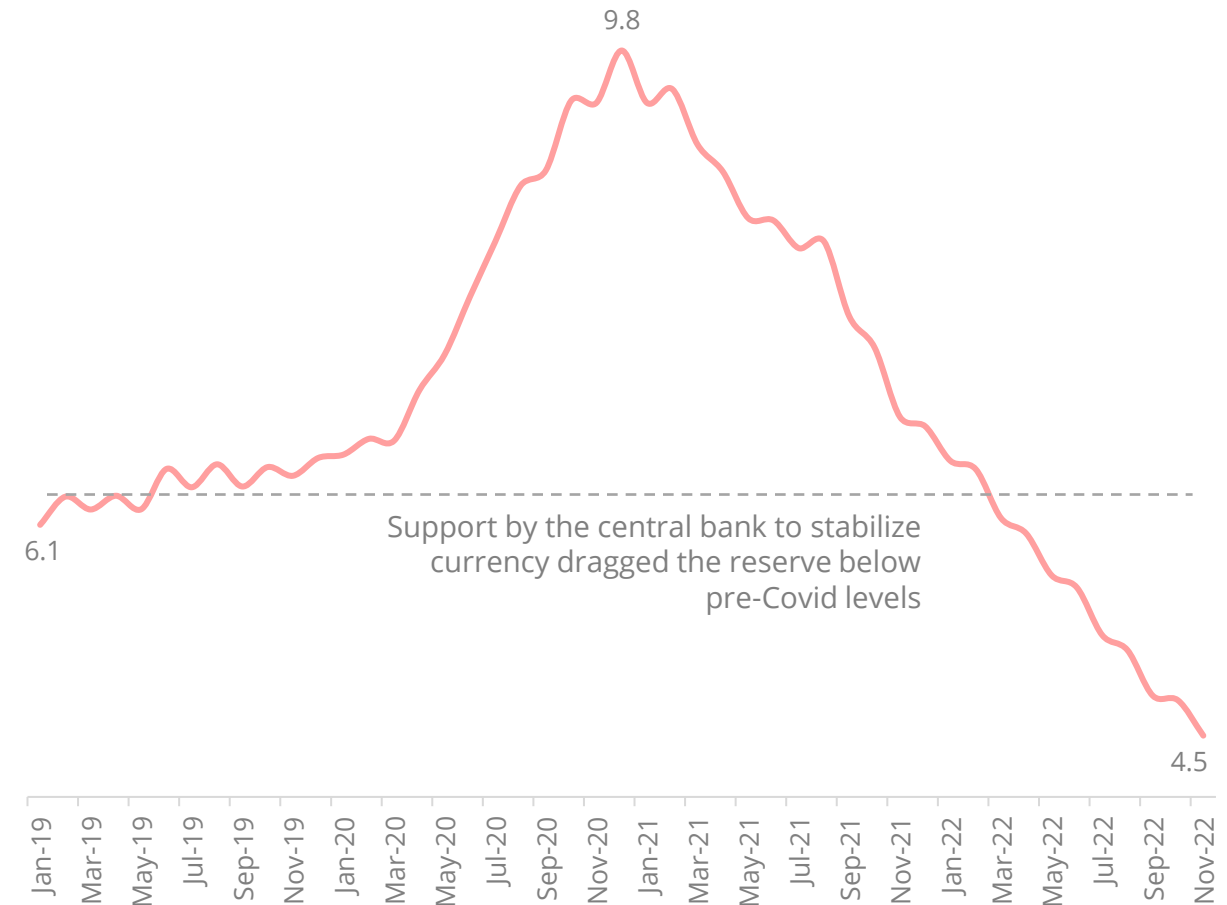
24 September, 2022, 09:25 pm

Last modified: 24 September, 2022, 09:32 pm

Govt curbs causing difficulties in capital machinery import: MCCI president

Some businesses are facing difficulties in importing capital machinery due to the government's import control aimed at reducing pressure on dollar reserves, said Md Saiful Islam, president of the Metropolitan Chamber of Commerce and Industry, Dhaka.

Forex reserve (Months of import)

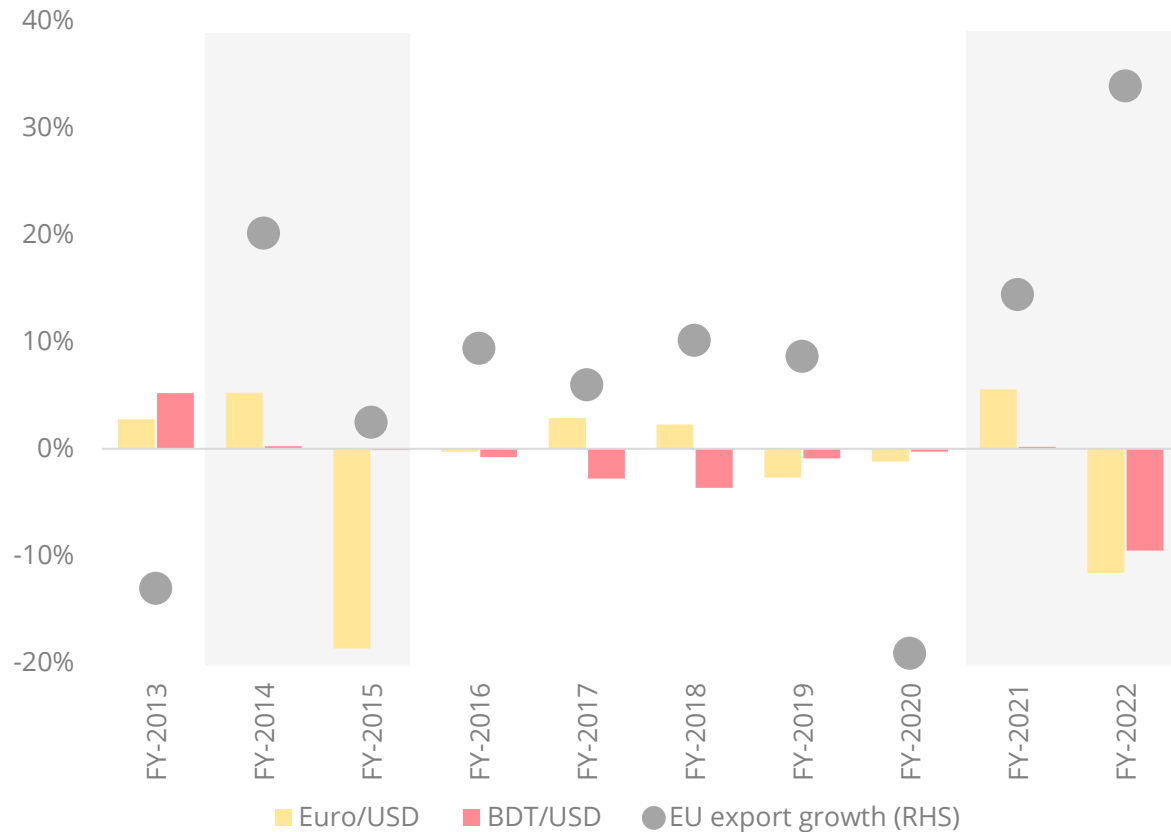


Lower consumer confidence in the EU will dent apparel export to the region while parallel currency depreciation of the Euro and the Taka against the dollar may ease the pressure.

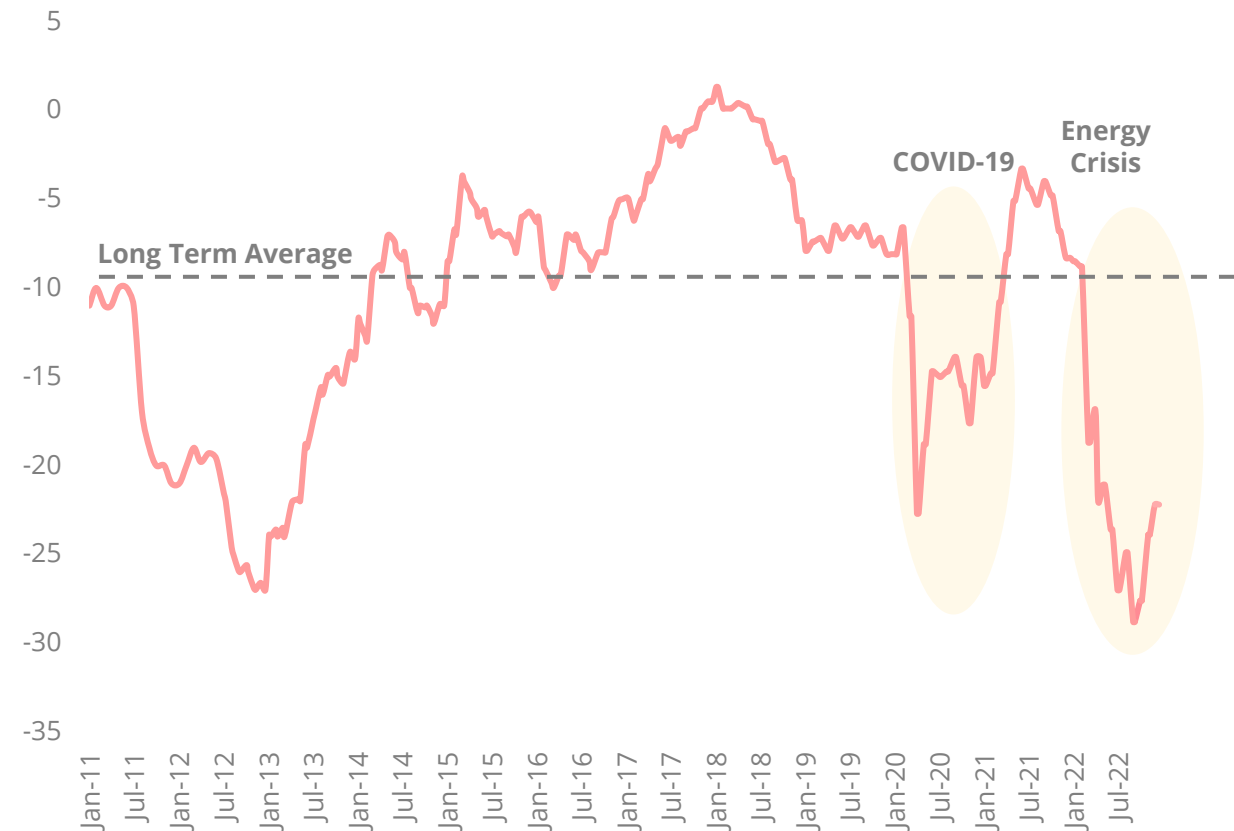
In the past, Bangladesh's apparel exports have remained relatively stable during times of parallel currency depreciation between the Euro and Taka against the USD, with depreciation in Taka helping to boost export growth in the EU markets.

The rising cost of living is hurting households, while energy shortages remain a potential constraint to economic production. Although, consumer confidence in the eurozone improved in December after reaching a record low in September. Despite the recovery, consumer confidence remains below its long-term average of -11.0 and has yet to recover to the levels seen before the outbreak of COVID-19 in the spring of 2020.

Apparel export to Eurozone and relative currency performance



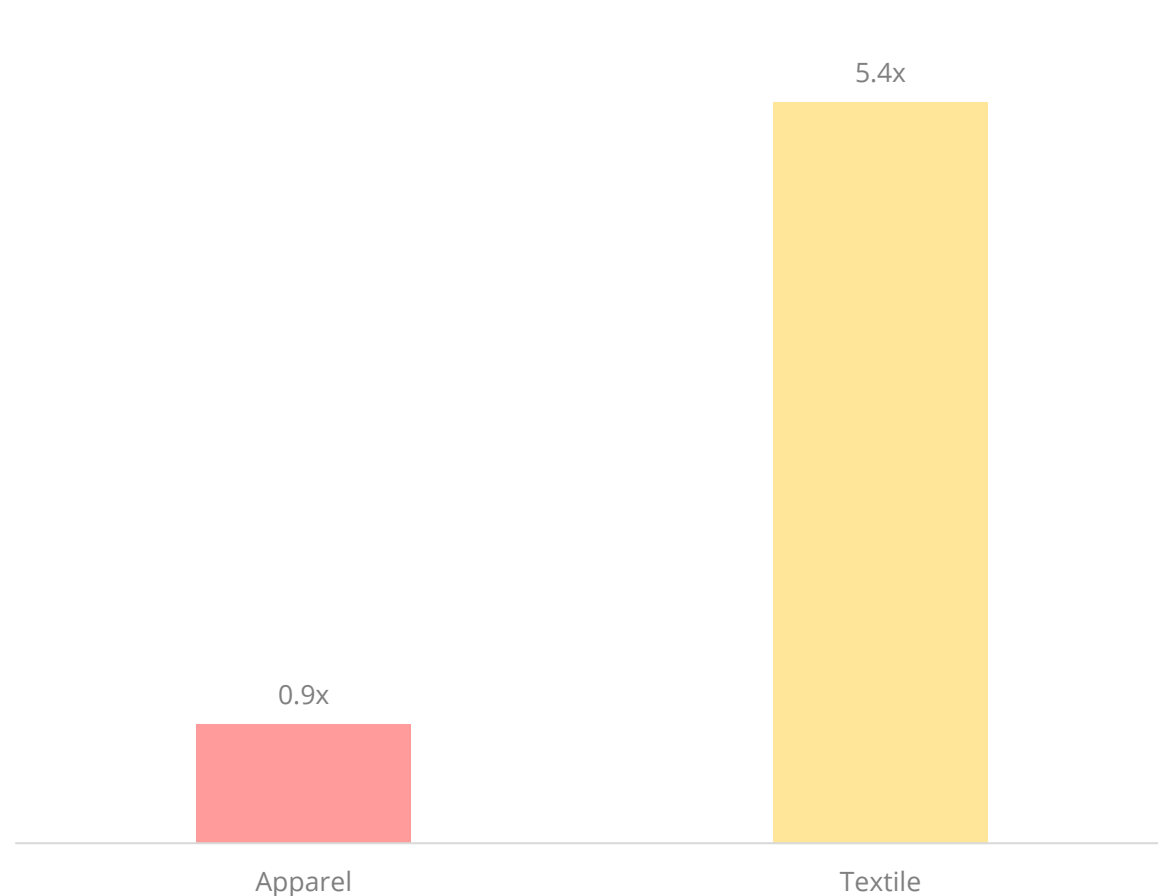
Eurozone consumer confidence



Toll on Textile: A high fixed cost structure and high-cost inventory will shrink textile sector margins in the short term.

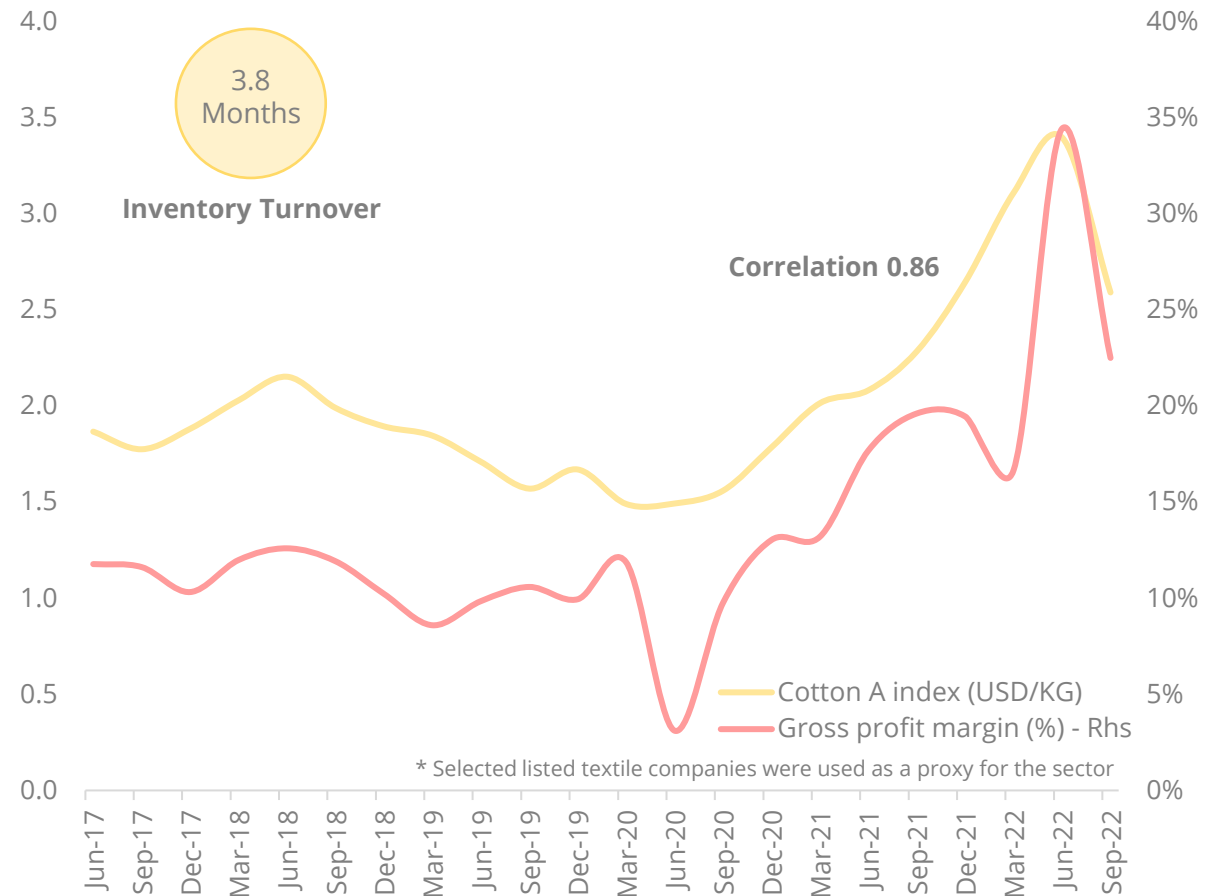
The textile sector has a significantly higher degree of operating leverage and a fall in cotton prices would have a greater impact on their profitability. As the textile sector holds 3.8 months of inventory at higher prices, a 14.4% correction in cotton prices in the last quarter will adversely affect the sector's profitability.

Operating leverage (Times)



* Selected listed textile companies were used as a proxy for the sector

Cotton price Vs. Gross profit margin of the textile sector



* Selected listed textile companies were used as a proxy for the sector

What does the short-term outlook mean for companies operating in the sector in 2023?

CAL's View:

EU Woes

Apparel exporters with higher exposure to European markets will experience a significant dip in revenue than those with higher exposure to the US markets.

Fixed Cost Burden

Companies with high fixed-cost structures will experience a substantial reduction in their bottom line, given that they cannot fill the capacity owing to lower demand.

Inventory Dilemma

Companies with high inventory and high debt exposure will struggle in 2023.

3 | MID-TERM OUTLOOK

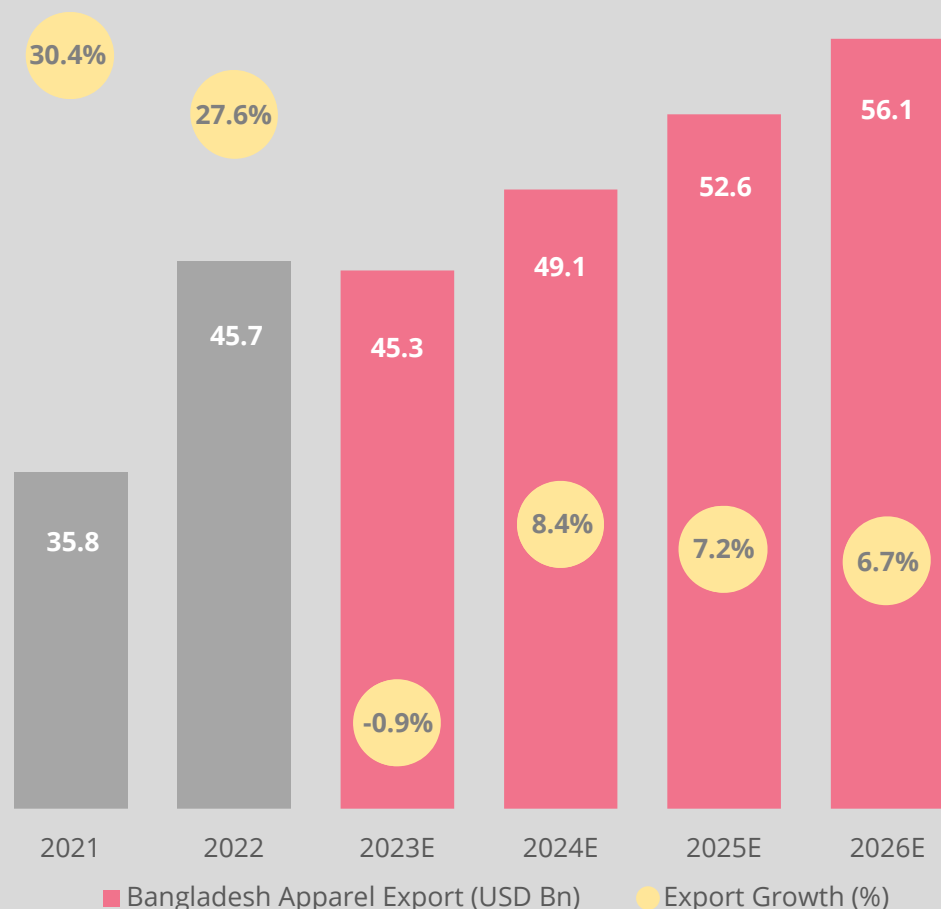
KNITTING THE NEXT PHASE OF GROWTH

We expect global demand to pick up steam in 2024E as central banks shift focus toward supporting growth as inflation recedes. CAL expects Bangladesh's apparel export to witness a strong rebound with a c. 8.4% growth in 2024E. The apparel export size of Bangladesh is expected to reach USD 56.1 Bn by 2026E. The growth will be driven by three primary factors: i. focus on the MMF, the largest global apparel segment; ii. market share consolidation as order flow shifts from China due to China plus one strategy, and iii. greater product diversification and expansion in the non-traditional apparel markets.



Despite a dip in 2023E, CAL expects Bangladesh apparel export to grow at c. 5.3% CAGR and reach USD 56 Bn by 2026E...

Bangladesh apparel export outlook (USD Bn)



What factors will drive the next growth phase?

MMF Focus

Growth in the MMF segment is picking up steam, fueled by increased investment in the MMF-based primary textile sector incentivized by a 10-year tax exemption for new MMF factories. From 2017 to 2020 share of the primary textile sector's investment in MMF increased by 10% points. MMF raw material import, a proxy for MMF apparel production, has maintained a 9.1% CAGR at Pre-Covid levels (2013-19) whereas apparel export CAGR during the same period was 3.8%.

China Plus One

As labor costs increase, China is losing its advantage in the labor-intensive apparel industry. However, its advanced technologies still enable its textile industry to retain its dominance as a major supplier of apparel. Thus, Bangladesh has benefited from this shift, posting an 8.5% CAGR in its Apparel Export to the US since 2017. Since China's apparel shift is still in a transitional phase, Bangladesh's textile sector is expected to receive increased order flow during this transitional period.

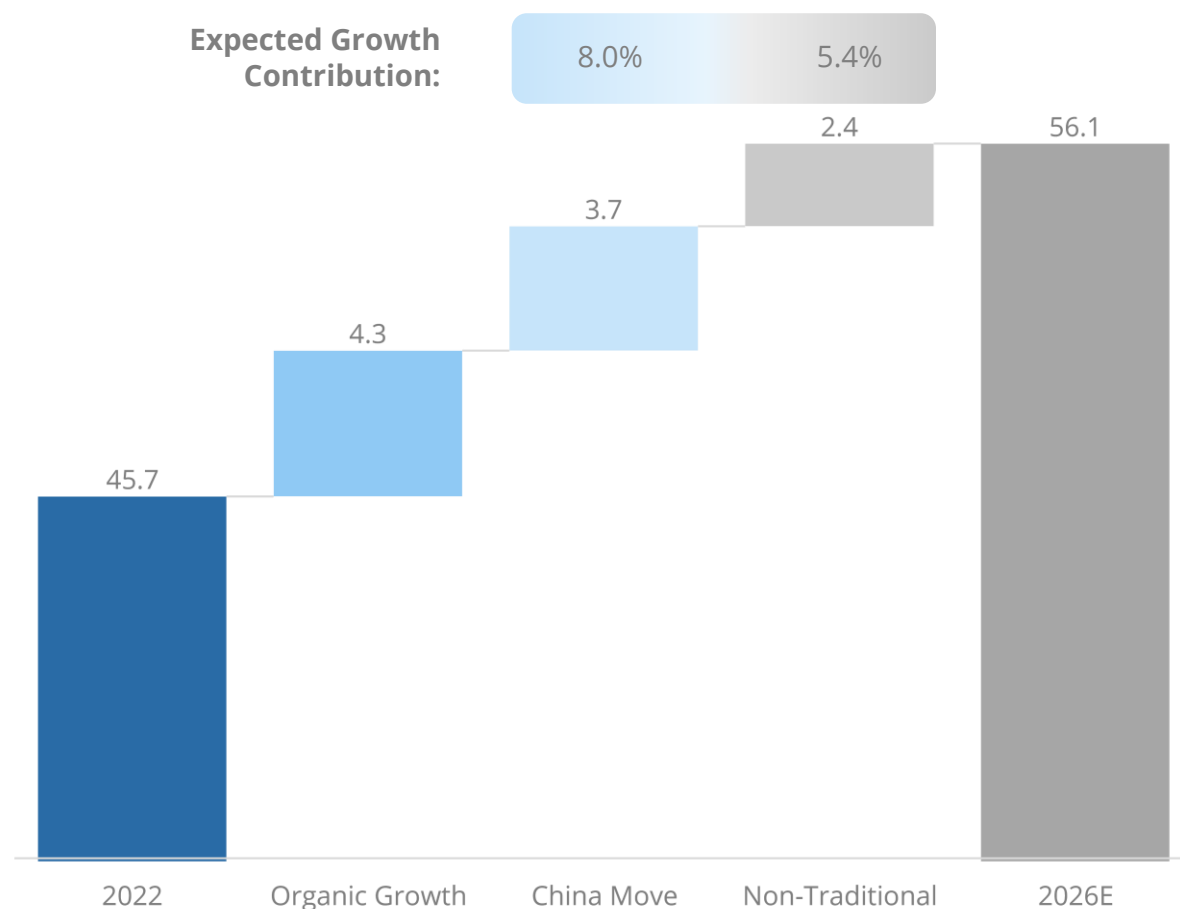
Market & Product Diversification

Bangladesh is diversifying its apparel export market beyond the US and Europe, with a 2.5x increase in export share to non-traditional markets since 2008. This trend is expected to continue with a 4% cash incentive for exports to non-traditional markets. Additionally, the proportion of cotton T-shirts and trousers in total apparel exports has decreased since 2013. As the country diversifies its product offerings it will translate into additional export revenue.

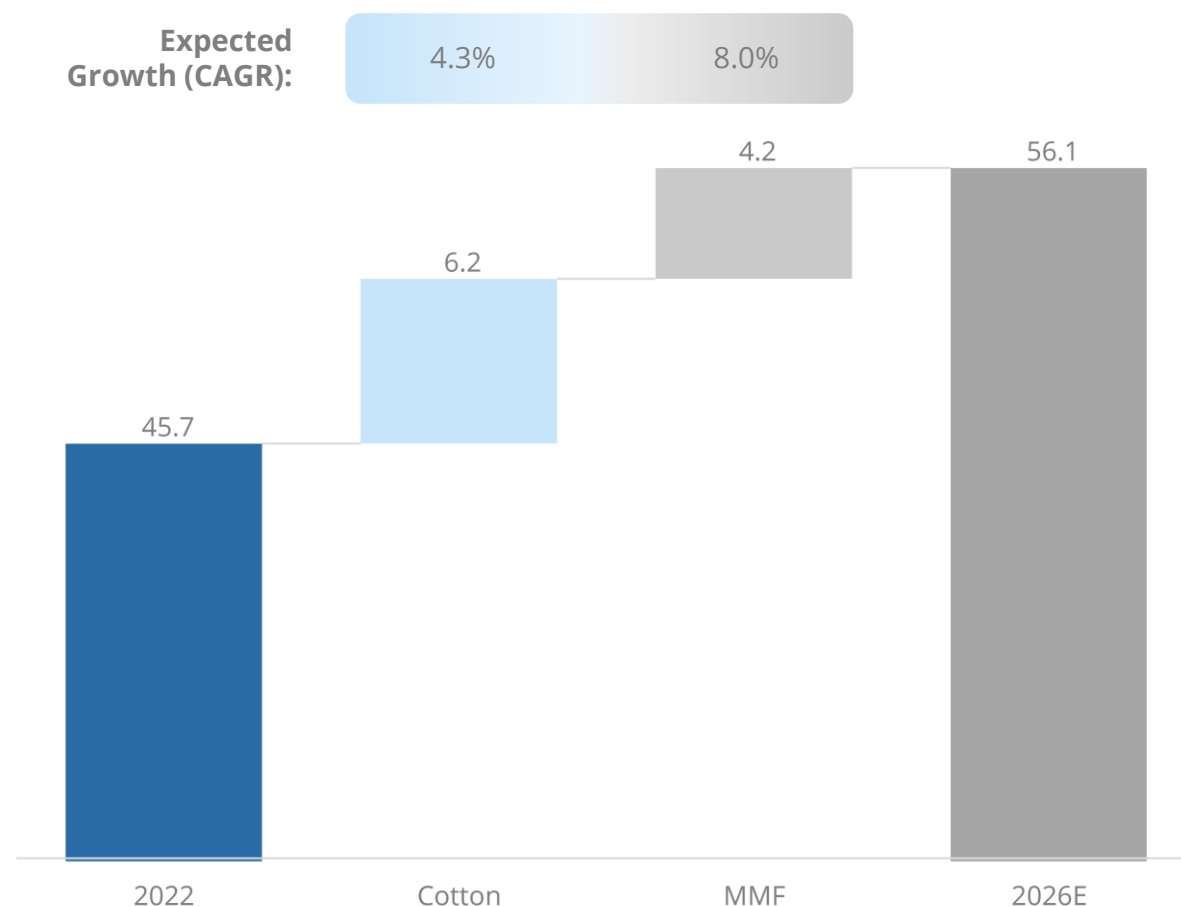
...driven by expansion in the Man Made Fiber (MMF) segment, apparel order shift from China, and market diversification.

During the mid-term growth phase, we expect a shift in order flow from China, owing to the "China plus one" strategy will contribute to 8% of the overall apparel export growth. Furthermore, we expect the Man Made Fiber (MMF) segment to record a Compound Annual Growth Rate (CAGR) of 8% during this period.

Segment-wise apparel export outlook (USD Bn)



Fiber-wise apparel export outlook (USD Bn)

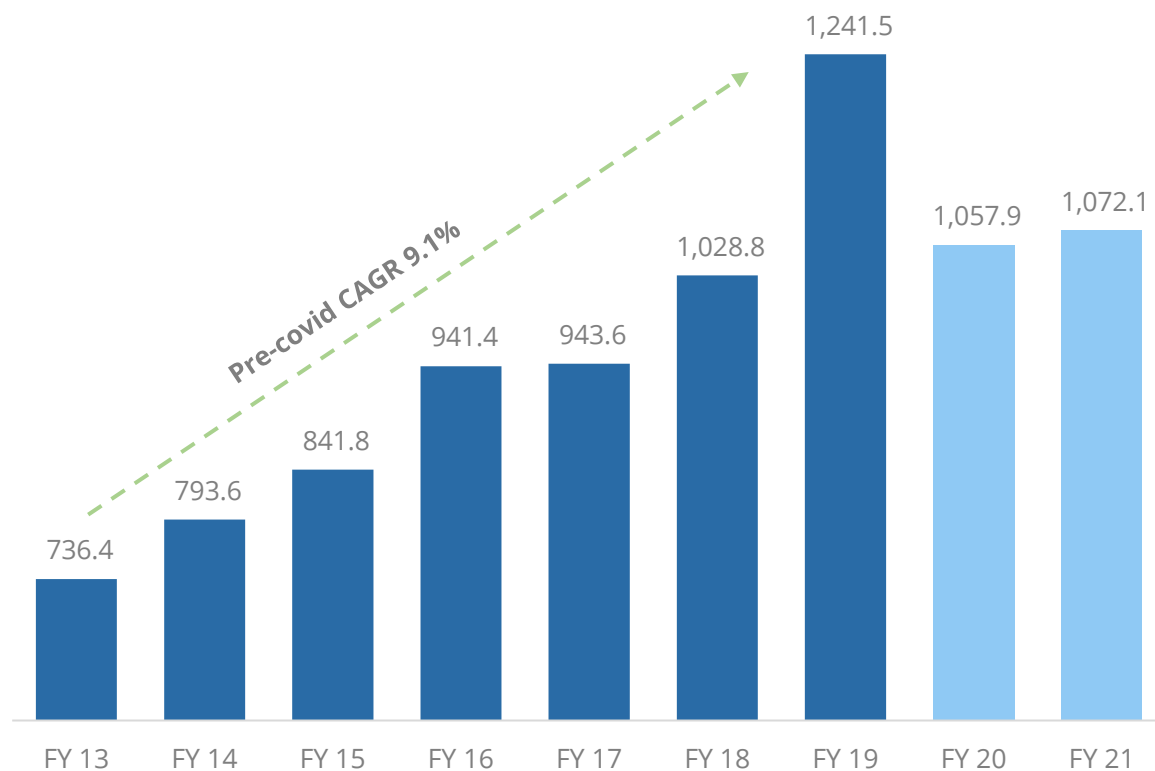


MMF Focus: With dominance in cotton-based apparel, Bangladesh is increasingly focusing on MMF, the largest segment in the global apparel market...

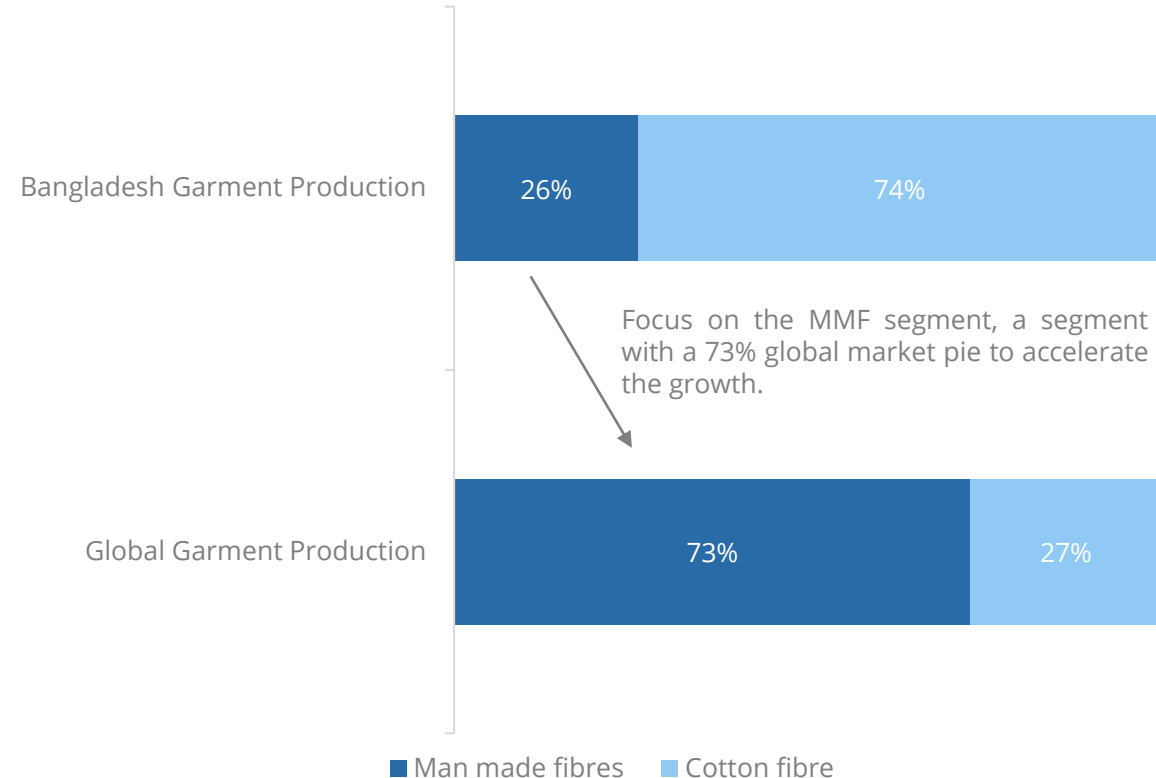
As the backward linkage for the MMF apparel segment is still at a growth stage, Bangladesh caters to its increased raw material demand for the MMF apparel export orders through fiber, yarn, and fabric imports. MMF raw material supply for the sector relies heavily on China, which supplies 62% of the man-made staple fibers (HS 55).

Even though only 27% global apparel market is cotton based, focusing mainly on the cotton segment, Bangladesh has been able to grab 6.5% global apparel market share up to 2021. Emphasizing MMF apparel, Bangladesh is now eyeing the bigger market pie, where the acquisition of incremental market share would translate into more considerable export growth.

Bangladesh import of man-made staple fibers (USD Mn)



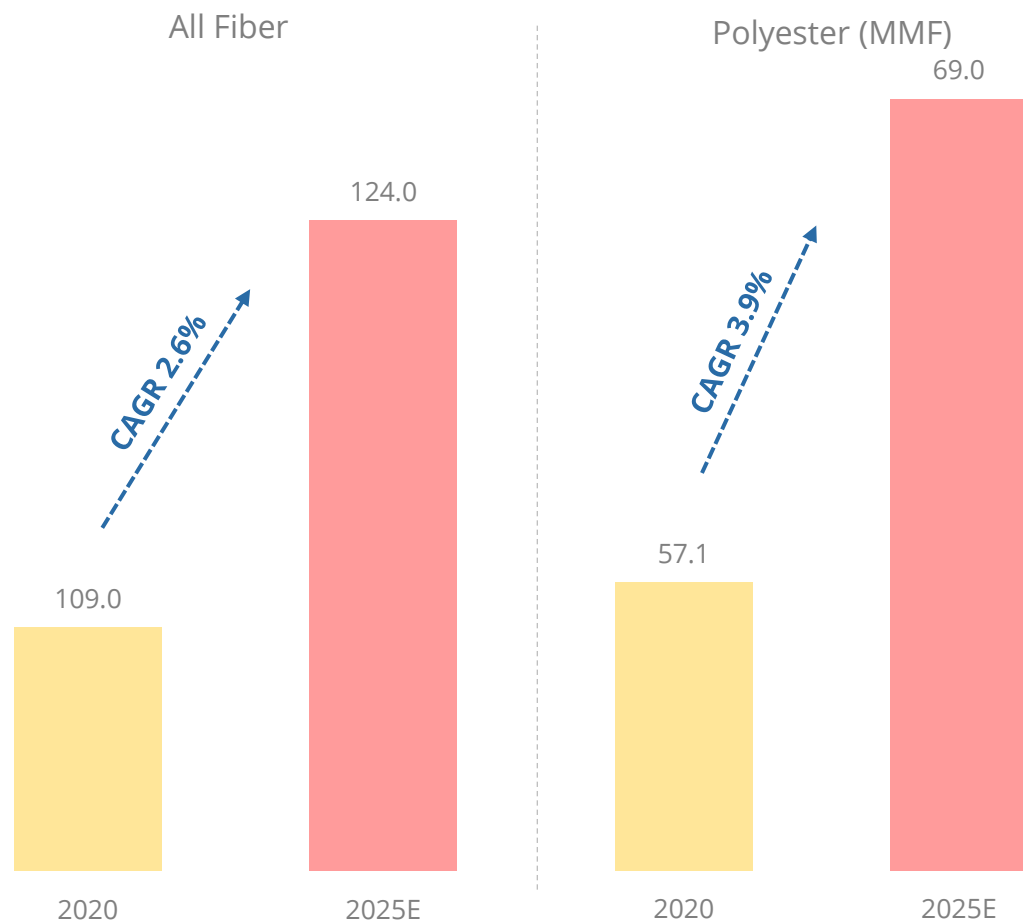
Composition of global and Bangladesh garment production (%)



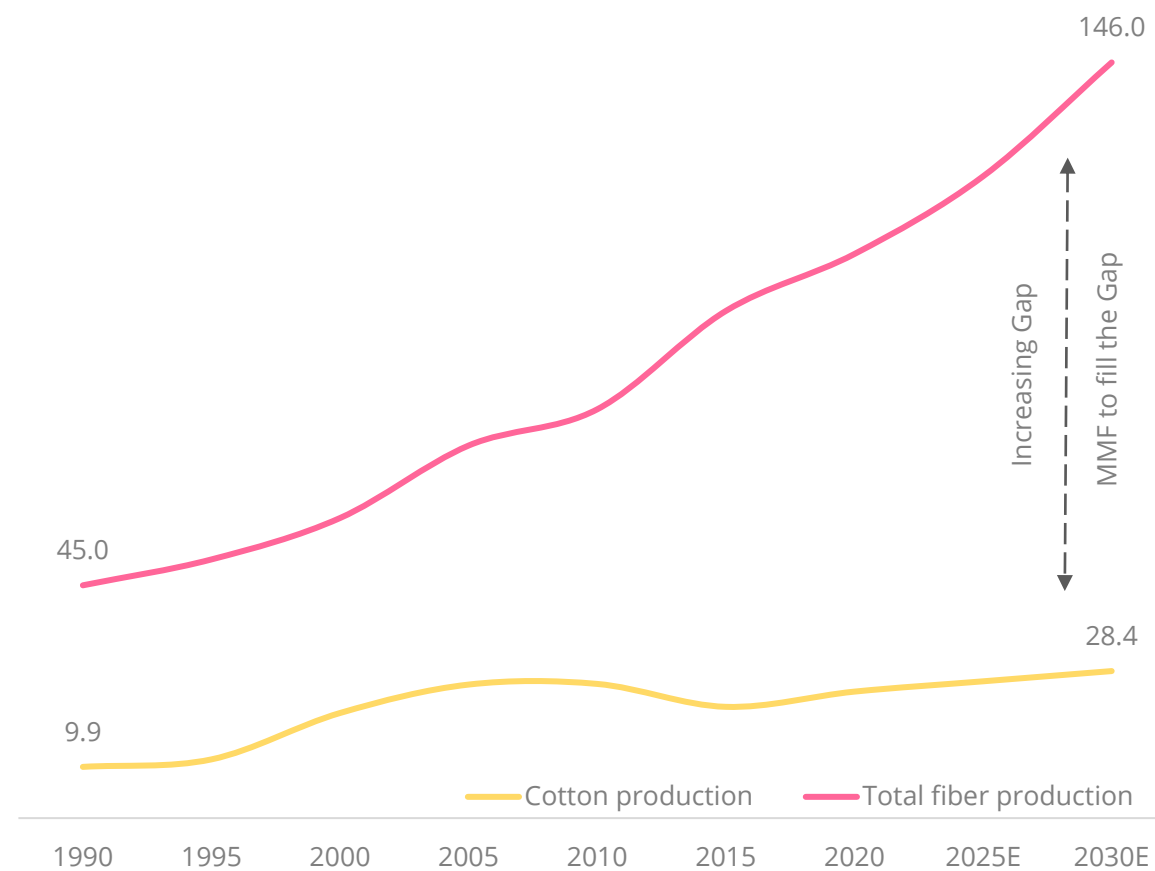
...to ride on a stronger global growth outlook.

The growth outlook for man-made fibers is expected to experience more robust growth compared to other fibers, as cotton production is unlikely to keep pace with the rising demand. MMF will likely fill this demand gap as a substitute source.

Global fiber market growth outlook (Mn Tonnes)



Global fiber market outlook and cotton production (Mn Tonnes)

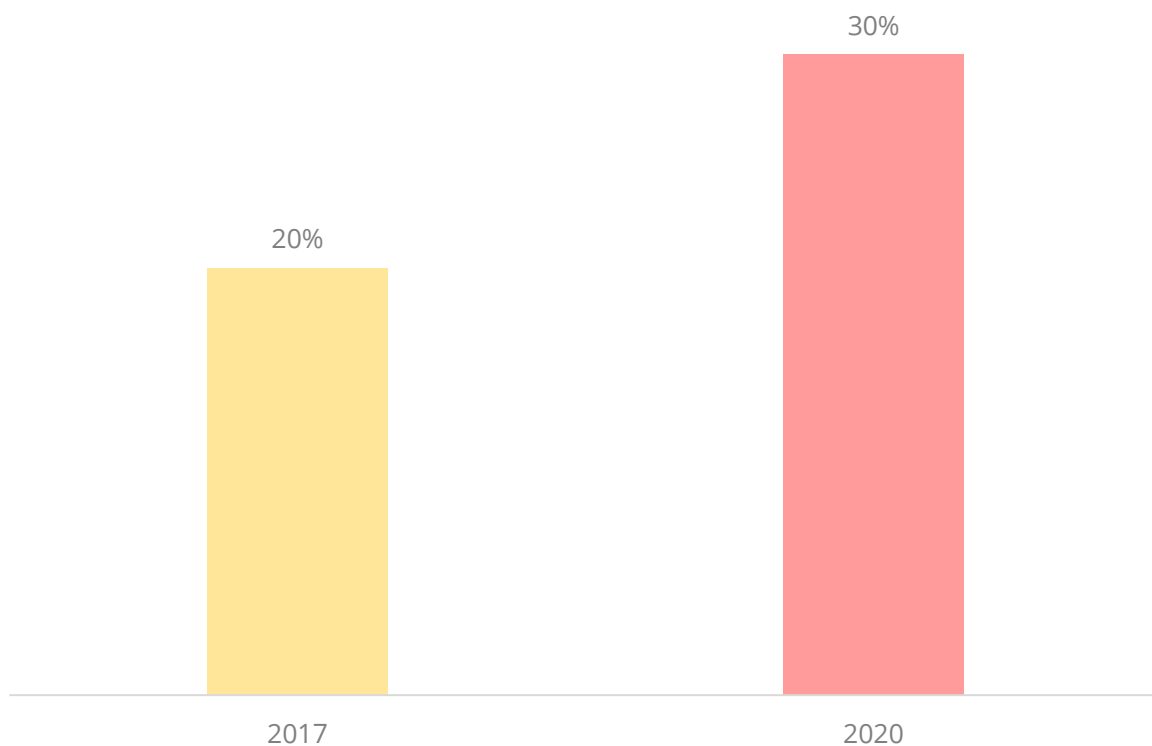


The growth in the MMF segment will be facilitated by increased investment in the segment which is already in a rising trend...

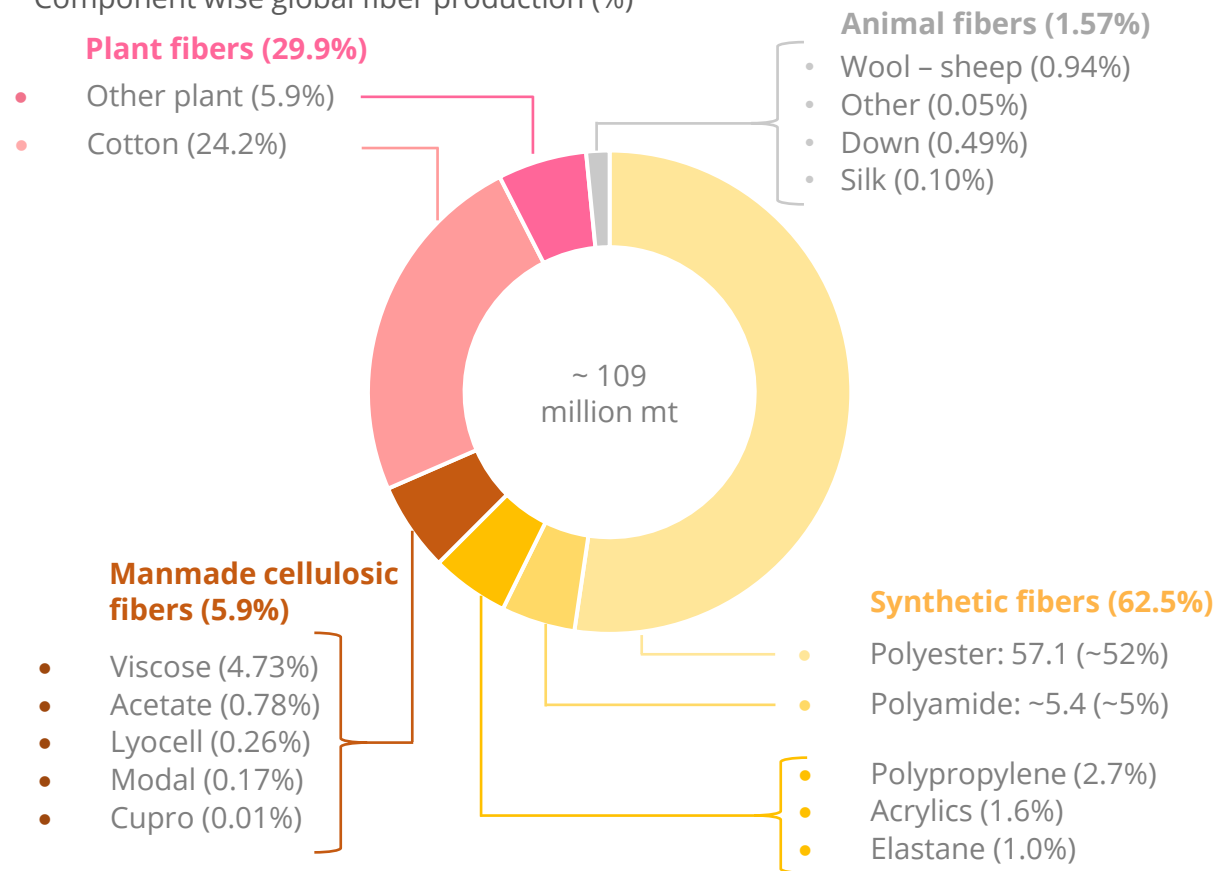
Local RMG entrepreneurs are eying to invest around USD 2.5 Billion by 2023 to meet the growing demand for textile products, primarily focusing on man-made fiber.

As the world's second-largest apparel exporter, Bangladesh's ready-made garment (RMG) sector is expected to align with global market trends and gradually shift its focus towards utilizing man-made fibers (MMF) and synthetic inputs.

Share of primary textile sector (PTS) investment in MMF in Bangladesh (%)



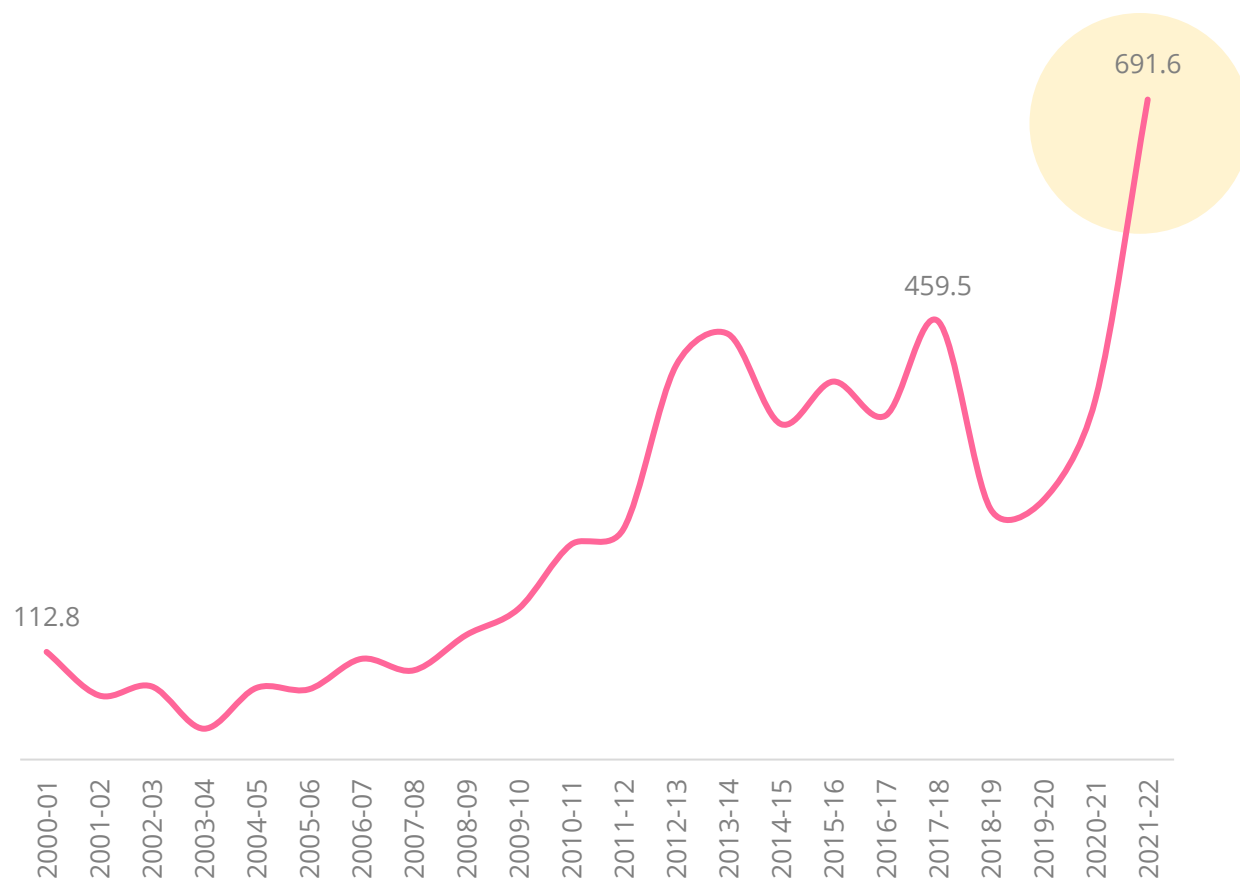
Component wise global fiber production (%)



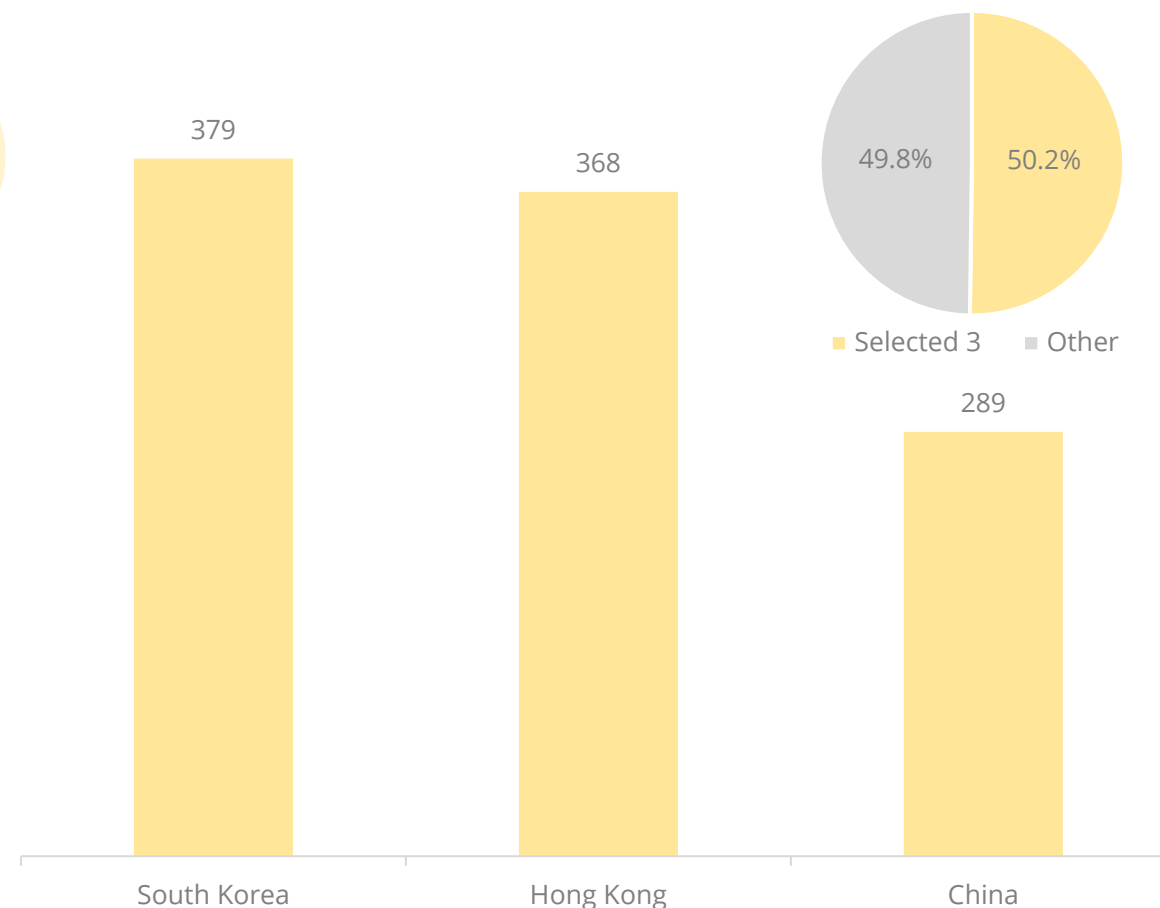
...driven by increased FDI flowing into the textile sector...

After experiencing a decrease in 2019 and during the COVID-19 period, foreign direct investment (FDI) recently began to rise and recorded its highest annual net inflow during the fiscal year 2022. We expect a rise in both FDI and local investment to be directed toward the man-made fiber (MMF) segment, which has substantial growth potential.

FDI inflows (Net) in textile sector (USD Mn)



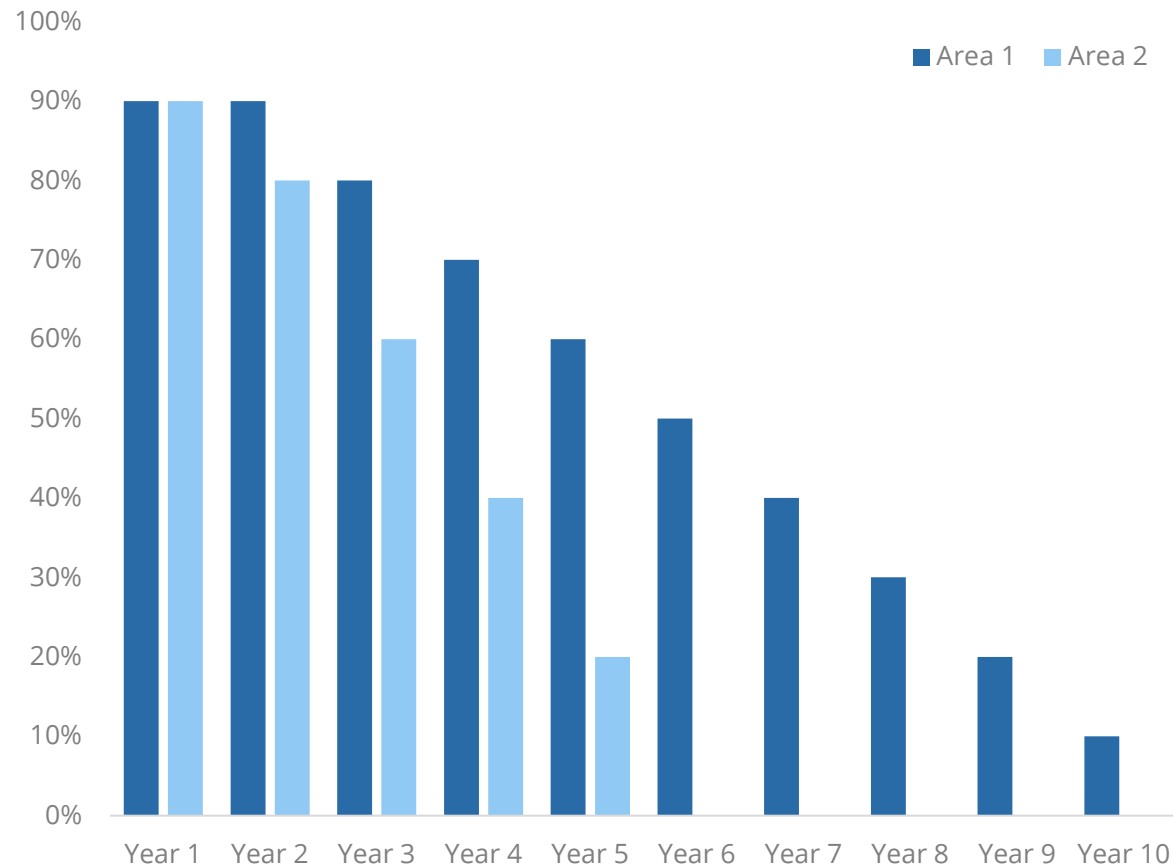
Cumulative investment in textile sector from FY-18 to FY-22 (USD Mn)



...and increased government incentives for textile companies to shift focus towards MMF.

The establishment of a man-made fiber (MMF) factory by June 2024 will provide the benefit of tax exemptions for a period of up to 10 years. These fiscal incentives are expected to incentivize increased investments in the segment and foster the development of a robust backward linkage.

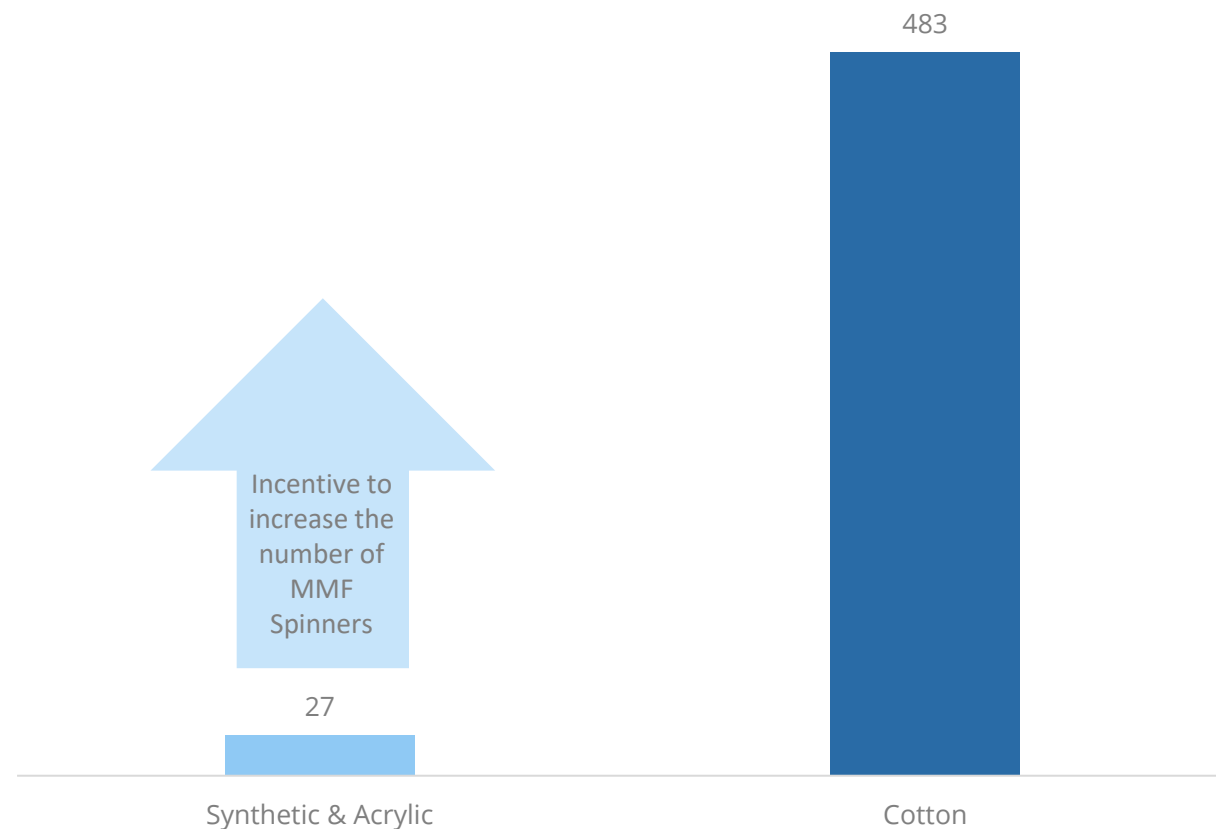
Tax exemption for an MMF factory set-up (with COD) till Jun-2024 (% of Income)



Area 1: Dhaka, Mymensingh, Chattogram Divisions. (Excluding Exception Areas)

Area 2: Rajshahi, Khulna, Sylhet, Barisal, Rangpur Division;
Rangamati, Bandarban & Khagrachari Districts.

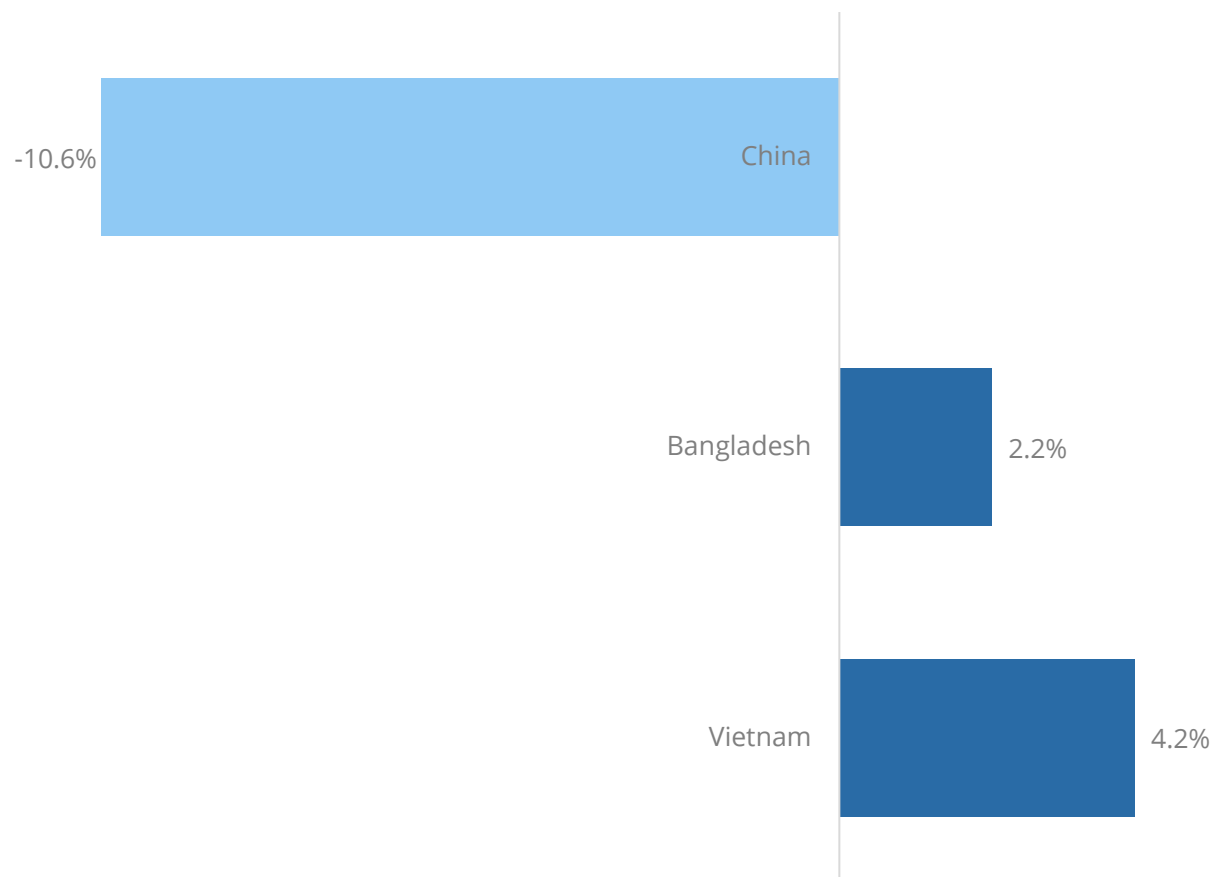
Spinning mills composition (%)



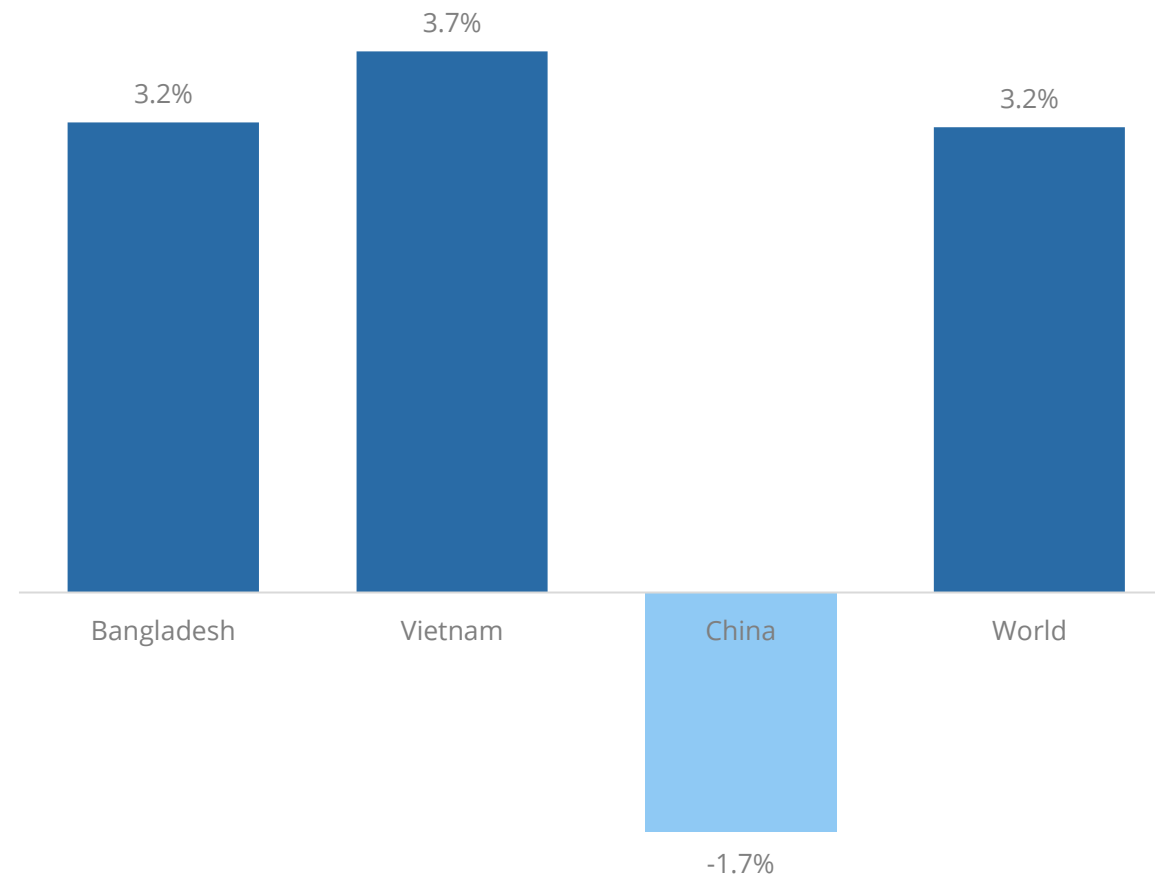
China Plus One: The continued shift of global fashion retailers' orders from China will further expand Bangladesh's apparel export market share.

Between 2016 and 2021, China experienced a decline of 10.6% in its market share in the United States. Vietnam and Bangladesh, on the other hand, saw an increase in their market share by 4.2% and 2.2%, respectively. A similar pattern was observed in the European Union (EU) region, although the decline in China's market share was less significant in the EU compared to the US markets.

Change in US apparel market share (% points, 2016-2021)



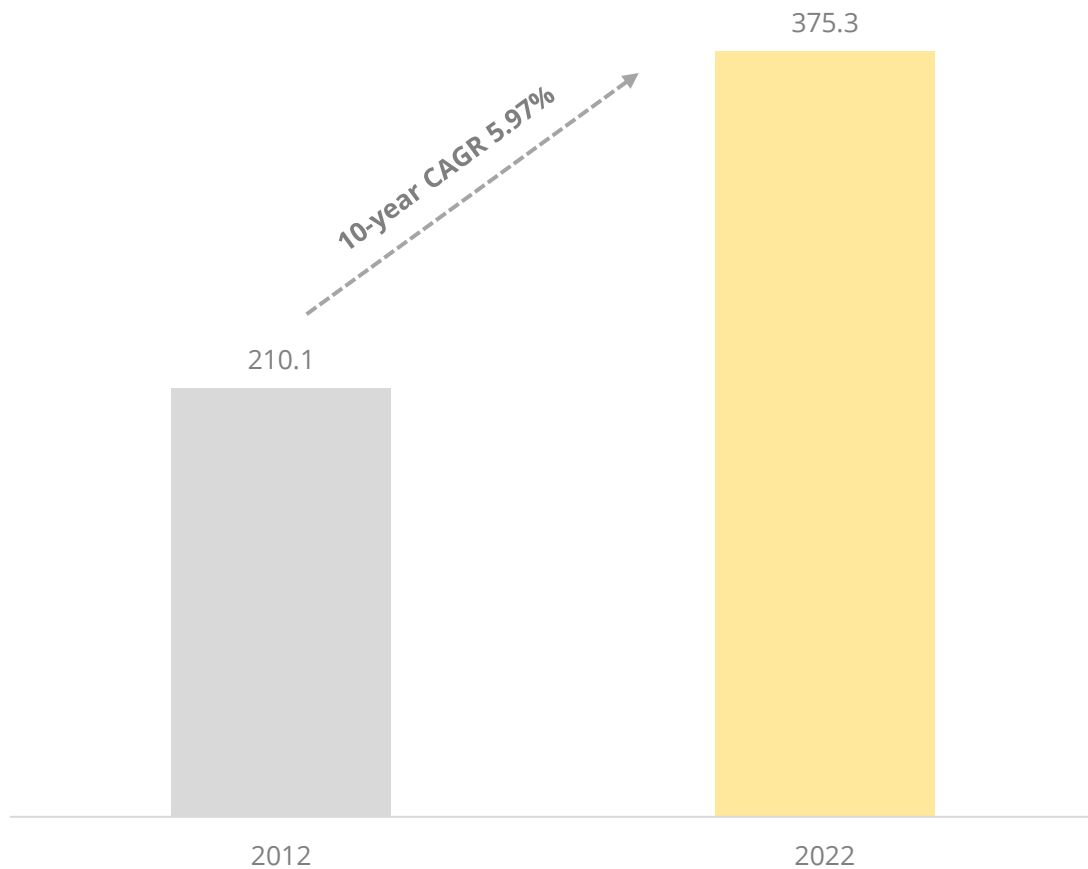
Four-year (2016-21) CAGR of export performance in EU market



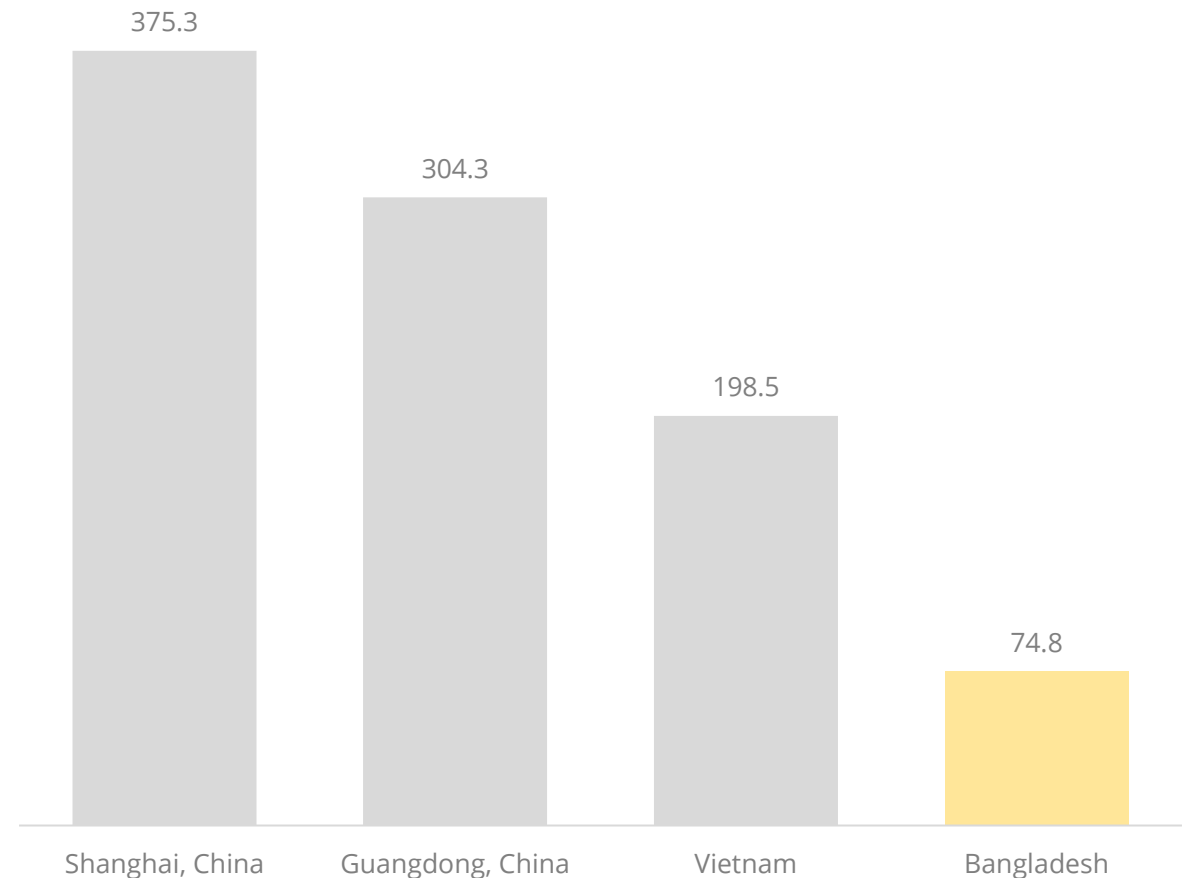
Bangladesh remains an attractive destination for the labor-intensive apparel sector owing to the increasing labor costs in China.

Over the past ten years, the minimum monthly wage in China has seen a 1.8-fold increase. At the same time, China is four times more expensive than Bangladesh in terms of labor costs.

Minimum monthly wage in China (USD)

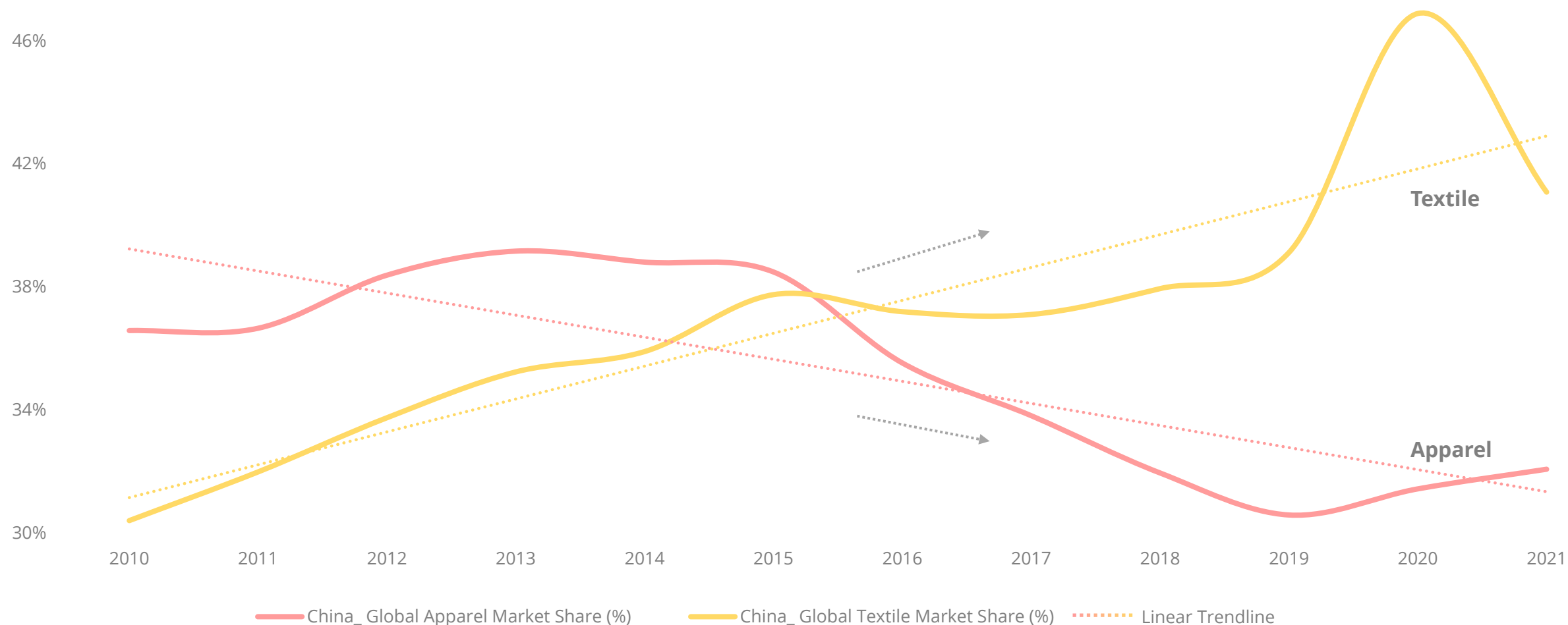


Country-wise minimum monthly wage in 2022 (USD)

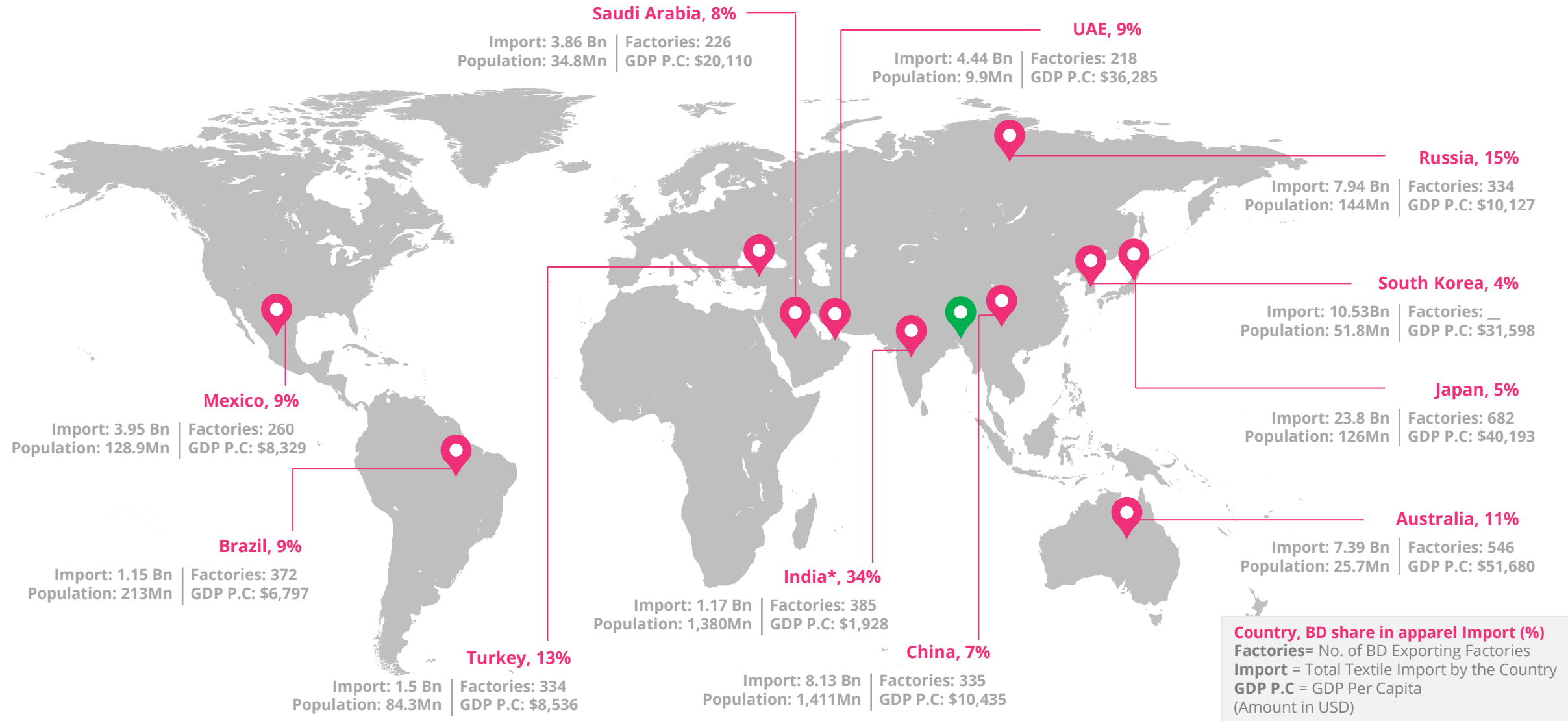


China's tech-intensive textile exports continue to expand while labor-intensive apparel export shrinks in the global market.

China's share in the global textile and apparel market (%)

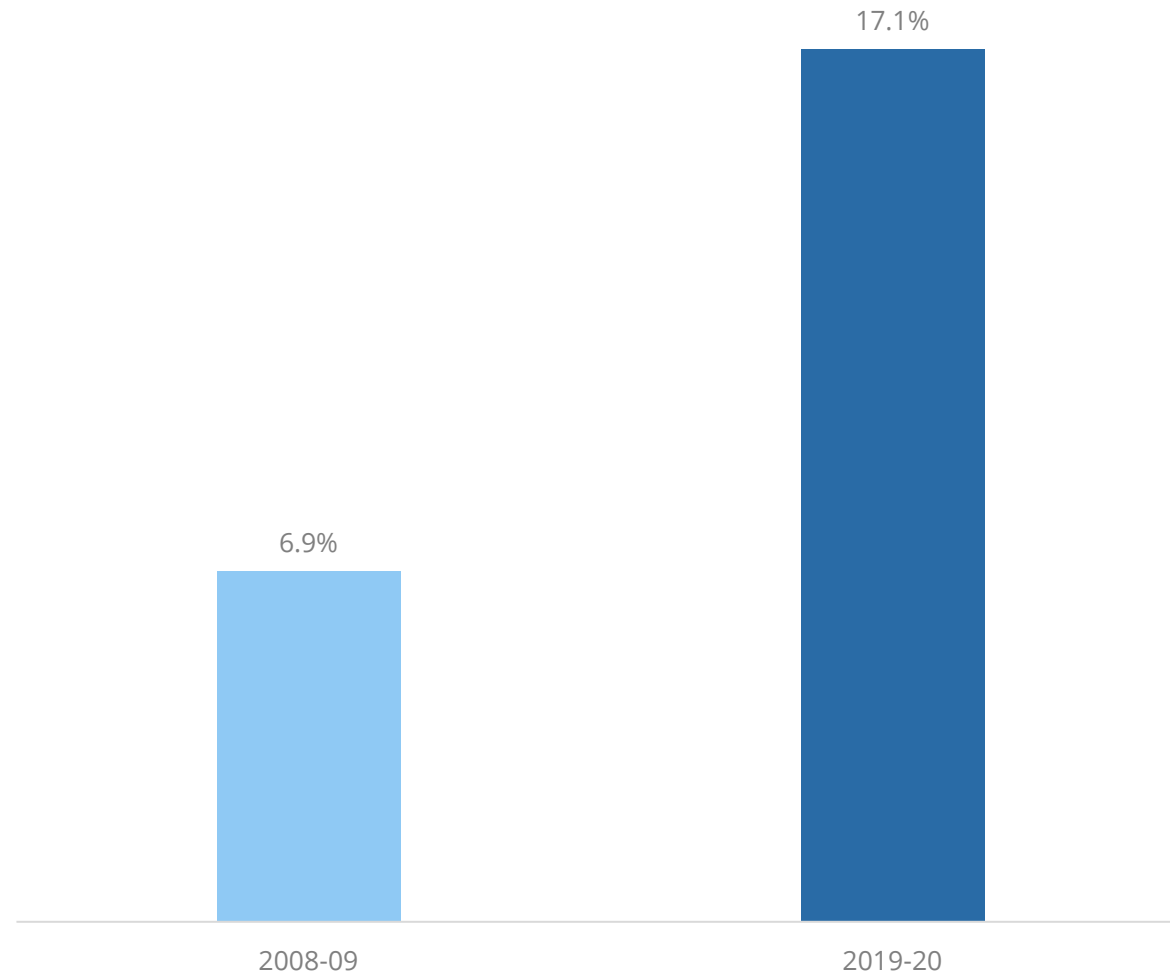


Market Diversification: With a c.10% expected export CAGR, the market share in major non-traditional markets is expected to increase to c.10% from the existing share of 8%.

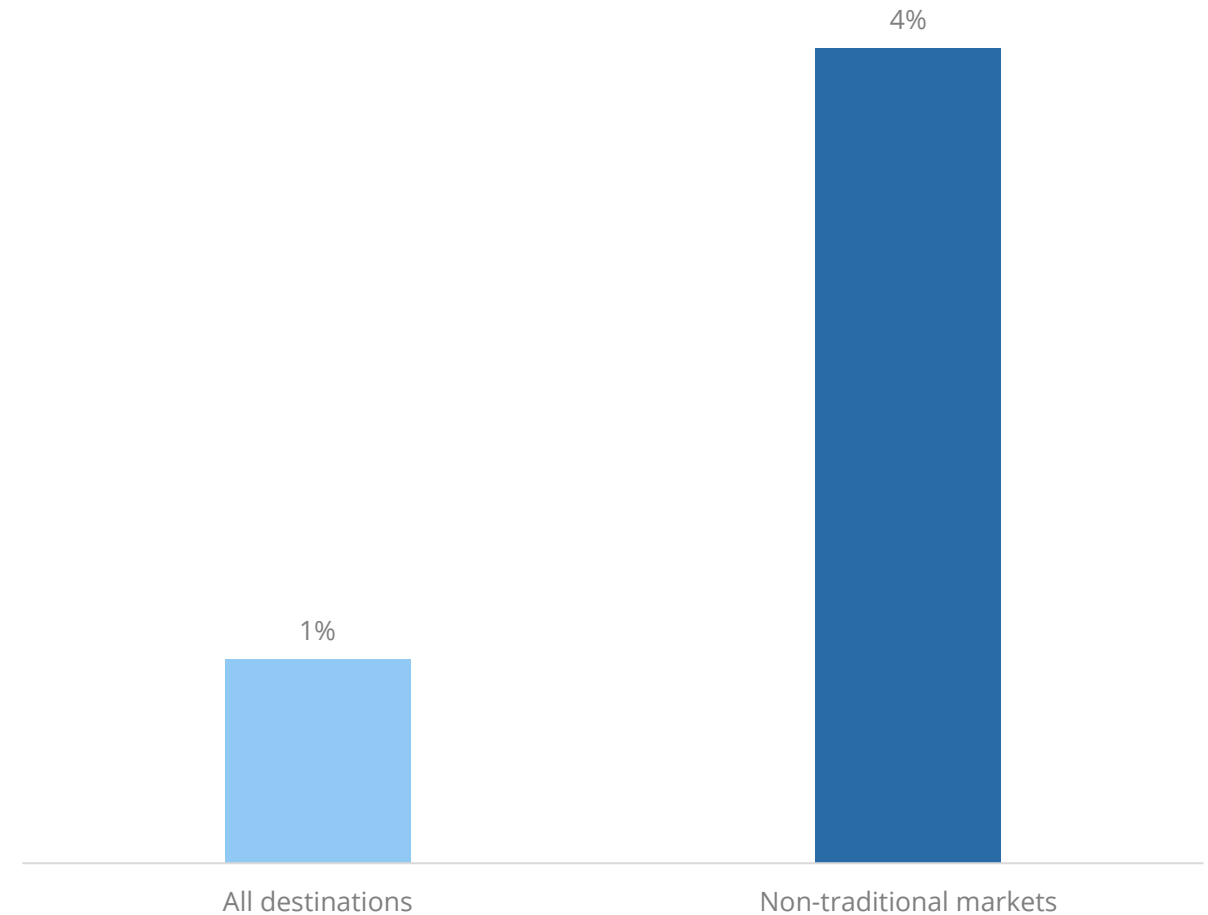


The cash incentive of 4% for exporting to non-traditional markets will drive a continued expansion of apparel exports.

Apparel export share to the non-traditional markets (%)



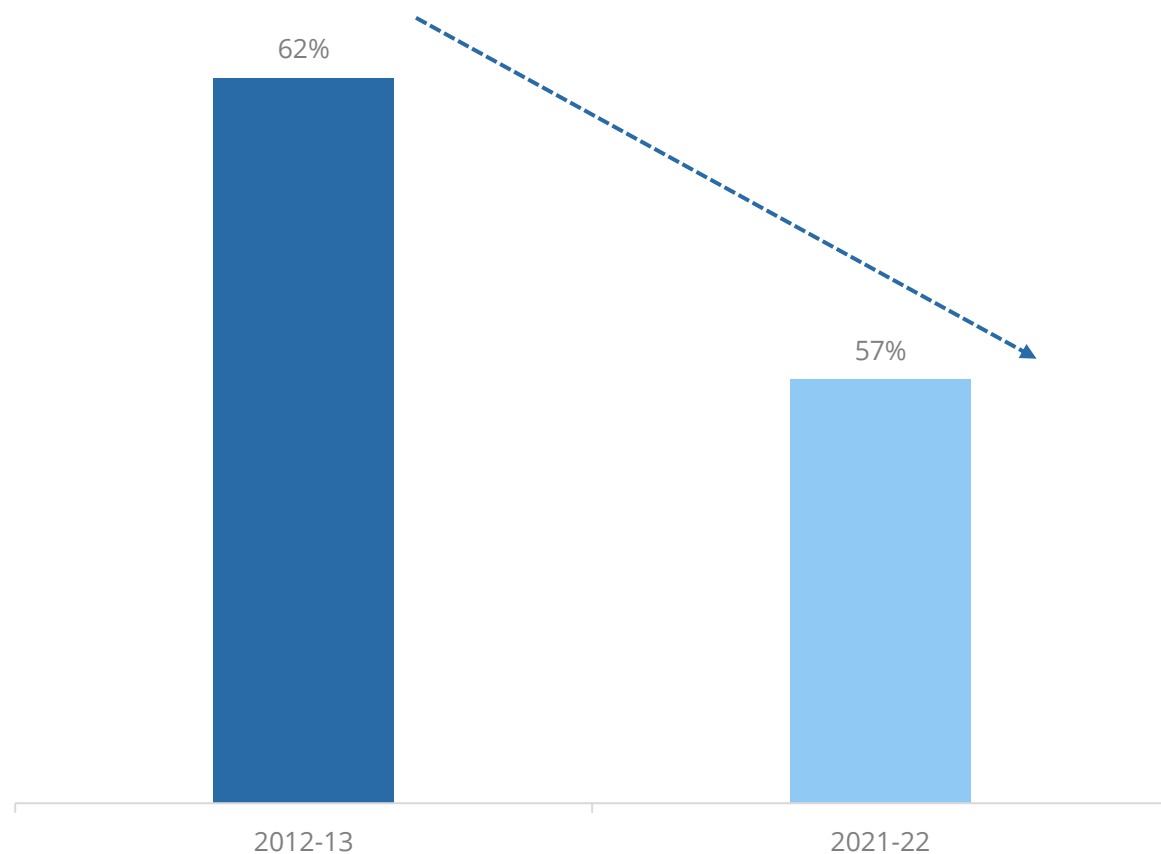
Cash incentive to apparel export (%)



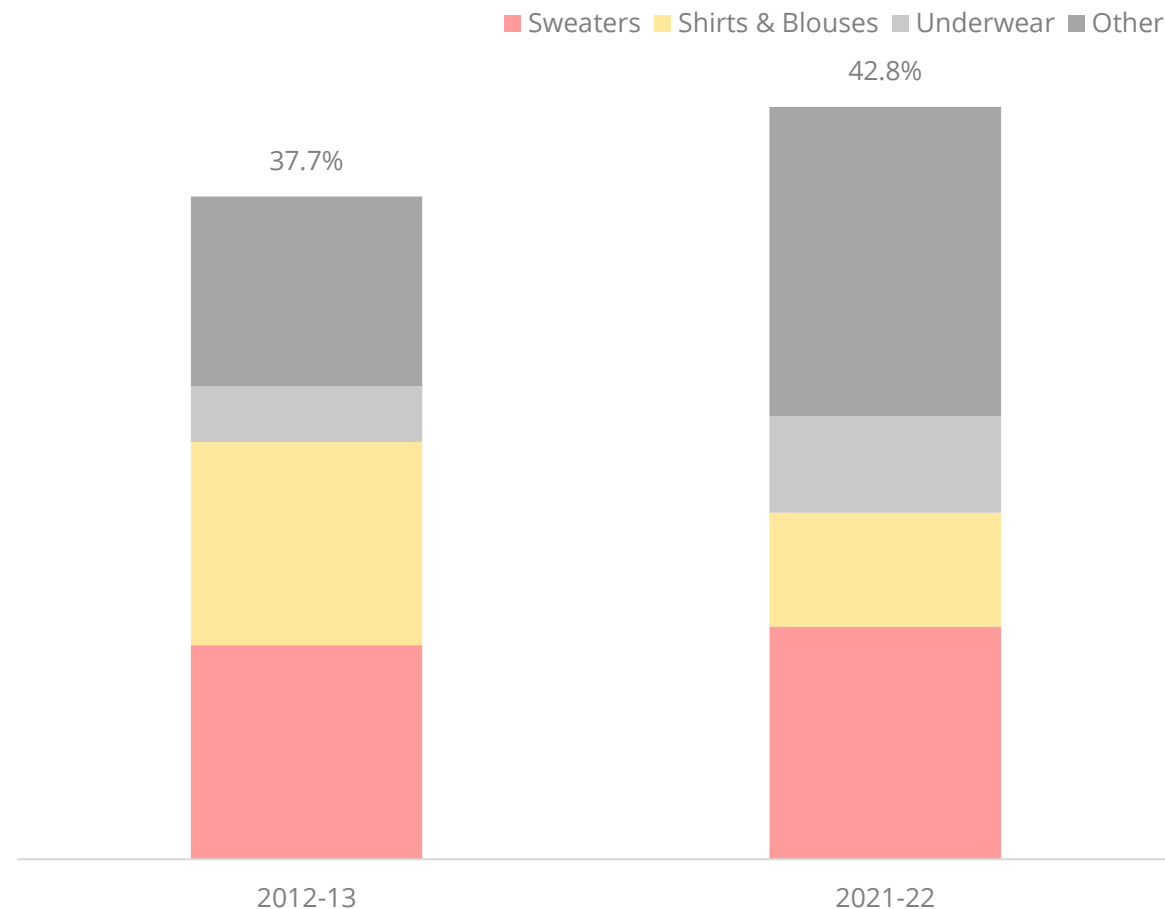
Product Diversification: Moving up the value chain through a gradual shift towards higher-margin products will facilitate higher export growth.

Bangladesh has shifted its focus from basic cotton T-shirt production to other product categories. Apparel producers in the country are moving towards producing higher-margin products, which will help the apparel industry to diversify its product offerings.

Contribution of trouser and T-shirt in total apparel export (%)



Contribution of other product categories in the total apparel export (%)



What does the mid-term outlook mean for companies operating in the sector?

CAL's View:

MMF Focus

Companies investing to enhance capacity in the MMF segment are likely to witness faster growth.

Moving up the value chain

Companies expanding their portfolio with higher-margin product categories is likely to perform better.

Beyond Traditional Markets

Companies diversifying their export into non-traditional markets to expand market share.

4 | GRADUATION FROM LDC

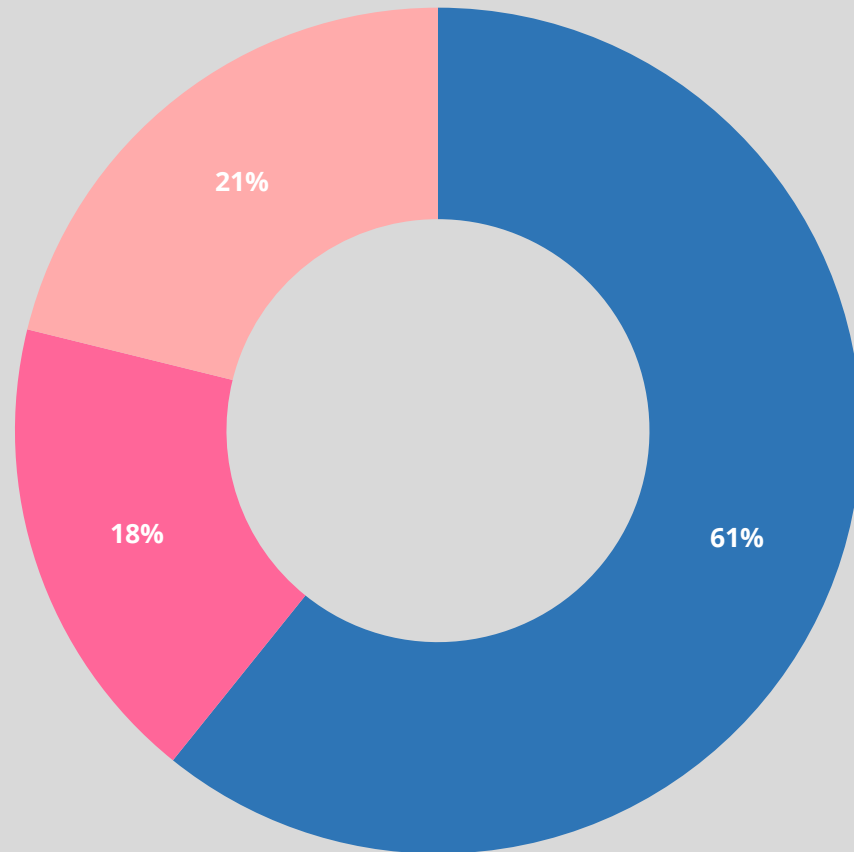
A FEW CARDS UP THE SLEEVE

Bangladesh is scheduled to become a developing country in 2026. Securing Preferential Trade Agreements (PTAs), Free Trade Agreements (FTAs), and establishing strong backward linkage could ensure a smooth transition for the apparel sector toward LDC graduation. Three trends likely to emerge from LDC graduation include i. market share consolidation of well-established apparel exporters ii. product portfolio to have a greater share in higher margin products iii. well-established companies shifting lower-margin manufacturing to countries that still enjoy duty benefits.



Preferential trade deals and strong backward linkage could ensure a smooth transition for the apparel sector toward LDC graduation.

Trade preference-wise export share after LDC graduation (%)



What to expect?

Export growth picked up after the initial transition phase in Sri Lanka following the removal of GSP facilitation in 2010. The case study of Sri Lanka provides a precedent for what to expect. Three major trends observed during the period leading to and following the removal of GSP facilities include a shift towards higher value-added products, industry consolidation, and large corporates moving their production facilities into countries enjoying duty benefits.

Challenges Ahead

An increase in tariff rates and stringent rules of origin are likely to be the biggest challenges for the apparel industry after LDC graduation. Bangladeshi garment makers will need a "double transformation", which will amount to 40% local value addition – a level achieved by knit garment makers.

Mitigation

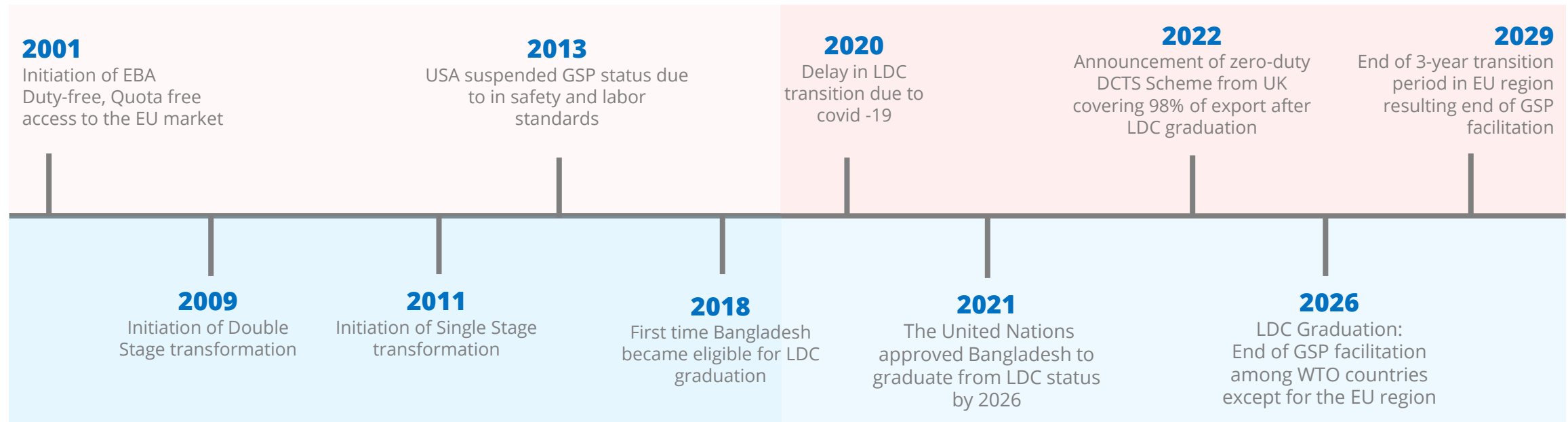
Based on the country competitiveness score Bangladesh still lags behind peer competitors in terms of price, vertical integration, lead time, and efficiency. Emphasis on sustainability metrics will put the sector in a better position to negotiate better prices. At the same time, enhanced capacity, greater productivity, and lead time will help improve the score in the metrics related to competitiveness.

■ Export under preferential trade ■ Export without preferential trade ■ USA

Bangladesh is scheduled to officially become a developing country in 2026.

Bangladesh has met all three eligibility criteria for graduation involving per capita income (\$2824), human assets index (75.4), and economic and environmental vulnerability index (27.3). The UN committee recommended a five-year transition period after LDC graduation due to the impact of Covid-19 on the economy.

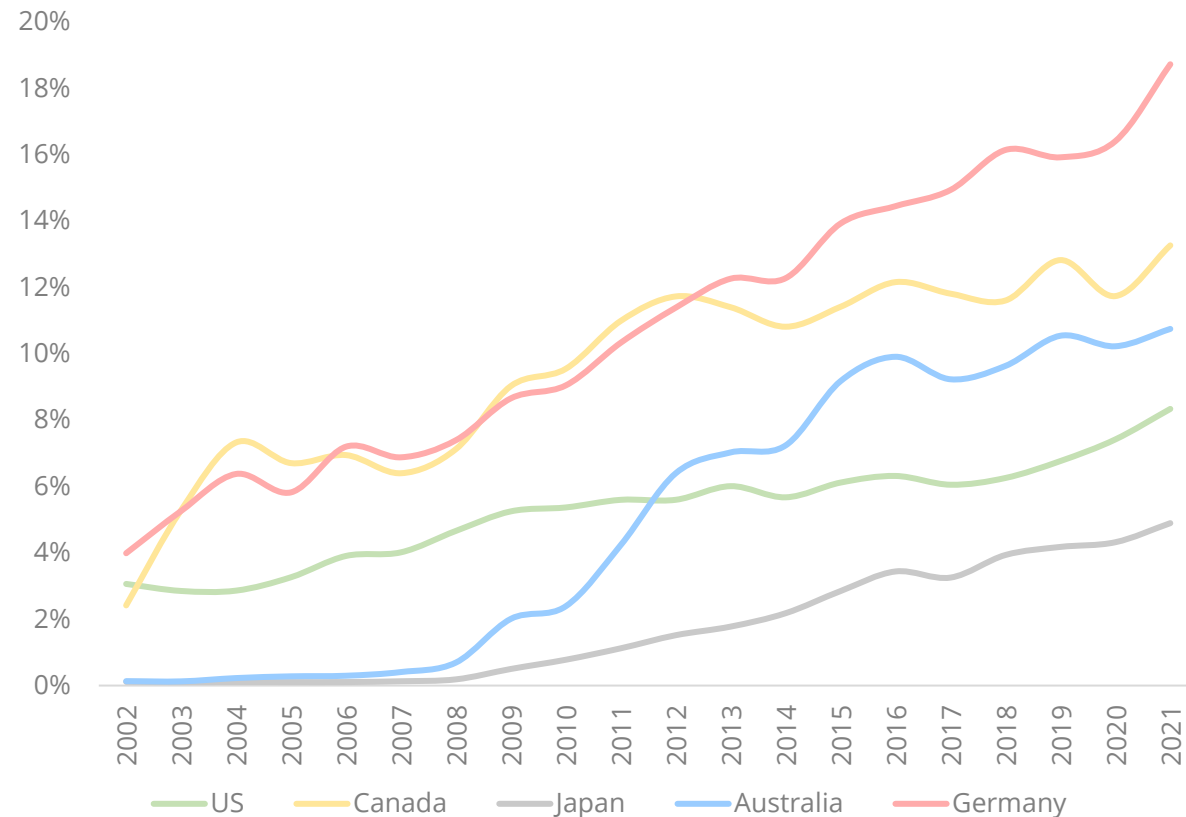
Timeline of major events in trade arrangements



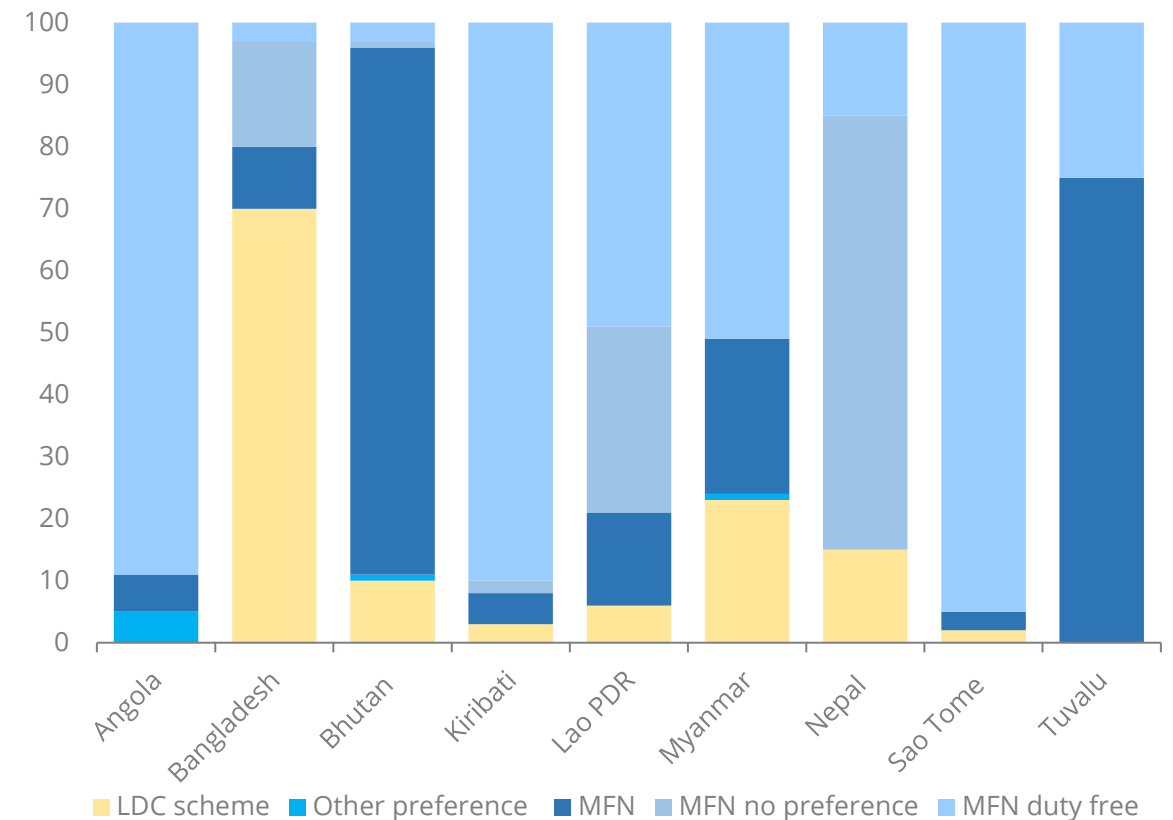
Preferential trade agreements played crucial roles in Bangladesh's meteoric export market development in major export destinations.

In 2002, Bangladesh's clothing market share in Canada and the United States was 2.4% and 3.1%, respectively. Over the next two decades, its share in Canada, which provides duty-free market access, rose to about 13.3%, in contrast to only around 8.3% in the United States. Similar trends were evident in Japan and Australia, which provided identical duty benefits.

Bangladesh's clothing market share in major partner countries

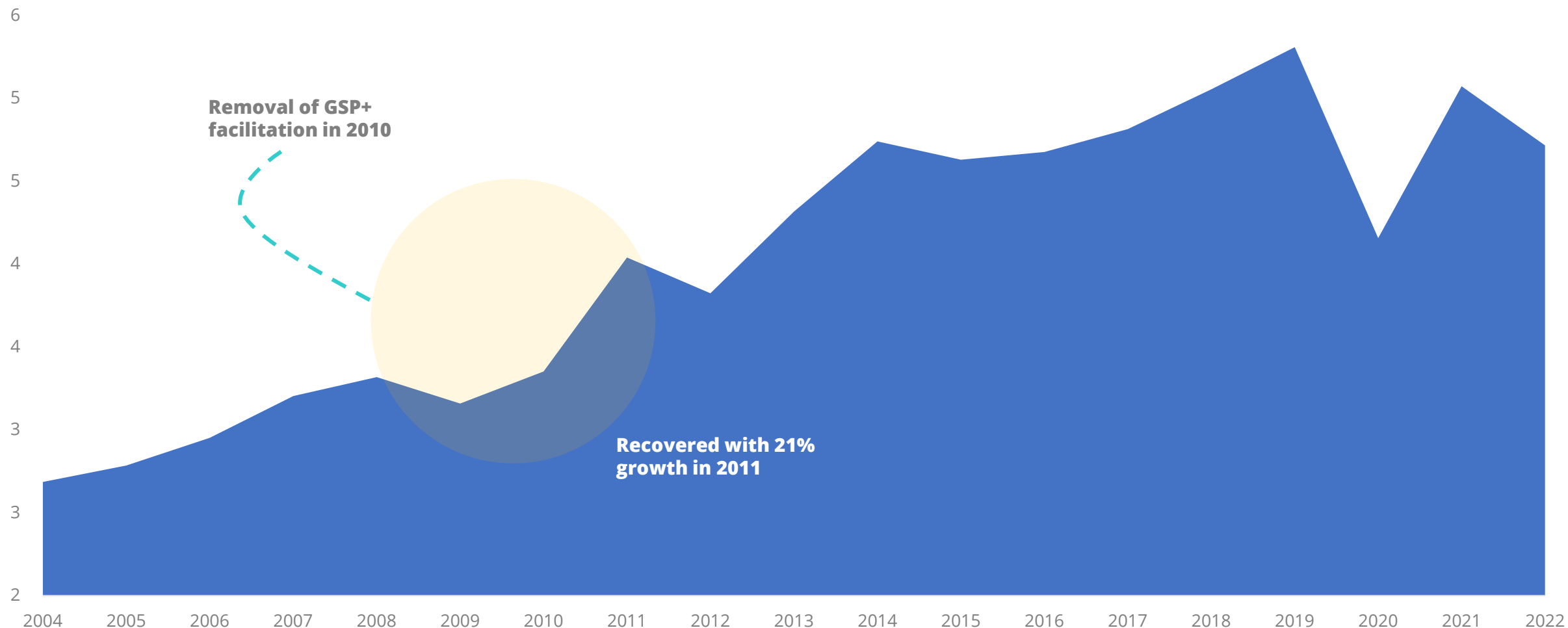


Share of preferential trade as % of total trade with comparable LDC's



A Case Study: Export growth picked up after the initial transition phase in Sri Lanka following the removal of GSP facilitation.

Total apparel export of Sri Lanka (USD Bn)

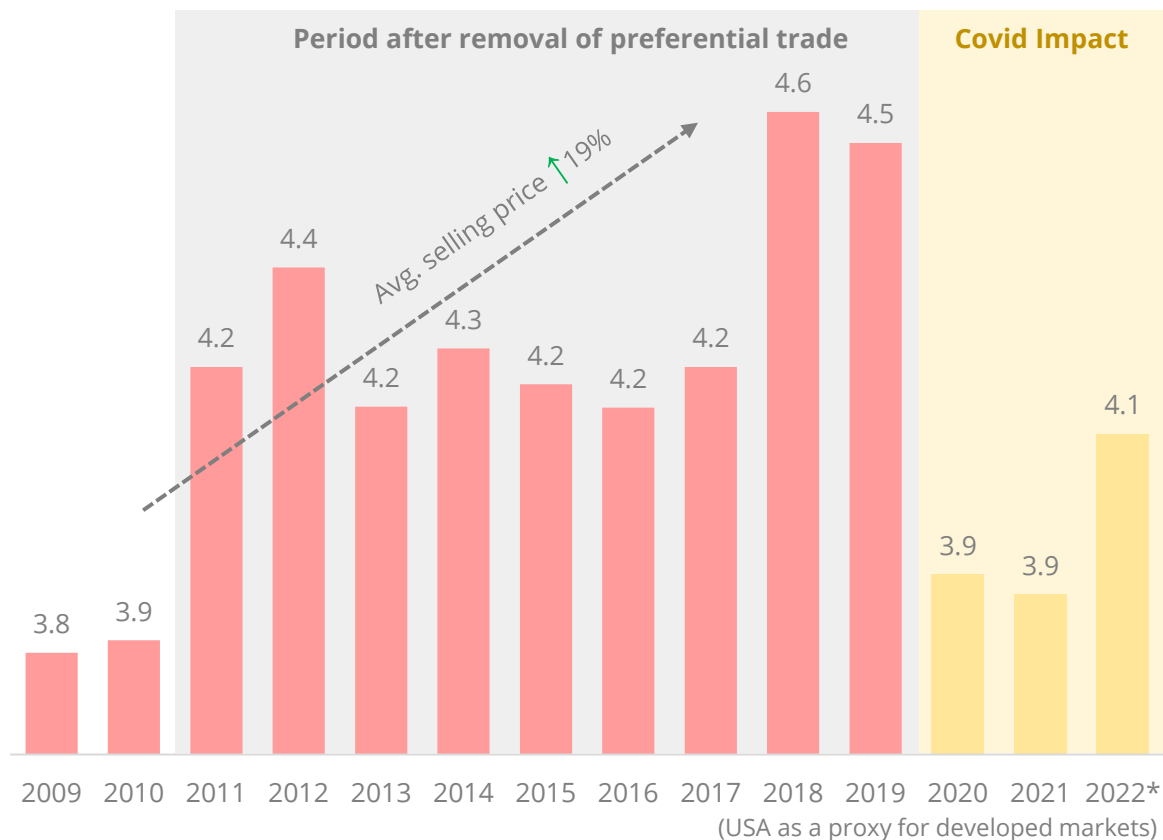


Major trends observed in Sri Lanka during the period include apparel manufacturers moving towards higher value-added products, industry consolidation...

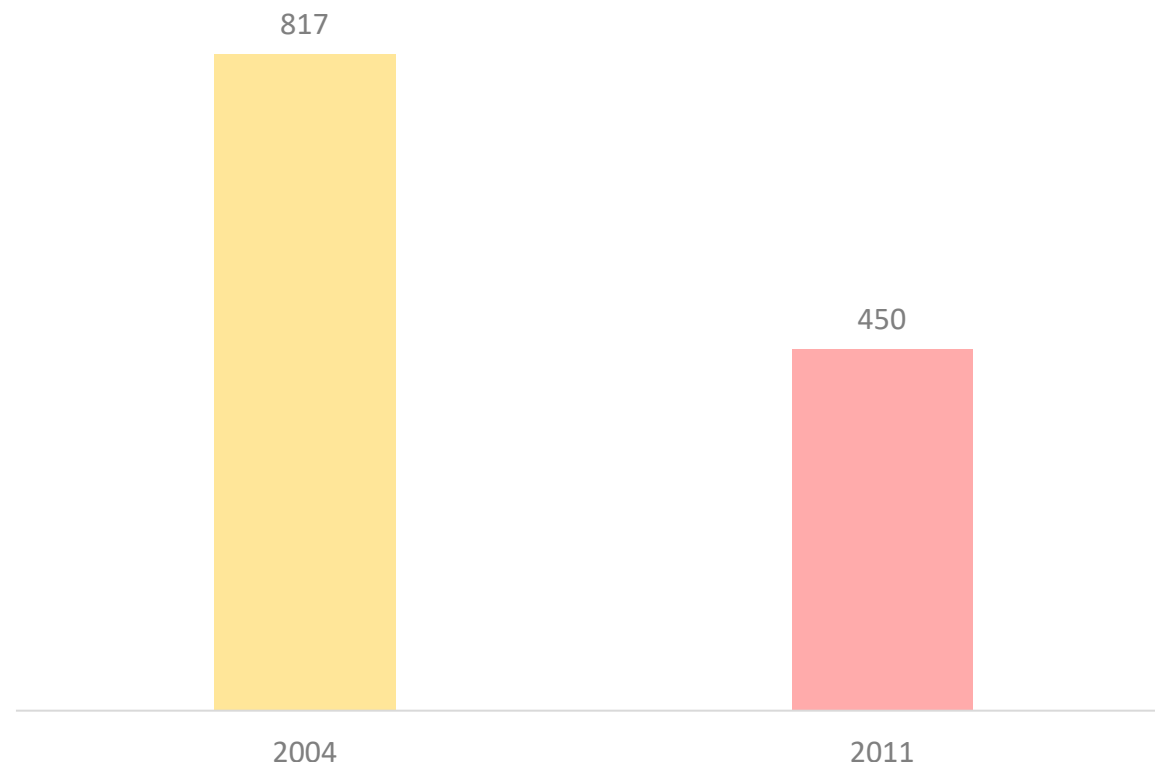
Since losing preferential access to EU markets in 2010, the portfolio transition towards higher value-added products resulted in a 19% increase in the average per-square-meter apparel selling price over eight years.

In 2011, the number of apparel firms dropped significantly by 44.9% as smaller factories closed down or were absorbed by larger conglomerates leading to industry consolidation.

Sri Lanka's average apparel selling price in the developed market (USD/SQM)



Number of apparel firms in Sri Lanka



...and large corporates moving beyond borders, expanding production facilities into countries with strategic advantages.

Large apparel companies shifted their lower value-added production facilities into countries with preferential trade facilities or low labor costs. At the same time, large conglomerates set up their design and product development units in Europe and North American regions.

Europe



Africa



North America



Asia



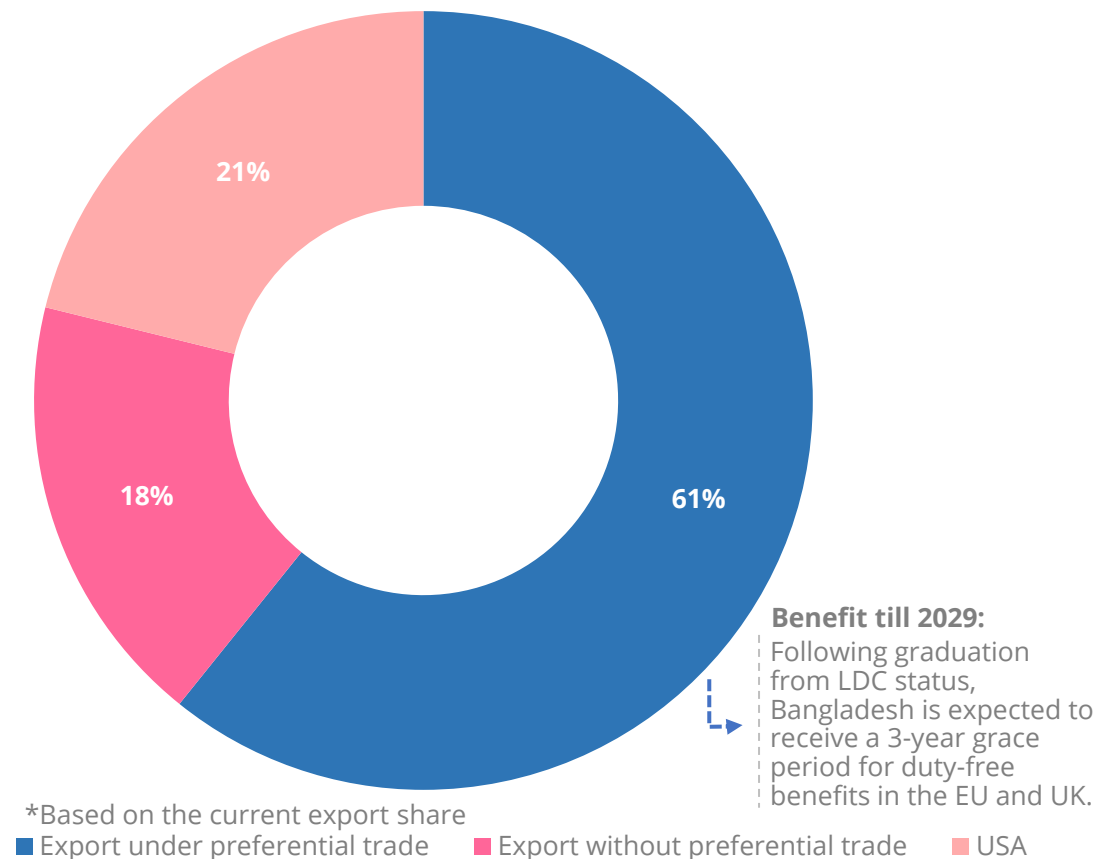
Region/Company	Manufacturing Unit	Design Unit
Africa	5	-
Hela	4	-
MAS	1	-
Asia	16	1
MAS	15	1
Teejay	1	-
Europe	-	3
Hela	-	2
MAS	-	1
North America	4	2
Hela	-	1
MAS	4	1
Grand Total	25	6

(Three big apparel companies of Sri Lanka, MAS Holdings, Hela Apparel Holdings, and Teejay Lanka PLC were taken into consideration. Company data is taken from the company websites/annual reports and subjective judgment is used for data categorization.)

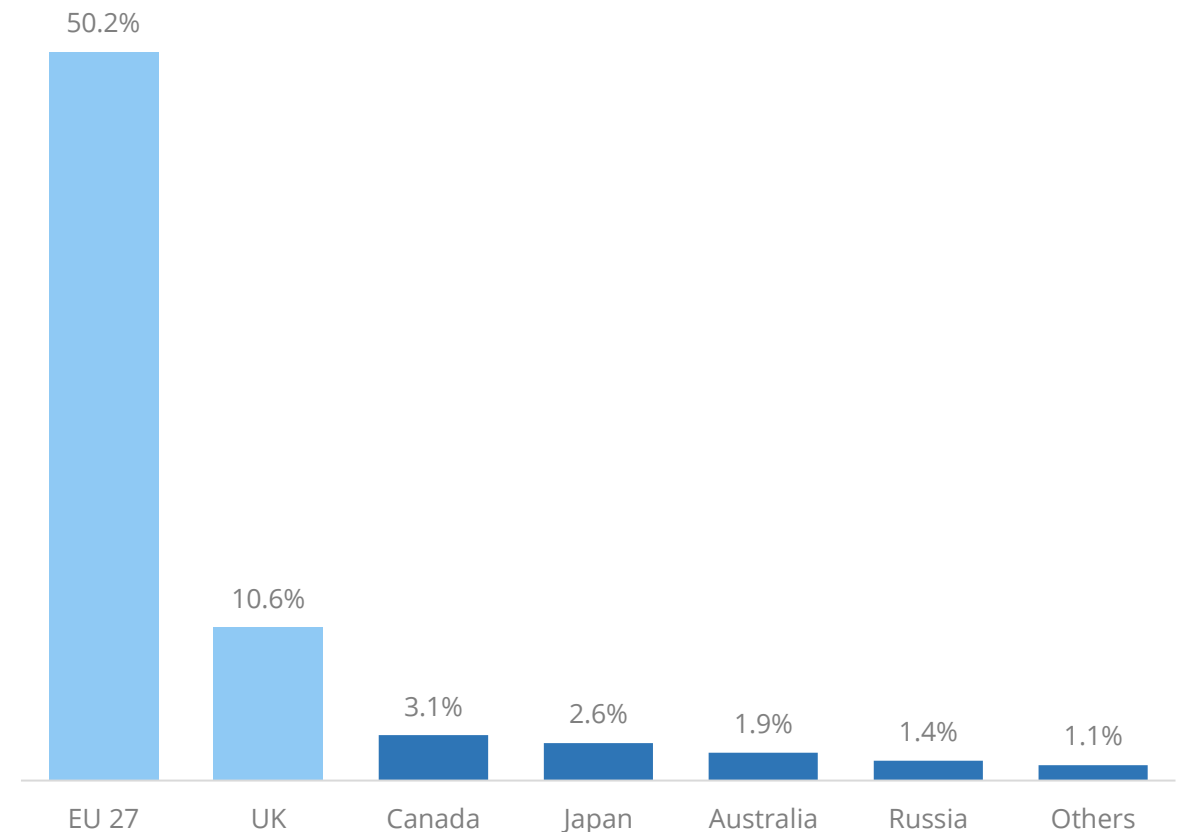
Challenges Ahead: After LDC graduation, 18% of the total apparel export is likely to be affected in 2026...

Textiles and clothing products are excluded from the GSP program in the United States. As a result, the impact of tariffs or Rules of Origin (RoO) on Textile and Clothing (T&C) products in the US will not be applicable in the post-LDC graduation period.

Trade preference-wise export share after LDC graduation, 2026 (%)

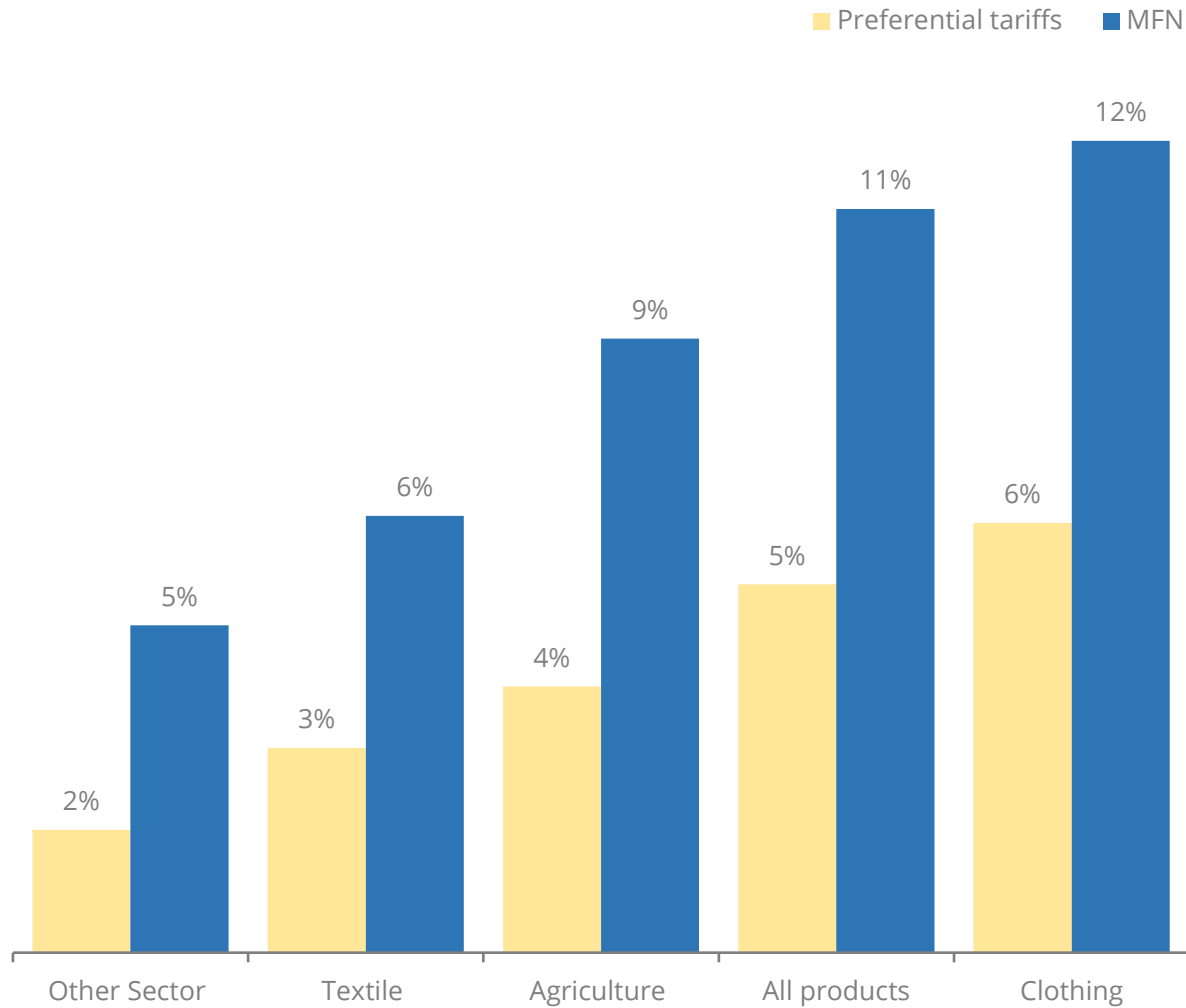


GSP donor countries with major export share

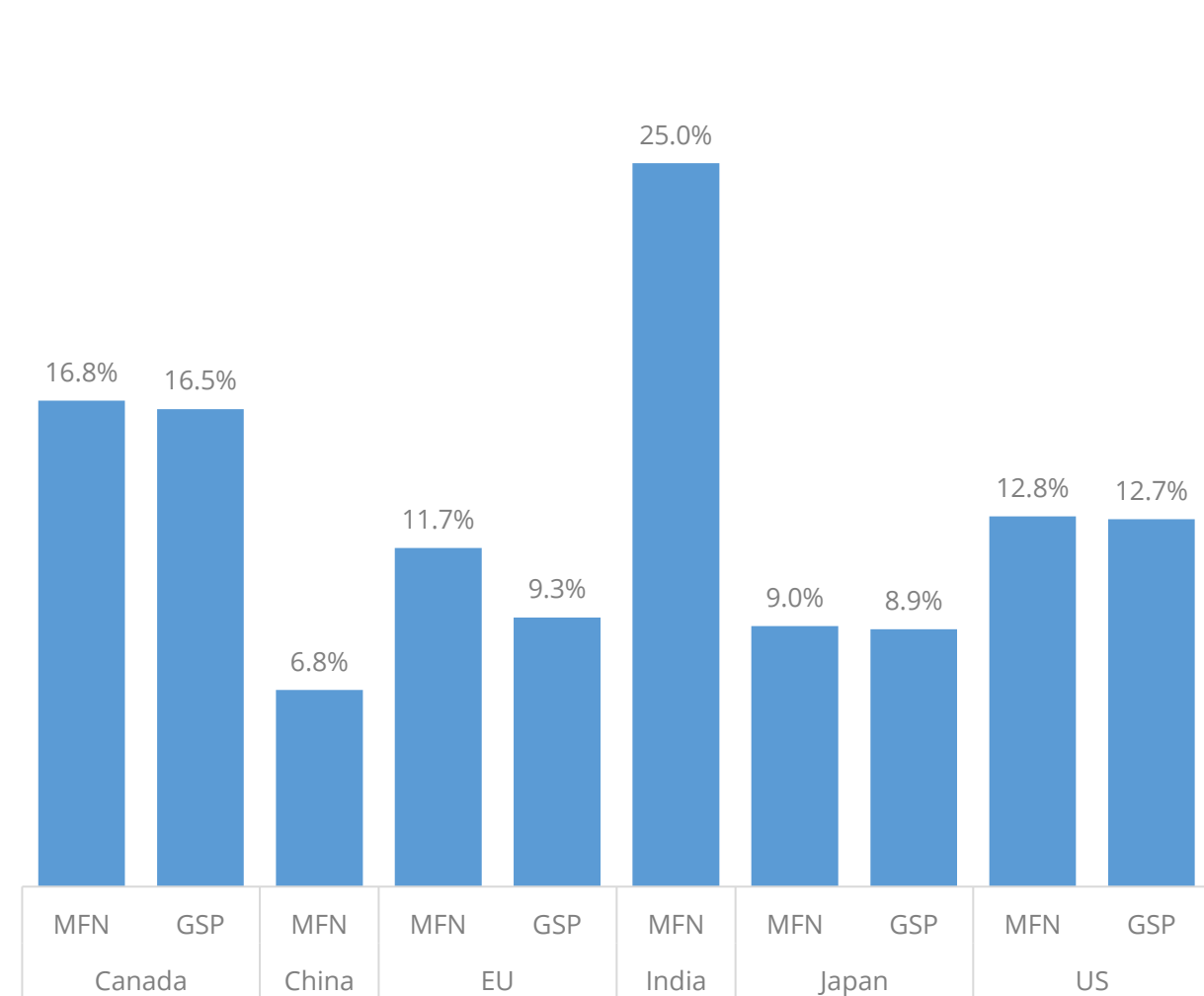


...resulting in a significant increase in tariff rates to export destinations in the absence of preferential trade agreements.

Current tariff across different export segment



MFN/GSP rates applicable to apparel (knitted) imports



Graduation Woes: Absence of GSP facilities would require LDC clothing exporters to perform more complex manufacturing processes.

LDC firms are only required to undertake a “single-stage transformation” for apparel exports. After LDC graduation, a “double-stage transformation” would be required under the standard GSP.

After LDC graduation, exports to non-preferential destinations will require at least 40% value addition. The Knit segment is already in compliance, while the woven segment will need to catch up by 2026E.

Single transformation

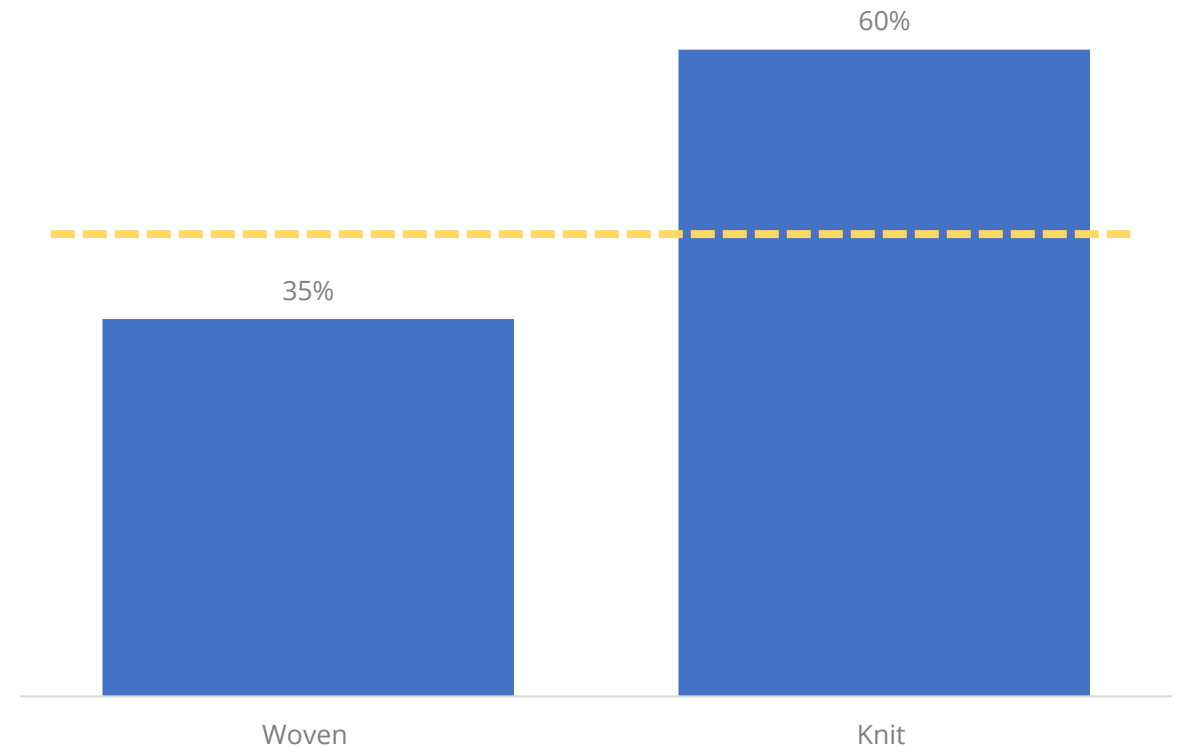


Double transformation








- Could be sourced from anywhere
- Must be manufactured within the FTA region

Segment wise value addition (%)



Mitigation: Securing preferential trade agreements, focusing on sustainability, and enhancing competitiveness would help to smoothen the transition path of LDG graduation.

Country competitiveness score of textile and clothing industry

	Price	Vertical Integration	Efficiency	Lead Time
	3.0	5.0	4.5	4.0
	4.5	2.0	3.0	3.5
	4.0	3.0	4.0	4.5
	3.0	3.0	3.0	2.0
	4.5	2.0	3.0	3.0

What factors will play a key role in LDC graduation preparation?

Securing PTAs & FTAs

Bangladesh is negotiating to secure Preferential Trade Agreements (PTA) and Free Trade Agreements (FTA) with major exporting countries, which could help mitigate the impact of the absence of concessional trade deals. The number of secured commitments must be increased significantly in line with other graduating LDCs.

Pricing Power

The "Go Human, Go Green" move adopted by BGMEA is transforming the sector, which now boasts the highest number of green apparel factories in the world. Focused branding initiatives surrounding the paradigm shift in sustainability metrics, including ethical manufacturing practices and large-scale structural reforms, can put the sector in a better position to negotiate better prices.

Vertical Integration

By 2026, the textile sector of Bangladesh will have to strengthen the vertical integration related to the woven segment and further consolidate the knitting segment. After LDC graduation, the required minimum value addition on the woven segment will be 40%. Currently, which is at 30-35%. Continued investment towards vertical integration and value addition of the apparel industry in Bangladesh will enhance the ability for local value addition.

Productivity & Lead Time

Bangladesh ranks low among its peers in productivity and lead time metrics. By 2026, we expect gradual improvement in productivity metrics as the industry apex trade association, BGMEA, and apparel companies continue to invest in labor upskilling initiatives. In 2022 Bangladesh introduced 7 new shipping routes destined for its major markets. Such initiatives will help reduce the shipping time by 40%-60% and shipping costs by 25%-40% improving lead time metrics.

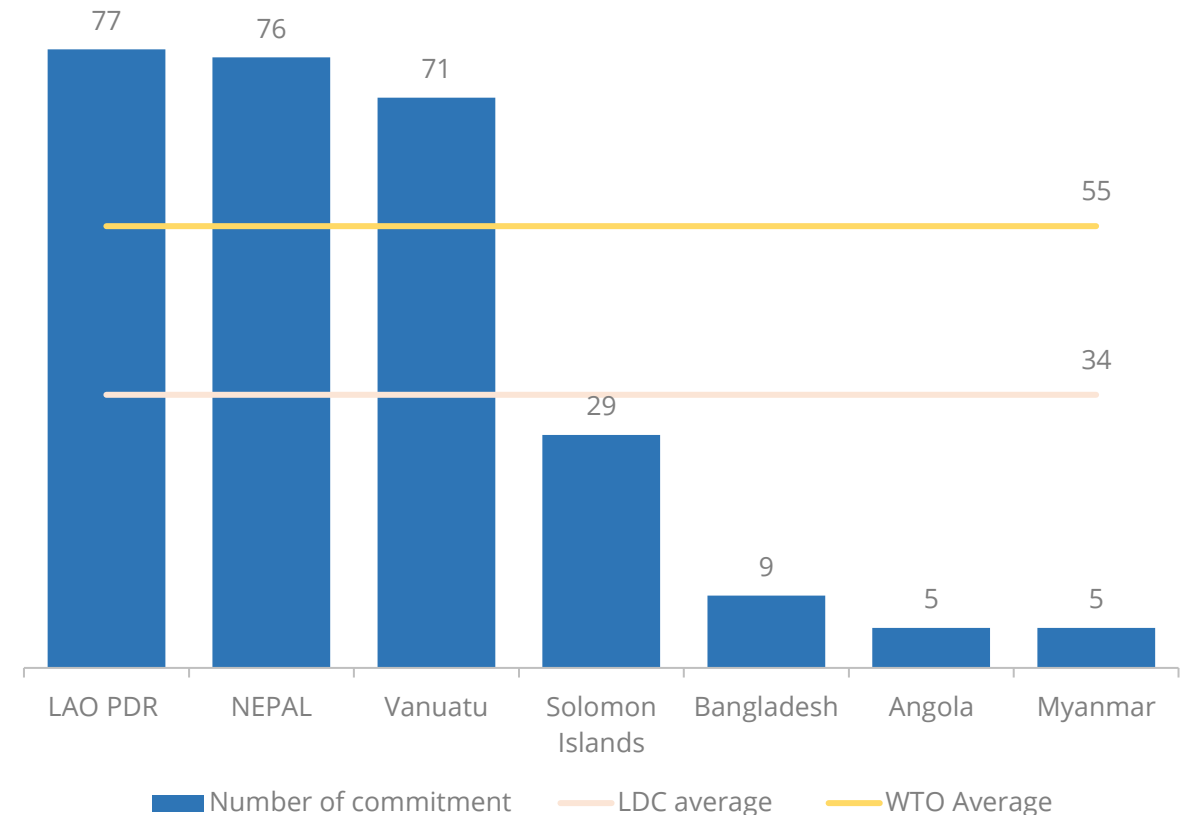
Securing PTAs & FTAs: Securing bilateral deals with related trade partners could mitigate the tariff impact in the absence of concessional trade deals.

Bangladesh is in a negotiating phase to secure bilateral trade deals with major export destinations. The number of secured commitments between Bangladesh and its exporting destinations is relatively low compared to other graduating LDCs. Government bodies and industry players will require significant collaborative efforts to meet this gap.

Current and Proposed trade deals

Market	Access arrangement till 2026	Proposed commitments
European Union	GSP-LDC (EBA)-2012	GSP extended till 2029
United Kingdom	GSP-2003	DCTS
Canada	GSP-2003	FTA
Japan	GSP-2011	FTA / EPA
China	Duty free access (except textiles)	APTA
Australia	GSP	Duty free-Quota Free
Russia	GSP (excluding apparel)	FTA
Turkey	GSP, LDC-2011	FTA

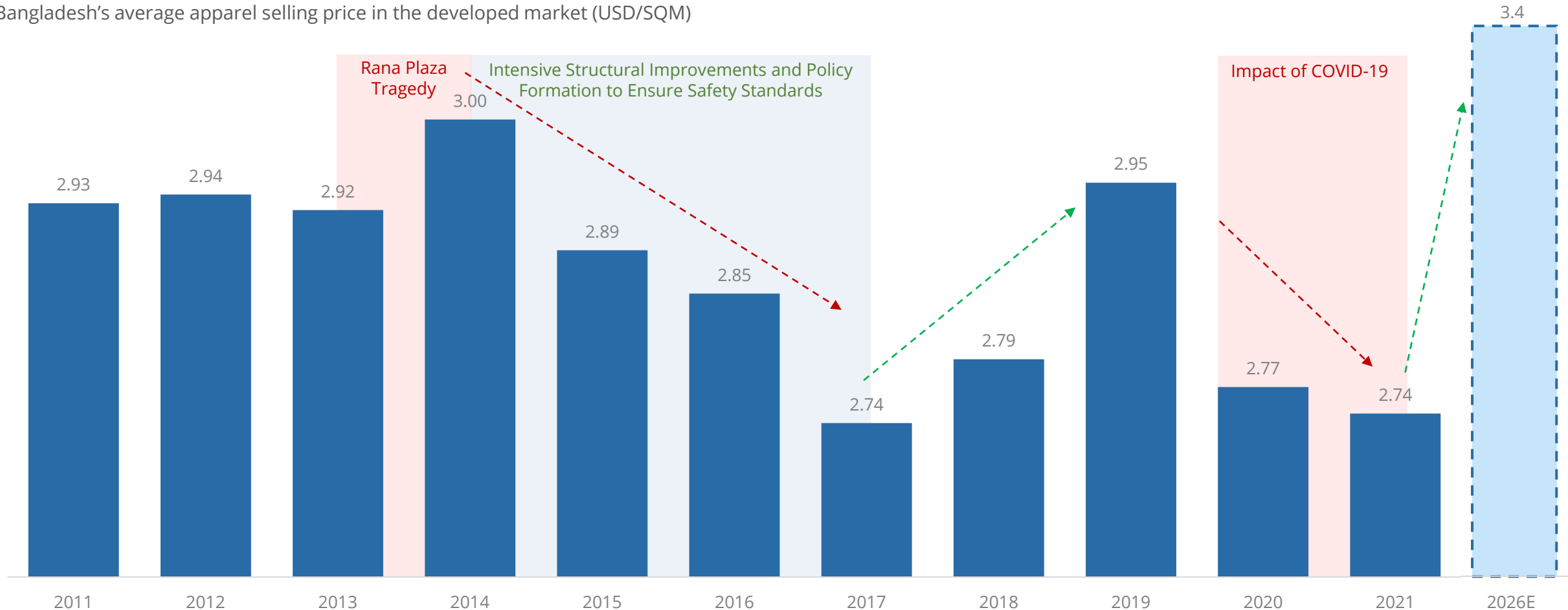
Number of General Agreement on Trade in Services (GATS) commitments by graduating LDCs



Pricing Power: Riding on sustainable reforms, CAL expects apparel selling prices to increase by 24% due to the improved industry image, which was eroded following industrial tragedies...

Two major industrial tragedies, the fire incident at the Tazreen Fashion factory in 2012 and the Rana Plaza factory collapse in 2013, took more than a thousand lives. These incidents significantly damaged the industry's image and indirectly led to an industrywide decline in average prices. However, in response, the industry adopted focused, sustainable initiatives, emphasizing green factories and workers' health & safety measures. Restoration of damaged industry image will likely lead to normalization in industry selling price.

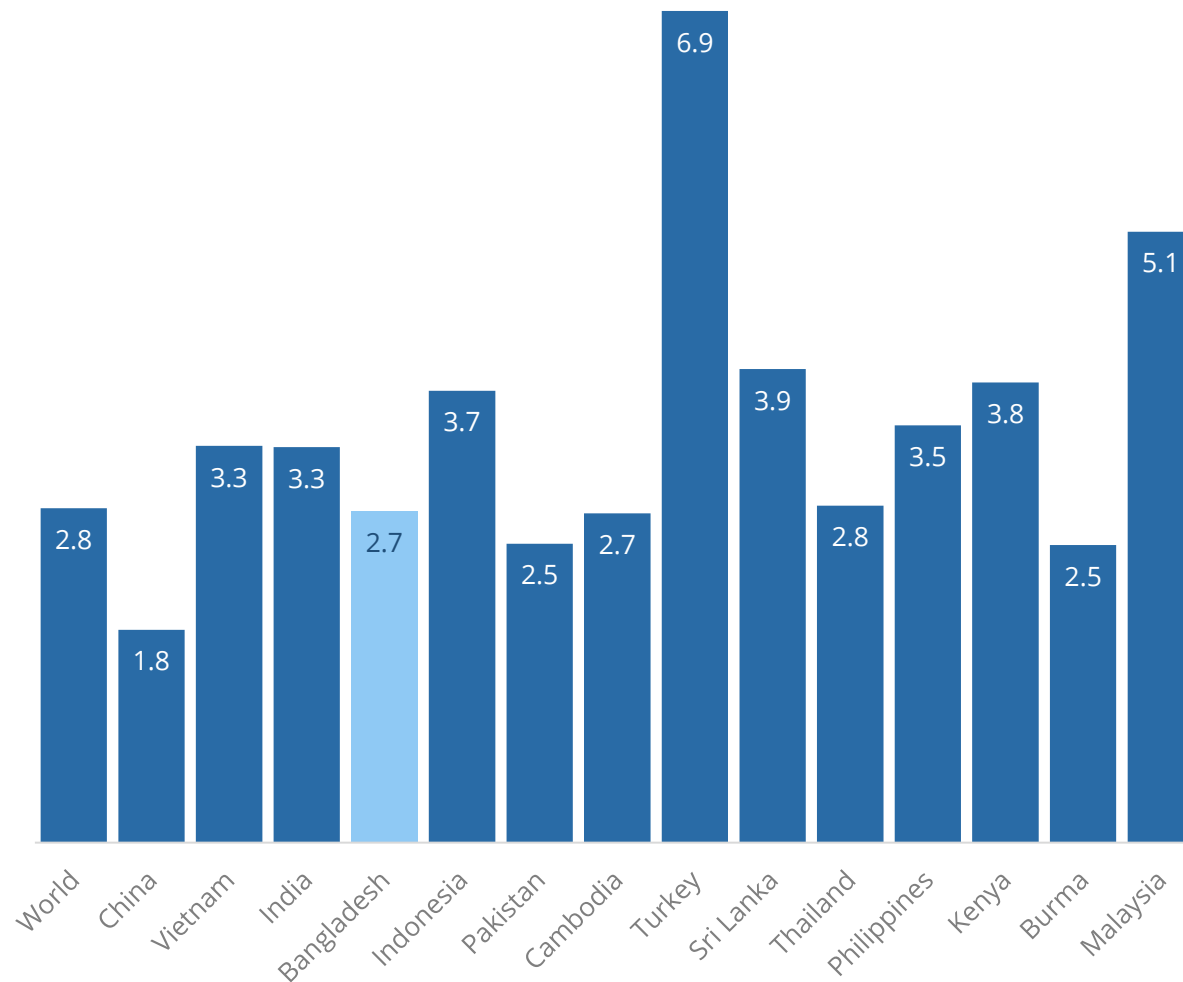
Bangladesh's average apparel selling price in the developed market (USD/SQM)



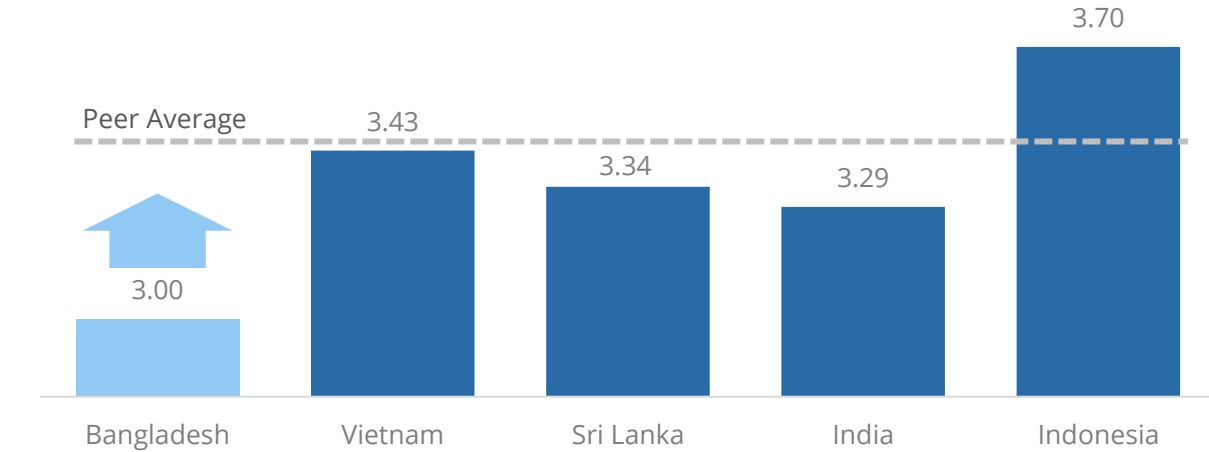
* USA as a proxy for developed market

...also, the current unit selling price is one the lowest among the peer countries which is expected to move towards the peer average for both cotton and MMF apparel.

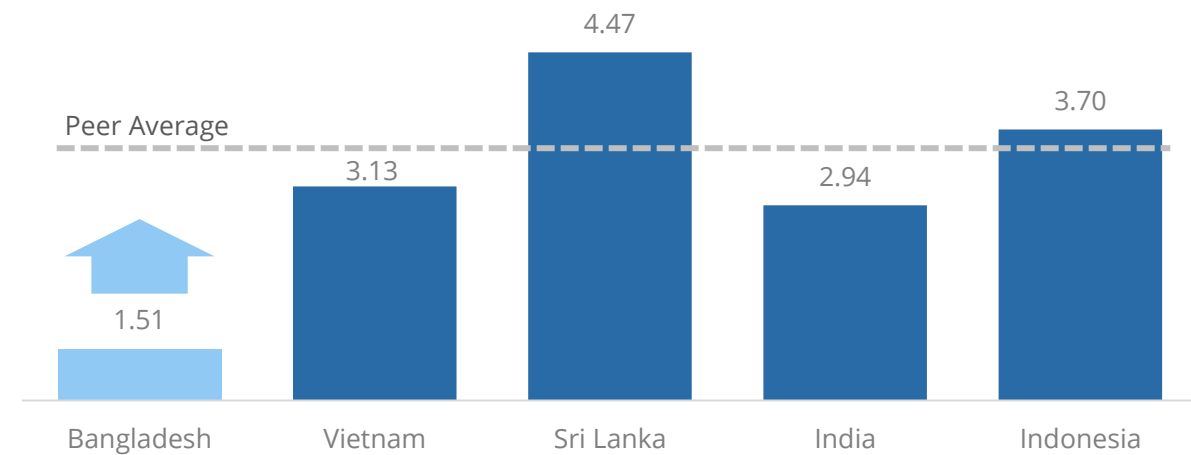
USA's average apparel import price from peer countries (USD/SQM)



Cotton apparel USD/SME



MMF apparel USD/SME

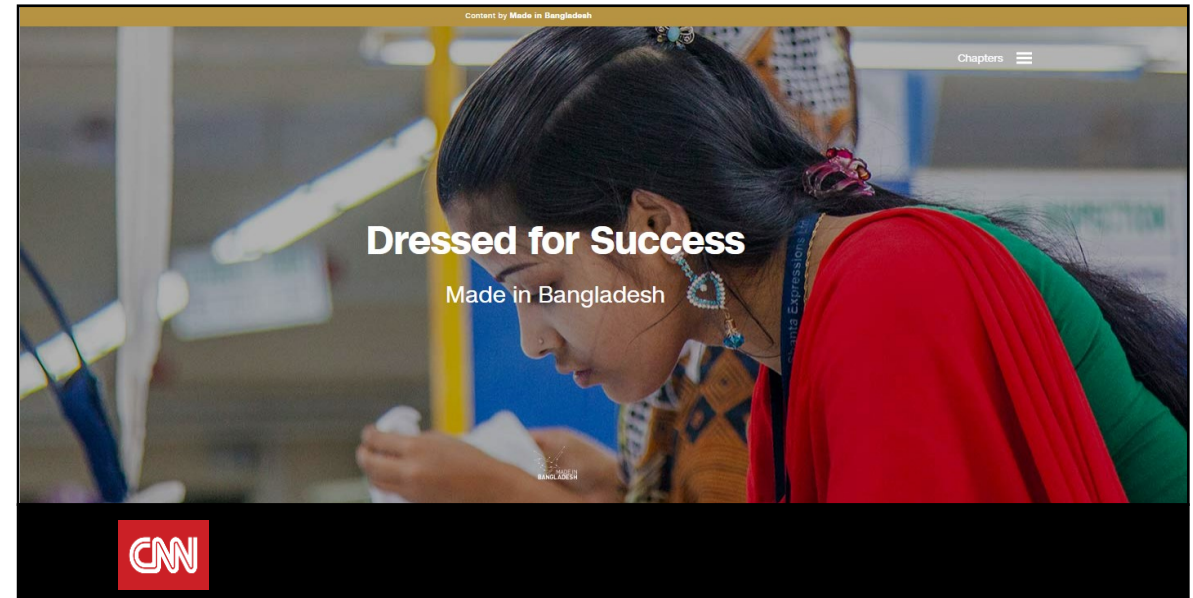
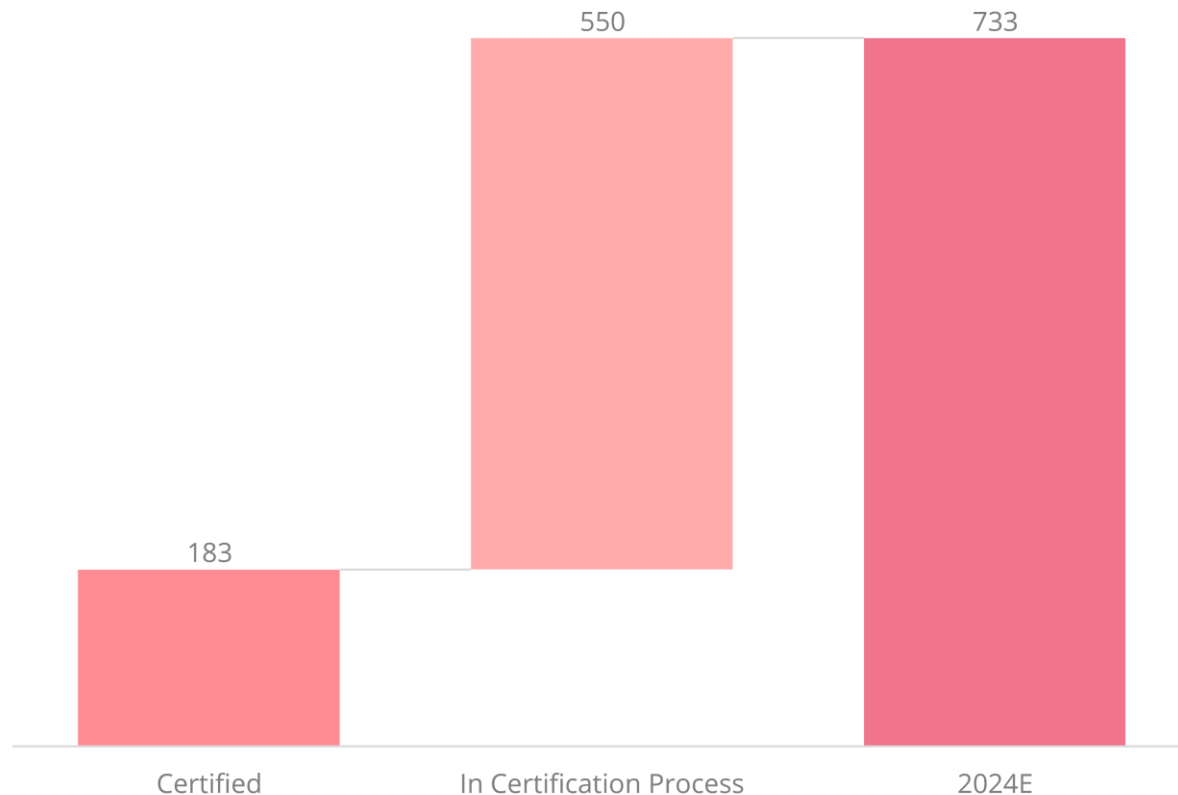


Focused branding initiatives surrounding improved sustainability metrics can position the sector to negotiate better prices.

Bangladesh has the highest number of green garment units in the world, with 58 platinum, 106 gold, 10 silver, and 4 certified factories. In addition, 550 factories are in the process of being certified by 2023E, accelerating the sustainability move across the industry.

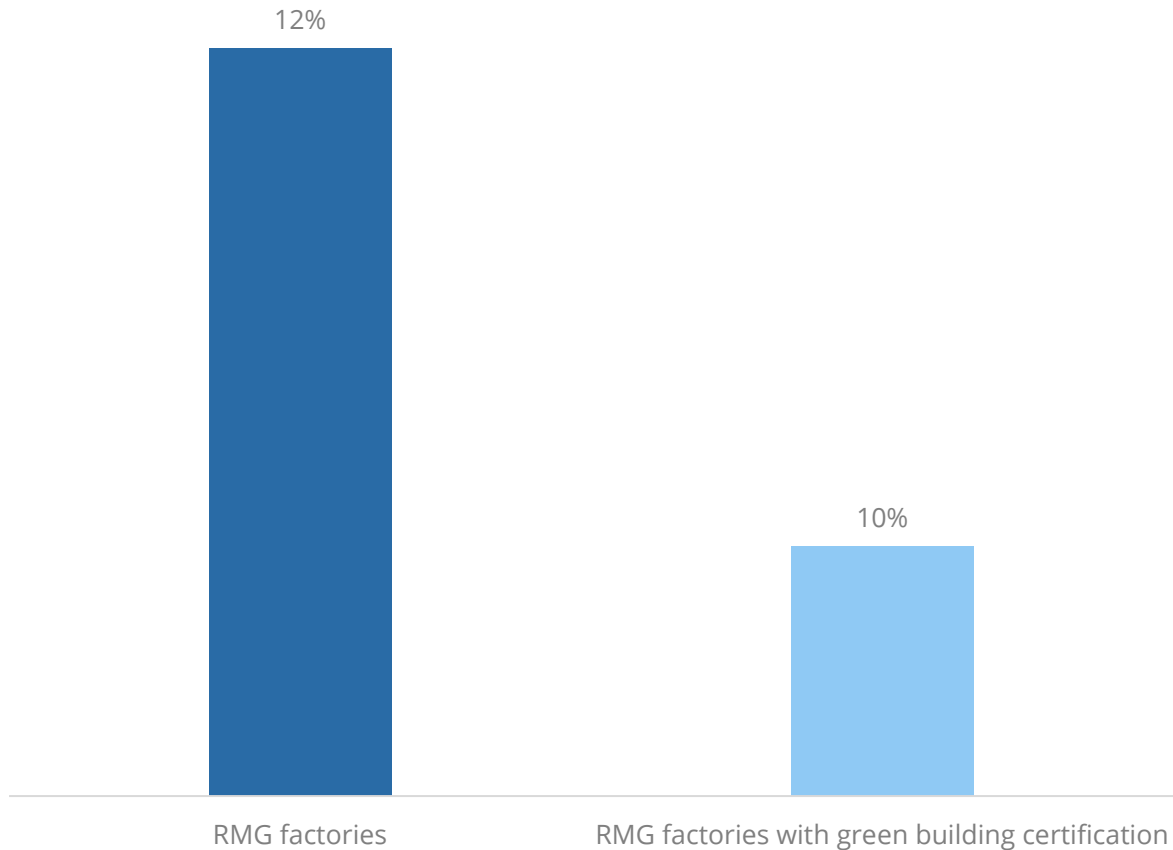
In a move to brand "Made in Bangladesh" globally, Bangladesh Foreign Trade Institute signed an MoU with CNN International Commercial, where BGMEA teamed up to showcase the apparel sector's growth stories, strides in workplace safety, environmental sustainability, and workers' wellbeing.

LEED certified, green RMG factories in Bangladesh

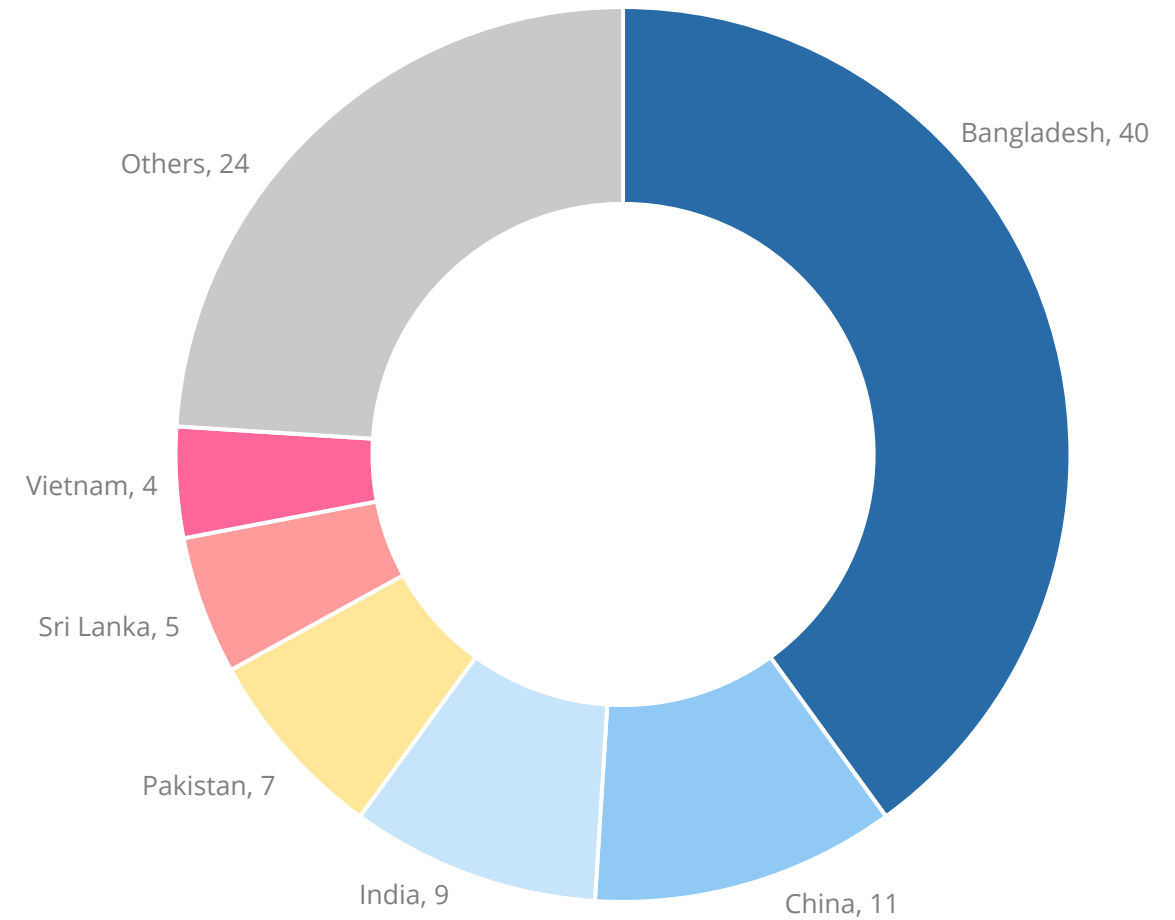


Ongoing fiscal incentives will continue to attract investments and strengthen the industry's position as a global leader in green factories.

Fiscal incentive for green building certification_ Tax rate (%)



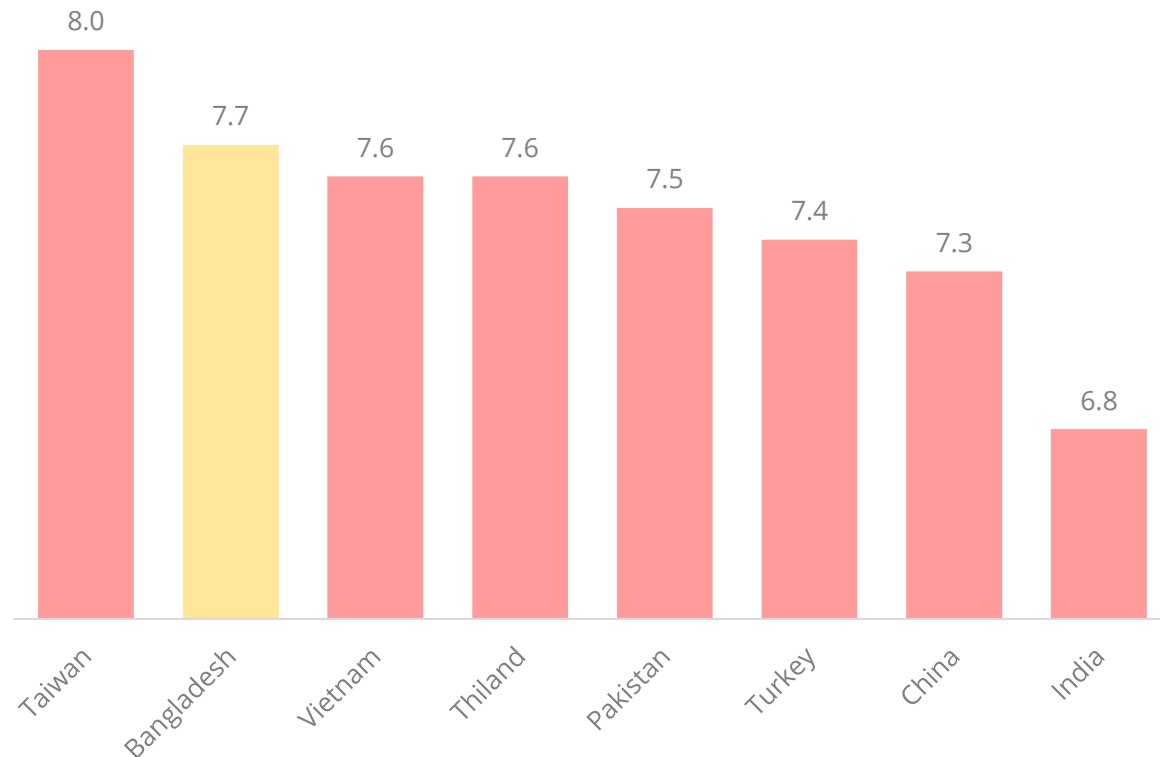
Top 100 LEED certified green factories in the world



The brand image of the sector can be enhanced by promoting the improvement made in labor well-being and structural reforms.

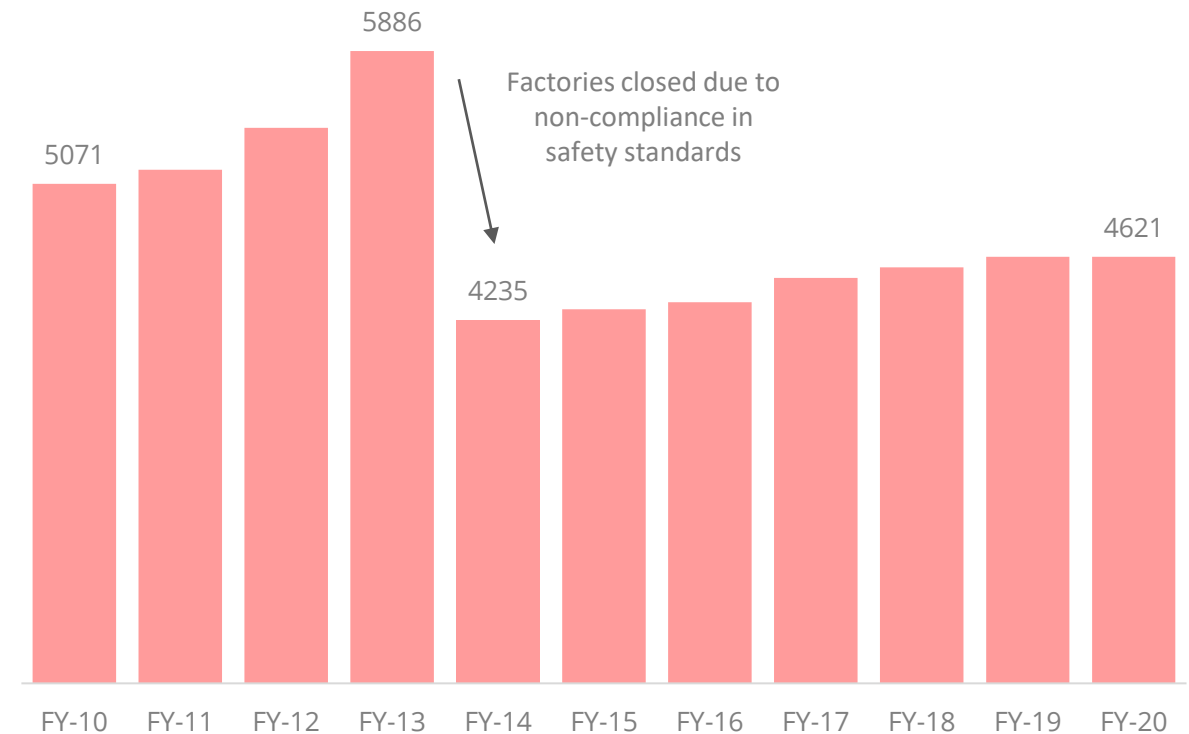
Hong Kong-based compliance solutions provider, QIMA, ranked Bangladesh as the second-best country among its peers in terms of ethical auditing practices in manufacturing. The auditing process considers ethical practices related to health and safety, hygiene, waste management, child labor, working hours, benefits, and labor practices, among other factors.

Average ethical audit scores



In 2013, ACCORD, Alliance, and National Action Plan were launched with the participation of European, American, and global buyers and the government of Bangladesh, to establish strong safety standards in garment factories. The initiative led to the closure of many factories that could not meet safety standards.

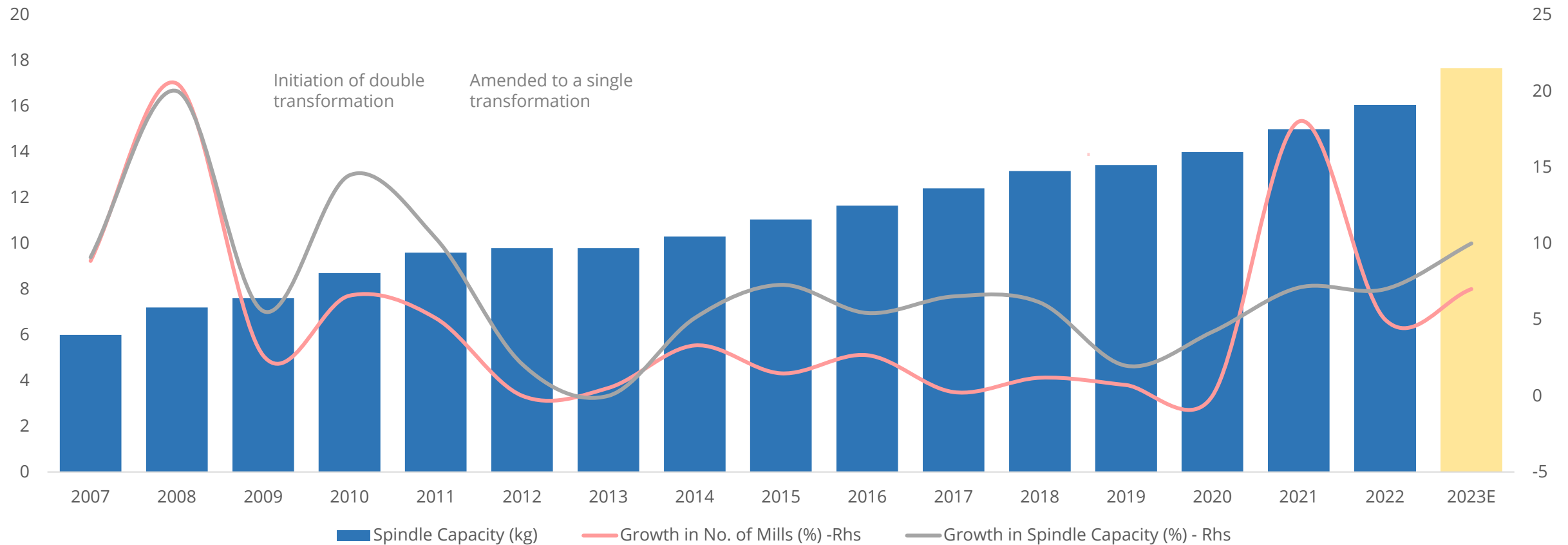
Number of BGMEA member factories



Vertical Integration: Backward linkage will continue to attract significant investment leading to LDC graduation to meet the minimum value-addition requirement.

By 2023, an investment of USD 2.5 billion is expected to be completed to increase spindle capacity by 20%. This will add an incremental 2.5 million spindles, with more than 30% of these spindles being used for synthetic yarn manufacturing. This investment is part of an ongoing effort to improve vertical integration and value addition in Bangladesh's apparel industry, thereby enhancing the country's competitiveness.

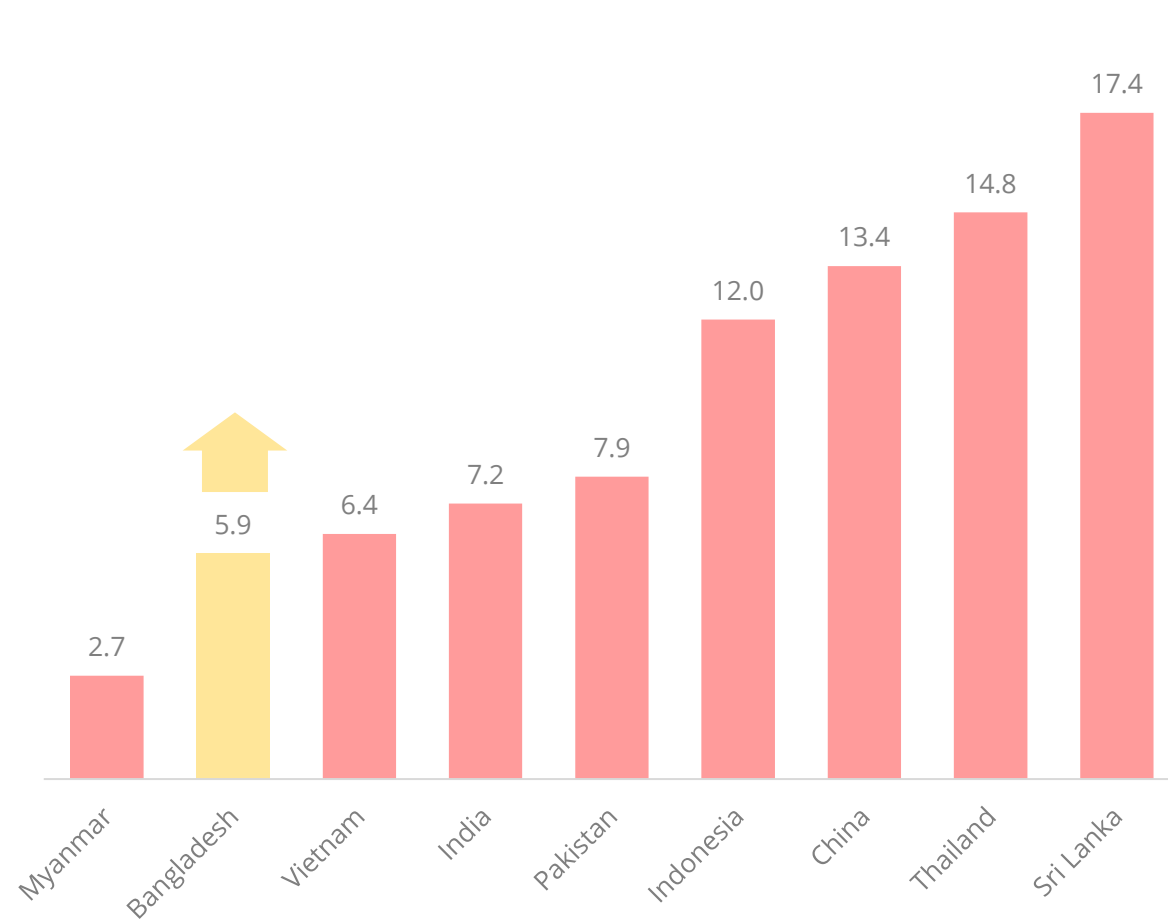
Number of spindles (Million units)



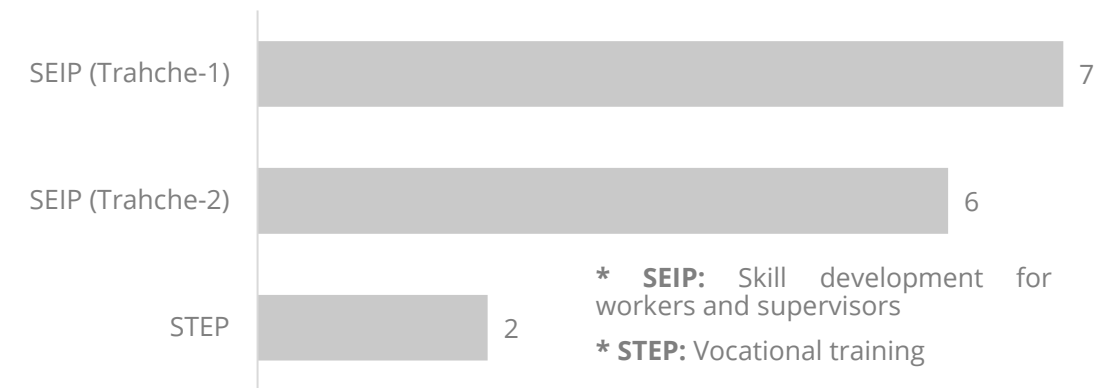
Productivity: Collaborative workforce upskilling initiatives will increase industry productivity.

Bangladesh currently ranks low in terms of labor productivity compared to its peers. However, through ongoing investment in the training and upskilling of the workforce, labor productivity could be enhanced, helping to raise the industry's competitiveness.

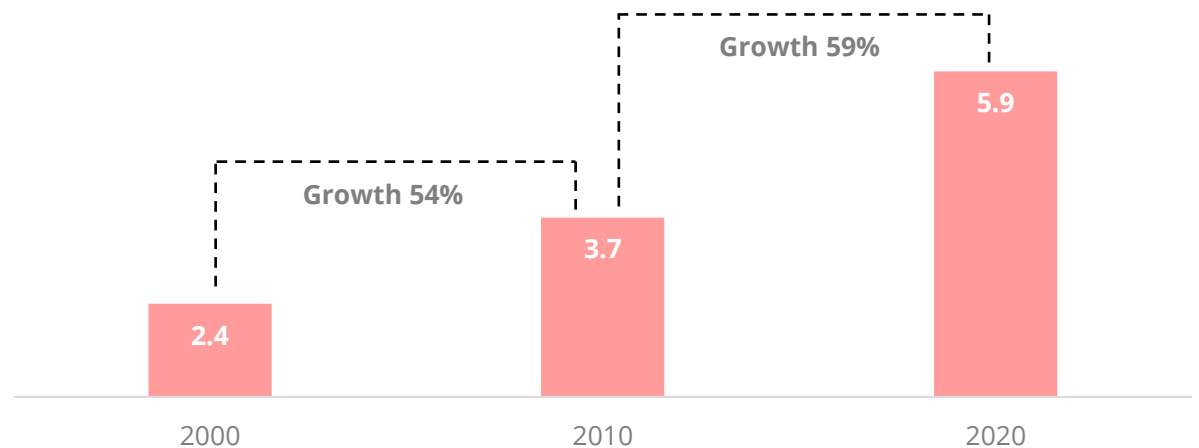
Labor productivity for RMG manufacturing countries (USD/Hour)



BGMEA along with its partner's investment in workers training from 2014 to 2019 (USD mn)

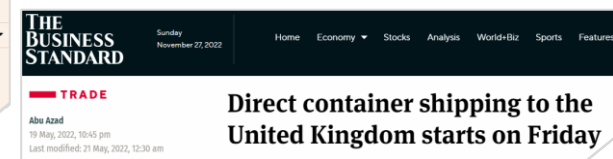
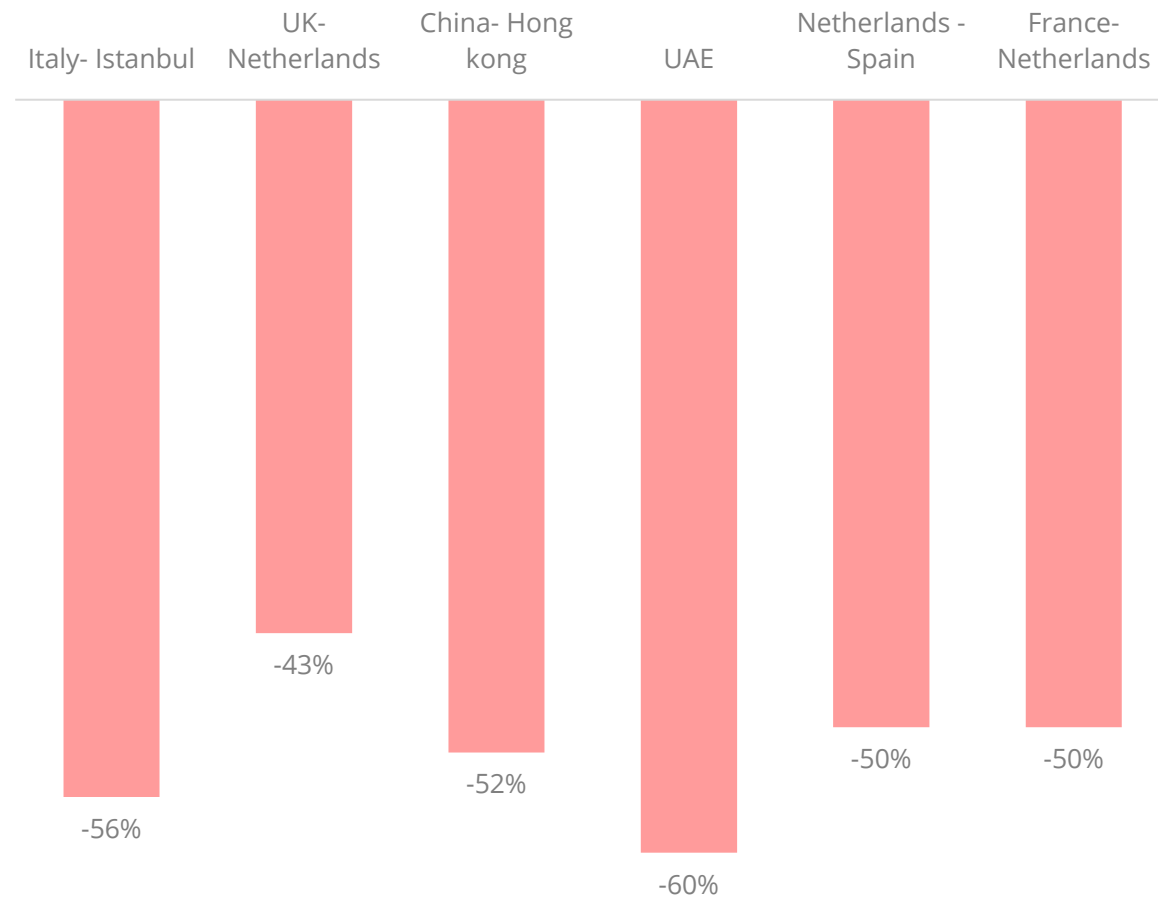


Labor productivity of Bangladesh (USD/Hour)

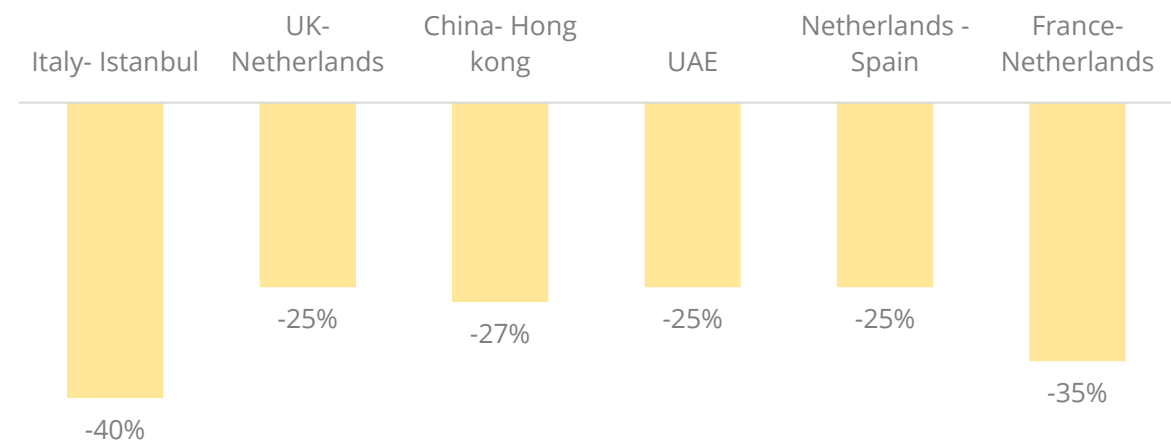


Lead Time: Introduction of new direct shipping routes continues to make headlines signaling an improvement in lead time and a reduction of shipping costs.

Reduction in shipping time (%) through direct shipping routes



Reduction in shipping costs (%) through direct shipping routes



What does LDC graduation mean for companies operating in the sector?

CAL's View:

Consolidation

We expect well-established apparel exporters to consolidate their market share further.

Higher Margin Products

Portfolio mix will progressively gravitate towards higher-margin products.

Beyond Borders

Well-established companies to move lower margin manufacturing to countries that still enjoy duty benefits.

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