

# Analytical Review of Bangladesh's Macroeconomic Performance in Fiscal Year 2011-12

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*(First Reading)*

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# CPD IRBD 2011-12 Team

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*Dr Debapriya Bhattacharya*, Distinguished Fellow, CPD and *Professor Mustafizur Rahman*, Executive Director, CPD were in overall charge of preparing this report as team leaders.

Lead contributions were provided by *Dr Fahmida Khatun*, Head, Research Division; *Dr Khondaker Golam Moazzem*, Senior Research Fellow; *Mr Syed Saifuddin Hossain*, Senior Research Associate; *Mr Md. Ashiq Iqbal*, Senior Research Associate; *Mr Towfiqul Islam Khan*, Senior Research Associate and *Mr Ashiqun Nabi*, Senior Research Associate.

Valuable research support was received from *Mr Md Tariqur Rahman*, Senior Research Associate; *Ms Farzana A Misha*, Senior Research Associate; *Mr Kishore Kumer Basak*, Research Associate; *Mr Mazbahul Golam Ahamad*, Research Associate; *Mr Md Zafar Sadique*, Research Associate; *Mr Napoleon Dewan*, Programme Associate; *Ms Nusrat Jahan Tania*, Programme Associate; *Mr Shouro Dasgupta*, Programme Associate and *Ms Nimat Chowdhury*, Research Intern.

In the process of preparation of the IRBD report useful inputs were received from *Mr Hasanuzzaman*, Senior Research Associate and *Ms Mehruna Islam Chowdhury*, Research Associate.

*Mr Towfiqul Islam Khan* acted as the coordinator of the IRBD 2011-12 team.

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The CPD IRBD 2011-12 team alone remains responsible for the analyses and interpretations presented in this report.

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## 1. Introduction

The present document seeks to trace the emerging trends in the Bangladesh economy in the fiscal year 2011-12 (FY12). To this end, the paper first establishes the benchmark conditions of the current fiscal year by sketching a consolidated picture of FY11 with an analysis of the year-closing data.

The document then attempts to analyse the early signals of the current fiscal year.

With a view to highlight the major challenges facing the Bangladesh economy in the FY12, the paper focuses on four critical issues. These are the followings:

- a. Implications of the new wave of global economic crisis
- b. Deepening stresses in public finance management
- c. Unabated price inflation, and
- d. Increasing pressure on the balance of payment

The document rounds up by drawing lessons from the foregoing analyses and by putting forward a number of policy suggestions to deal with the identified macroeconomic concerns.

The document has been structured around its key objectives. It builds on CPD's earlier works on the subject and uses the most recent information available from official sources to provide an up-to-date analysis of the current state of Bangladesh economy.

This is a first reading of the state of Bangladesh economy in FY12 prepared under CPD's programme on *Independent Review of Bangladesh's Development*. It will be followed up by two other assessments before the announcement of the national budget for FY13.

## 2. Establishing the Benchmark: An Evaluation of the Fiscal Year 2010-11

### Growth Performance

A notable turnaround of the manufacturing sector (backed up by the export-oriented enterprises), strong performance of the crop sector, and anticipated momentum in public investment contributed to a high projection of 6.7 per cent of GDP growth by the BBS for FY2010-11. A recovering global economy with attendant prospects of robust performance by the country's export and linked sectors was also a reason that informed this optimistic scenario. Indeed, if this turns out to be actually the case, the estimated GDP growth rate for FY2010-11 would be the highest ever achieved in post-independence Bangladesh. What is also remarkable is that, this high growth rate would have been achieved over the relatively high benchmark of 6.1 per cent in FY2009-10 (Table 2.1).

TABLE 2.1: GDP GROWTH AND SECTORAL SHARE

Sectors	Share		Growth		Incremental Share	
	FY10	FY11	FY10	FY11*	FY10	FY11
Agricultural Sector	19.6	19.3	5.2	5.0	17.1	14.6
<i>of which - Crops</i>	11.0	10.9	6.1	5.0	11.1	8.3
Industry	28.9	29.3	6.5	8.2	30.8	35.4
<i>of which - Manufacturing</i>	17.3	17.8	6.5	9.5	18.5	24.8
Service Sector	48.1	48.1	6.5	6.6	51.1	47.9
Import Duty	3.4	3.3	1.8	4.2	1.0	2.1
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>6.1</b>	<b>6.7</b>	<b>100.0</b>	<b>100.0</b>

\*Provisional estimates

Source: BBS

The impressive GDP estimates, however, are provisional and are likely to be revised. Actual growth performance would hinge on two critical factors: (a) robustness of investment projections, particularly of public investment based on the revised ADP when the GDP estimates for FY2010-11 were prepared, and (b) estimates of growth of the manufacturing sector which, in view of information on the actual performance over the first six months, appeared to be rather optimistic. As is known, even the reduced RADP could be implemented only to the tune of 91.5 per cent. However, it appears that growth in the manufacturing sector gained some momentum in the second half of FY2010-11. Driven by an upbeat export sector that posted a high 41.5 per cent growth, medium and large scale manufacturing sectors posted a record 17.7 per cent growth in terms of QIP. The QIP of small industries also marked 3.3 per cent growth, a significant upturn in view of the negative (-) 6.1 per cent growth in the first half of the fiscal year. Whether, in the end, the final GDP growth estimate for FY2010-11 manages to reach the record high growth projections of 6.7 per cent is to be seen when BBS comes out with the final figures in a few months' time.

### Three major achievements

**Export was robust.** Exports showed remarkable turnaround in FY2010-11 having experienced the adverse consequences of the global economic slowdown in FY2009-10. Bangladesh's global export in FY2010-11 posted a high growth of 41.5 per cent against only 4.1 per cent growth in FY2009-10, with both RMG and non-RMG products registering significant growth rates of 43.4 per cent and 35.1 per cent respectively. Robust export performance helped maintain a foreign exchange reserve of USD10,911.6 million at the end of FY2010-11, which matched the corresponding reserve levels at the close of FY2009-10

(USD 10,749.7 million). However, the attained growth was achieved over a low benchmark growth of FY2009-10, and could, prove difficult to sustain in FY2011-12.

An important aspect of the impressive export performance in FY2010-11 was that along with growth in the volume of exports, average prices in the global market also appear to have posted some rise. For example, growth rates in terms of export volume for knit and woven-RMG were 19.0 per cent and 20.0 per cent respectively in FY2010-11, which would imply that price indices have also seen significant rise. However, rise in prices also reflected a significant increase in cost of production particularly in view of high cotton prices in FY2010-11.

***Collection of tax revenue strengthened.*** In continuation of its commendable efforts in the recent past, the National Board of Revenue (NBR) has achieved a significant 27.2 per cent revenue growth in FY2010-11, far outpacing (by Tk. 6,502 crore) the targeted growth rate of 16.8 per cent. Impressive growth rates were achieved for most of the components, particularly in case of income tax component (32.4 per cent). In the non-NBR tax component as well, an impressive 17.7 per cent growth was recorded in FY2010-11. Although this was lower than the annual target of 25.8 per cent, this is a significant improvement in view of the low growth of 3.4 per cent achieved in FY2009-10.

***Turnaround in manpower export.*** Significant slowdown in the outward migration had emerged as a major concern for Bangladesh in FY2009-10. The adverse impact of this was quite obvious, particularly from the perspective of foreign exchange earnings, domestic employment situation, poverty alleviation efforts and forex reserve situation. As may be recalled, the number of people going abroad for jobs declined from about 6.5 lakh in FY2008-09 to 4.3 lakh in FY2009-10. It was somewhat of a relief that the decline appears to have been arrested in FY2010-11: as a matter of fact, the number of migrant workers leaving the country marginally increased to reach 4.4 lakh in this year. However, growth in remittance earnings further slowed to single digit (6.0 per cent) in FY2010-11 from the robust 13.4 per cent recorded in the previous year.

In spite of some of the positive achievements relating to a number of important macroeconomic performance indicators, several disquieting fault lines began to appear in the economy as FY2010-11 approached its finishing line. Inflationary momentum continued to sustain, overall balance of payments position went into a negative terrain, burden of subsidies started to pick up significantly, particularly in the backdrop of operationalisation of (quick) rental plants, and bank borrowings were rising as a consequence of lower utilisation of foreign aid and higher unplanned public expenditure. Sustained moderately high growth with macroeconomic stability, which was the hallmark of Bangladesh's economic performance during the last decade, came under serious threat as the economy moved towards FY2011-12.

### **Pressure points of macroeconomic situation**

Despite the high GDP growth in FY2010-11 and the success in terms of high export earnings, remittance flow and revenue collection, a number of pressure points developed in the overall macroeconomic scenario of the country. These worrying developments transmitted a cautionary signal with regard to the country's macroeconomic management in the near-term. A number of these developments were new, whilst some of the others were carried from the past only to have had aggravated in the process with the passage of time.

**Prices continued to soar.** Contrary to what one would have expected from the impressive growth in the crop sector, noted earlier, food prices continued to soar and drove up the overall inflation rate in FY2010-11. Moving average inflation rate for the fiscal year stood at 8.8 per cent, higher than the set target of 7.0 per cent. Point-to-point inflation in June 2011 was 10.2 per cent compared to 8.7 per cent in June 2010. Food inflation rate was higher<sup>1</sup> than the general inflation rate. It appears that trends in food prices have become somewhat delinked from the food production and availability situation. With no major production shocks in recent times, food price hike appears to reflect a transmission of the high global prices to the domestic market. As Table 2 would evince, in FY2010-11 production was better, import had increased, public food-stock was higher and off takes under VGD, VGF, Food for Work and Open Market Sales (OMS) were more than the previous year. Yet, prices continued to rise, in tandem with the rising world prices. In this connection, one may recall World Bank estimates which indicate a contemporaneous correlation between rice prices of Kolkata-Dhaka and Thailand-Dhaka to be 0.9 and 0.8, implying that they tend to move closely together<sup>2</sup>.

**TABLE 2.2: FOOD SITUATION**

(Lakh, MT)

Year	Actual Production (Gross)	Net Production*	Foodgrain Imports			Public Procurement	Public Distribution	Foodgrain Stock (End June)
			Govt. & food aid	Private	Total			
FY2009-10	332.3	292.4	5.6	29.0	34.6	8.1	19.6	5.3
FY2010-11	345.1	321.5	22.0	31.1	53.1	4.6	22.9	8.9

\*After 12 per cent deduction for FY08, FY09 & FY10 and 10 per cent for other years for seed, feed, waste etc.

Source: Bangladesh Bank

In its attempt to control the inflationary pressure, the central bank resorted to intervening in the money market and bringing down the credit growth. Monetary Policy Statement (H1 FY11)<sup>3</sup> of the Bangladesh Bank targeted to significantly reduce the growth in money and credit supply. However, reining in credit growth proved to be difficult in the face of higher credit demand from both public and private sectors: total outstanding domestic credit increased by 27.4 per cent, while net credit to the government and to the private sector posted 34.9 per cent and 25.8 per cent growth respectively in FY2010-11. Disbursement of term loan increased by 24.3 per cent, while that of agricultural credit increased by 9.6 per cent. Money supply (M2) also recorded a significant increase of 21.3 per cent over the last year. In response, the Bangladesh Bank resorted to multiple increase in the policy rates<sup>4</sup>. At the same time, higher demand for trade financing originated from significant import growth of 41.8 per cent in FY2010-11. Growing investment demand and, more importantly, the bubble in the capital market also wiped out a large part of the excess liquidity in the system. This resulted in a decline in the level of the excess liquidity which stood at Tk. 20,660 crore at the end of January 2011. This was the lowest amount of excess liquidity in two years. The bust in the capital market, following the boom, however, helped ease the liquidity pressure on scheduled banks.

<sup>1</sup> (12.5 per cent in June 2011)

<sup>2</sup> World Bank (2011). Bangladesh Economic Update.

<sup>3</sup> In H2 FY11 no change has been mentioned on this.

<sup>4</sup> CRR and SLR were raised twice and Repo and Reverse Repo rates were increased thrice during FY2010-11.

**Subsidy pressure intensified.** As a strategy to combat food price hike, the government decided to focus more on food import rather than domestic procurement, through increased public as well as private imports. Higher imports and more extensive distribution of foodgrains led to significant rise in food subsidy requirement. Initial subsidy allocation of about Tk. 1,200 crore was later revised upwards to about Tk. 1,650 crore. However, it was the fuel subsidy requirement that emerged as the critical issue. This was underwritten not as much by the rise in international prices than the fact of the growing demand for petroleum products in the backdrop of rising fuel needs to service the newly installed fuel-fired quick rental and rental power plants. Loss of Bangladesh Petroleum Corporation (BPC), the sole importer of petroleum products, in FY2009-10 was to the tune of Tk. 2,300 crore in FY2009-10. In FY2010-11 BPC had incurred a loss of about Tk. 7,200 crore. This was way over the revised subsidy allocation of Tk 4,000 crore kept for the BPC in the revised budget of FY2010-11.<sup>5</sup>

**ADP-business as usual.** ADP implementation during FY2010-11 stood at Tk. 32,830 crore, which was Tk 5,670 crore less than the original target, implying an implementation rate of 85.3 per cent (of the original budget). This was about the same level of the last year (85.0 per cent). However, in Taka terms the implemented ADP was 26.7 per cent higher. As a result, ADP-GDP ratio in FY2010-11 was higher at 4.2 per cent, an improvement from the 3.7 per cent of the previous year. An added concern regarding the ADP had been the higher share of local financing in the absence of envisaged foreign financing. Of the implemented ADP of FY2010-11, about 70.6 per cent had to be financed from local sources; this was in the range of 60-65 per cent in the previous years. This led to a higher government borrowing from the banking system, putting pressure on credit availability for the private sector.

**Non-tax sources of revenue remained as low performers.** In continuation of the commendable performance of recent years, overall revenue collection increased by 20.3 per cent in FY2010-11<sup>6</sup>. This growth was singularly shouldered by National Board of Revenue (NBR) since non-tax component, constituting almost one-fifth of the total revenue target of FY2010-11, declined by 12.3 per cent compared to FY2009-10 (against the targeted growth of 25.2 per cent).

**Low off-take of foreign aid, budget deficit squeezed.** Budget deficit amounted to Tk. 31,013.2 crore (3.3 per cent of GDP against 5.0 per cent envisaged in the budget) in FY2010-11. However, one could argue that although the deficit remained under control, it was in part due to the wrong reason, i.e. the low level of ADP implementation. A major nagging concern in FY2010-11 was the low disbursement of foreign aid. In the backdrop of the expected project aid not having been materialised, government went on to finance a significantly larger proportion of the deficit through domestic borrowing, more specifically through bank borrowing. Against a negative net bank-borrowing of (-) Tk. 2,092.5 crore in FY2009-10, the amount borrowed in FY2010-11 was Tk. 25,210.2 crore. As financing opportunities by way of both non-bank borrowing and foreign borrowing was low, as much as 81.3 per cent of the deficit needed to be financed from bank borrowing. To compare, in FY2009-10, about 27.6 per cent of the financing was made from foreign borrowing and 82.0 per cent from non-bank borrowing; indeed contribution from the banking sources experienced a decline (by (-)9.6 per cent).

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<sup>5</sup> 100 crore = 1 billion

<sup>6</sup> Original target for revenue growth in FY2010-11 was set at 22.0 per cent, which was raised to 25.4 per cent in the revised budget.

***Collapse of the capital market.*** As was mentioned, excess liquidity of the scheduled banks declined quite dramatically and reached its nadir during December-January period of FY2010-11. This was accompanied by a significantly rising trend in market capitalisation in the share market. While excess liquidity declined by over 28 per cent between June 2010 and December 2010, market capitalisation increased by over 24 per cent during the same period. Evidence suggests that a large part of industrial, consumer and other credit money were diverted to the capital market. This contributed to drying up of liquidity in the banking system, contrary to the liquidity requirement ratios set by the Bangladesh Bank. When cash reserve ratio (CRR) was raised by Bangladesh Bank in December 2010, this led to forced selling of shares by the over-exposed banks to comply with the new requirement. This had a knock-on effect on the capital market which experienced a sharp downturn. However, as a consequence, liquidity situation improved also because the Bangladesh Bank complemented this by injecting money into the market through the use of repo auctions. Undermining of the nexus between banking sector and capital market has significantly weakened the management of monetary sector. Lack of prudential management by the central bank, particularly in the early stages of capital market boom, contributed to this and stability in the capital market was not restored till the close of the fiscal year in end-June 2011.

***BoP under pressure.*** Balance of Payments situation came under increasing pressure in FY2010-11. Current account balance experienced significant deterioration mainly because of the negative trade balance component with a deficit of USD2.2 billion, and imports outpaced the robust export. Trade balance stood at negative (-) USD7,328 million as against a negative balance of (-) USD5,155 million in FY2009-10. Financial account also recorded significant deficit of (-) USD1,584 million against a deficit of (-) USD651 million in FY2009-10. This was driven by lower FDI inflow (USD768 million as against USD913 million in FY2009-10) and reduction in net aid flow (USD312 million against USD902 million in FY2009-10). As a result, a deficit to the tune of (-) USD635 million was recorded in the overall balance, deteriorating from a surplus of USD2,865 million recorded in FY2009-10. The emergent BoP situation further necessitated the need to improve remittance flow and secure foreign financing to meet rising investment demand.

### 3. Four Critical Concerns for Fiscal Year 2011-12

#### 3.1 Adverse Spill-overs from Global Economic Situation

##### Uncertain Global Prospect

Nearly three years after the downturn observed in 2009, the developed countries in the North America, Europe and Asia still continue to grapple with an uncertain future and markets are agitated by trepidations of new setbacks, defaults and the possibility of a “double-dip” recession. A number of factors are behind the current situation, including the high unemployment rate in the USA, the sovereign debt crisis in Europe and decision by credit rating agencies to downgrade the ratings of some of the developed countries. Also, the tsunami and earthquake in Japan had transmitted shocks to the global economy. The fact that the EU debt rescue package is in a vulnerable position due to the Greek referendum announcement, has further heightened the likelihood of a recession.

*Uneven recovery of output.* The growth of the world economy is expected to increase by 3.3 per cent in 2011, and in 2012 the rate may reach 3.6 per cent<sup>7</sup> – marginally higher than that was predicted earlier. For the European Union the growth rate may remain stagnant in 2011 and 2012 at level lower than the pre-crisis benchmark. According to the latest forecast, USA is expected to grow in 2012 at a rate lower than that of 2011 (see for details Table 3.1).

TABLE 3.1: GROWTH OF WORLD OUTPUT AND TRADE, 2005-2012

Region	<i>(annual percentage change)</i>						
	2005-2008 (average)	2009	2010	2011	2012	2011 <sup>8</sup>	2012 <sup>2</sup>
World	3.3	-2.1	3.9	3.3	3.6	3.5	3.7
U S A	1.9	-2.6	2.9	1.6	2.5	3.0	2.8
European Union	2.2	-4.2	1.8	1.7	1.9	1.8	1.8
South Asia	7.5	5.7	7.1	6.9	7.0	6.8	6.8
China	11.3	9.1	10.3	9.1	8.9	8.9	9.0
LDCs	7.7	4.1	4.7	5.6	5.8	5.5	5.7
World Trade in Goods and Services	7.1	-11.1	11.9	7.1	6.8	7.6	7.1

Source: UN/DESA, WESP 2011

The Federal Reserve has cut the GDP growth forecast for the US to 1.6 per cent in 2011, down from an earlier forecast of 2.9 per cent. The Federal Reserve also predicted that the US economy would grow at 2.5 per cent in 2012 and by 3.5 per cent in 2013<sup>9</sup>.

Thus, the world economy continues to experience a faltering recovery. Moreover, the process is uneven as China, India, Brazil and other emerging economies are demonstrating impressive growth and fuelling the engine of global recovery, while developed countries are lagging behind.

<sup>7</sup> “World Economic Situation and Prospects 2011- Update as of Mid-2011”, United Nations, 2011

<sup>8</sup> Updated forecast, WESP 2011

<sup>9</sup> Economic Projections of Federal Reserve FOMC, November 2011; available at <http://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20111102.pdf>

**Slowdown in global trade.** Recent global trade expansion was mostly led by the Asian economies. World trade in goods and services expanded by about 12.0 per cent in 2010, more than what was previously estimated, after the steep decline of 11.0 per cent in 2009. Yet growth of global trade is expected to fall, as per latest estimates, to 7.6 per cent in 2011 and further down to 7.1 per cent in 2012.

**Inflationary trend.** It needs to be further noted that the covariate shocks in Japan have undermined the world financial market, whereas unrest in Western Asia and North Africa have contributed to further increase in oil prices. Sustained high prices of foodgrains along with other commodities also poses a threat to the process of economic recovery. Soaring headline inflation is corroding real income of the common people across the world. This has compelled governments to safeguard consumers' interests through subsidies and cash transfer programmes which, in turn, is putting further pressure on the fiscal situation.

However, a weak dollar is expected to help take some of the heat off the mounting oil and food prices in the world market. In addition, better harvests are expected to moderate food prices in the near term. Nevertheless all projections indicate that there is hardly any possibilities of food prices going back to their pre-2007 levels, although they may come down somewhat.

**Capital flow.** Net private capital flows to developing countries have increased as investors are shifting parts of their portfolios to emerging markets, mostly in developing economies, in the form of short term equity investments and FDI. This trend has put upward pressure on the foreign exchange rate of the currencies of developing countries putting pressure to undertake sterilisation measures to offset the risks allied with the influx of capital inflows.

**Scope for another stimulus.** Many of the developed countries had to prematurely discontinue their stimulus packages as a consequence of deteriorating fiscal situation. Thus, the scope for a second round of stimulus package appears to be bleak. High inflationary trend has also made pursuance of counter-cyclical policy difficult.

In sum, as the world economy braces for a possible second cycle of economic recession, opportunities to deploy counter-acting policy measures have reduced significantly. The developed economies have much less economic flexibility at present; to make a bad thing worse, new risks have appeared in the mean time. Indeed, the evolving adverse trends in the global economy are going to have cross-border spill over effects, affecting particularly the developing countries to various extent and degrees.

**Aid prospect.** In the backdrop of fiscal consolidation taking place in developed economies, and given the ongoing Eurozone debt crisis, the outlook for generous aid appears to be rather bleak; prospects of adequate financial support for implementation of the MDG-related investments in the low income countries also appear to be uninspiring.

## **Outlook for South Asia**

**Dual track.** South Asia has been able to absorb the impacts of the global financial shocks rather well. The reasons for this can be primarily attributed to the stellar economic performance of countries such as India and Sri Lanka. The South Asian economy is projected to grow at 7.0 per cent and 7.2 per cent in 2011 and 2012 respectively. Again, India is expected to be the major driver of this growth. The country with a population of 1.2 billion is

expected to achieve GDP growth rates of 8.6 per cent and 9.1 per cent in 2011 and 2012. Sri Lanka is projected to grow at a slightly higher than the South Asian average growth rate of 7.8 per cent and 7.4 per cent over the next two years.

However, countries such as Nepal (4.3 per cent and 4.6 per cent) and Pakistan (3.8 per cent and 4.2 per cent) are estimated to grow at a much slower pace. This is likely to be the story in the near future for South Asia - India will continue to grow with dynamism whilst the other South Asian countries will have mixed fortunes<sup>10</sup>.

***South Asian Resilience.*** The slowdown in the regional GDP growth rates by nearly 3 percentage points<sup>11</sup> was the least pronounced among the developing regions. The adverse affects were nevertheless significant – large negative output shocks, job, income and wealth losses, and erosion of confidence, stock market declines, indirect contagion effects propagated by domestic financial markets, losses in exports and tourism, and pressure on the already weak fiscal, balance-of-payments, reserves and exchange rates. However, these extent of the damage was eventually contained.

The macro-impacts of the crisis were most severe on countries with weaker macroeconomic fundamentals and higher external vulnerabilities. These included in Maldives, Pakistan and Sri Lanka. The crisis also affected India because of the contagion impact in terms of spending; there was limited negative impact in other countries including Bangladesh, Bhutan, and Nepal.

Some key factors insulated South Asia's growth during the crisis and have helped its strong recovery performance. Sources of this resilience included remittance flow, export expansion, good agriculture production and strong policy responses.

***Decline in external demand and weakened macroeconomic fundamentals.*** Continued recession in the development markets are affecting external sectors of the South Asian economies. Exports from South Asia are slowing in most recent months, including key exports such as garments. Remittances, thus far a key strength, are showing some signs of slowing down as well. The number of returning workers are rising further accelerated by recent Middle East unrest, as is the case for Bangladesh and Nepal.

Inflation, fuelled by the surging commodity prices (particularly oil prices), is volatile which pose special challenges for South Asia as a largely import-dependent region. The central banks of several countries such as Bangladesh, Pakistan and India responded by tightening monetary policy further. However if this continues it is likely to weaken domestic demand and economic growth in the near future.

It may be difficult for the individual countries in the region to come up with response mechanisms as they did at the time of previous economic crisis because of the following reasons:

- limited fiscal space, most of the countries have already implemented austerity measures
- high levels of public debt compared to the pre-crisis level

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<sup>10</sup>WESP- Updates as of Mid-2011

<sup>11</sup> From a peak of 8.9 per cent in 2007 to 6.3 per cent in 2009.

- inflationary pressure have resulted in central banks in the region raising the interest rates
- weakening of the USD would mean that regional currencies would not undergo significant devaluation against the USD.

The impact of a possible double dip recession will also be felt differently by the different South Asian countries because of their varying sources of resilience and vulnerability. Thus there is a need for the governments of these countries to design and implement policies relevant to their countries' needs and susceptibility.

### **Challenges for Bangladesh**

All economic risks are cross bordered and are by and large interdependent. Thus Bangladesh is no less threatened from the global risks and uncertainties. Despite having an estimated growth rate of 6.7 per cent in FY2010-11, several growing downside risks arising from external economic environment are exerting added pressure on economy.

The transmission channels of the implications of global economic downturn for the Bangladesh economy are primarily mediated through trade, remittances, foreign aid and FDI.

European countries accounts for 50 per cent of Bangladesh's export basket. Major export destinations in EU27 are Germany, United Kingdom, France, Spain, Italy, Belgium and Netherlands. Thus the current Euro debt crisis is likely to have adverse implications for Bangladesh's exports in general, and exports of apparels in particular, in the EU. First signs of this is already there. In view of this Bangladesh will need to focus on extra-EU markets, particularly markets in the developing countries.

The knock-on effect on remittances may not be very high since about two-third of the remittance flow originate from the middle-east. However, the spectre of double-dip crisis in the developed world and the after-effects of the turmoil in the Middle-East are likely to weaken remittance flow in the coming months.

Bilateral aid from the European countries (and Japan) may get constricted as the governments of these countries opt for austerity measures. However, a number of countries (e.g. UK) promised to stick to their pledge to expand the ODA volume, which is a good news for Bangladesh.

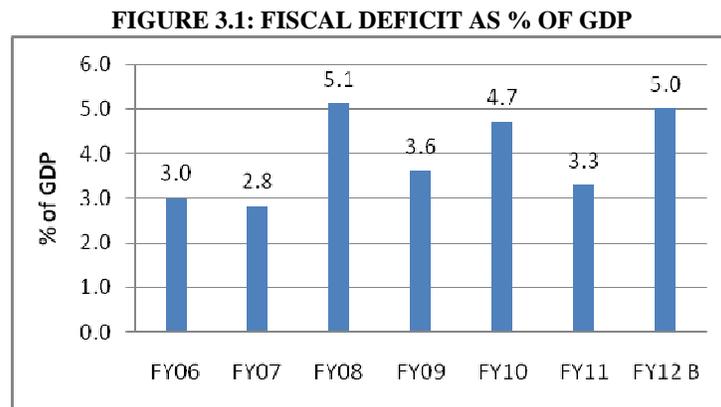
***Crisis on hand.*** In the event of another cycle of global economic crisis, it will be difficult for Bangladesh to come up with response mechanisms as she did in 2008 due to weakened macroeconomic fundamentals informed by surging non-development expenditures, pressure on balance of payment and high level of prices. These factors have eroded the fiscal and monetary space. On the other hand, Bangladesh should also be prepared to take advantage of the opportunities that may emerge. In the backdrop of current global situation and global demand, prices of key commodities in the international market, including that of fuel and key intermediates, could come down. This could help Bangladesh's macroeconomic balance. Demand switching could help some types of garments exports. Thus, there is a need to remain alert to such possibilities.

The global financial crisis that started in the US and Europe in 2008 had a lagged impact on the economy of Bangladesh resulting, by some estimates, in a 0.60 per cent loss of GDP growth<sup>12</sup>.

It will be a challenge for the government to manage the economy in the current fiscal year in view of the emergent pressure points, whilst at the same time addressing the negative spillovers of the recent developments in the global economy.

### 3.2 Deepening Stresses in Public Finance Management

**Managing fiscal deficit.** Over the last few years, barring FY2007-08, fiscal deficit remained below 5 per cent of GDP. This has happened largely because of underutilisation of development funds underwritten by foreign (project) aid. In the budget for FY2011-12 a deficit of 5.0 per cent of GDP has been projected, total volume of deficit being Tk. 45,204 crore. The projected deficit, in Taka terms, is 40.6 per cent higher than the actual deficit of the previous year. However, this proposed deficit figure remains within the trend (Figure 3.1).



Source: Ministry of Finance

However, a major structural change has been envisaged in the financing plan of the budget deficit for FY2011-12 in comparison to the realised figures for FY2010-11. Concretely, 32.4 per cent and 67.6 per cent of budget deficit are to be financed respectively from foreign and domestic sources in FY2011-12 (Table 3.2). The comparable actual figures for the previous year was 7.2 per cent and 92.8 per cent respectively. This means the government, in the current fiscal year, will have to secure foreign financing of almost six times more than the amount received in FY2010-11. The structural change programmed in the financing plan of the budget deficit relates to composition of the domestic sources of borrowing. If bank borrowing accounted for 87.6 per cent of the domestic sources of finance in FY2010-11, the comparable figures in the current fiscal year has been fixed at 69.7 per cent.

Early figures for FY2011-12 suggest that both these programmed compositional changes are far from being on track. Indeed, inability to maintain these changes epitomise the current fault lines of fiscal management in Bangladesh economy. A closer look at these two critical variables will reveal the underlying entrenched problems of macroeconomic situation of the country.

<sup>12</sup> Bhattacharya, D., & Dasgupta, S. (forthcoming). *Assessing the Impact of the Global Economic and Financial Crisis on Bangladesh: An Intervention Analysis*. Dhaka: CPD.

**TABLE 3.2: DEFICIT FINANCING IN FY11 AND FY12**

(Crore TK.)

Sources of Financing	FY11 Budget	FY11 Actual	Difference (Actual and Budget FY11)	FY12 Budget
<b>Foreign Borrowing-Net</b>	<b>10834.4</b> <b>(31.4)</b>	<b>2232.5</b> <b>(7.2)</b>	<b>-8601.9</b>	<b>13058.0</b> <b>(32.4)</b>
Foreign Borrowing	15968.0 (46.3)	7659.7 (24.7)	-8308.3	18685.0 (46.4)
Amortisation	-5133.6 (-14.9)	-5427.3 (-17.5)	-293.7	-5626.7 (-14.0)
<b>Domestic Borrowing</b>	<b>23679.6</b> <b>(68.6)</b>	<b>28780.8</b> <b>(92.8)</b>	<b>5101.2</b>	<b>27208.0</b> <b>(67.6)</b>
Bank Borrowing (Net)	15680.0 (45.4)	25210.2 (81.3)	9530.2	18957.0 (47.1)
Non-Bank Borrowing (Net)	7999.6 (22.2)	3570.6 (11.5)	-4429.0	8250.8 (20.5)
<b>Total Financing</b>	<b>34513.9</b> <b>(100.0)</b>	<b>31013.2</b> <b>(100.0)</b>	<b>-3500.7</b>	<b>40266</b> <b>(100.0)</b>

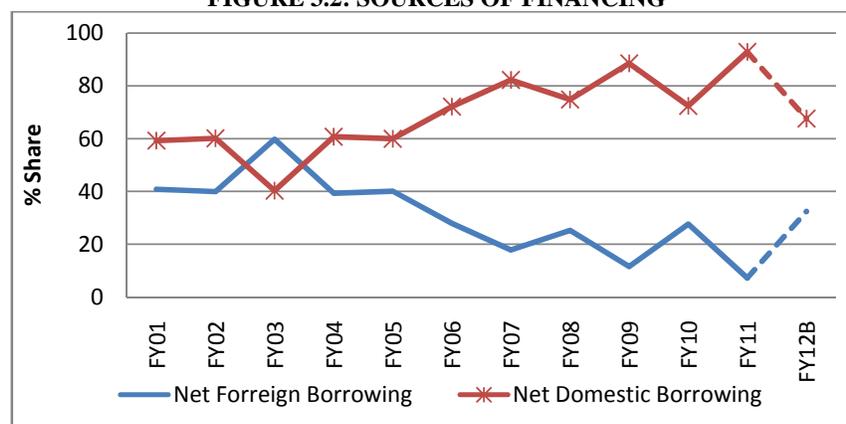
\* Figures in parentheses indicate share in total financing

Source: Ministry of Finance

**Marginalisation of foreign aid inflow.** Foreign aid inflow to Bangladesh economy has more or less steadily fallen during the current decade. This has led to an apparent fall in aid dependence of the country. However, development financing continued to remain critically dependent on foreign sources, particularly in the areas of social and physical infrastructure.

In FY2000-01, share of foreign sources accounted for about 40 per cent of the financing of fiscal deficit which, a decade later in FY2010-11, was only a little above 7 per cent of the same. The occasional rise in the share of foreign aid has been largely related to flow of humanitarian assistance during various natural disasters. This drop has very little to do with fall in aid commitment, as more than USD 13 billion remaining in the pipeline. Rather, it has mostly to do with the inability of government to keep up with the disbursement time line due to failure in undertaking collateral preparations. Arguably, low absorption capacity of the economy is partly responsible for the emerging situation. The direct fall out of such a negative trend had been low utilisation of project aid, leading to low delivery of ADP. In some cases, it has led to substitution of foreign financing by domestic resources.

**FIGURE 3.2: SOURCES OF FINANCING**



Source: Ministry of Finance

During July-September 2011, Bangladesh received USD 246.2 million in aid, while amortisation accounted for USD 171.8 million resulting in net flow of only USD 74.4 million. This figure happens to be USD 98.6 million (57.0 per cent) less than the comparable figure for the preceding year.

Recent developments in Bangladesh government's relationship with the major development partners indicate that this trend may not improve readily. For example, large part of the programmed foreign aid inflow was attributable to release of early tranches of the foreign fund earmarked for the *Padma Multipurpose Bridge* which is currently facing a stand off. Postponement of the meeting of the Bangladesh Development forum (BDF) signals the complexity currently afflicting the government's relationship with its international development partners. It may be safely underscored that without substantial increase in foreign aid flow, macroeconomic stability will remain under serious threats.

What are the options for the government in this regard? *First*, the government should put its best foot forward to get the committed foreign funds disbursed for the ongoing projects. Indeed, this will require project by project intensive monitoring jointly with the partners. A number of useful operational suggestions are available in this regard which only need to be acted upon with utmost urgency and sincerity.

*Second*, the government may intensify its effort to get budgetary support from the international and regional financial institutions. However, with the Padma Bridge impasse, World Bank will be hardly forthcoming to provide a budget support. The planned visit of the IMF mission in December may decide on a programme loan. However, the fiscal and other conditionalities usually associated with such loans call for caution. One would suspect, given the dire state of public exchequer, the government will have little flexibility to cautiously consider the conditionalities associated with such loans.

*Third*, the government may be prompted to go to the global market to secure high cost commercial loan by issuing *Sovereign Bonds*. Getting loans from foreign private sources to finance fiscal deficits, brought about by high level subsidy off-take, will not be prudent. Indeed, this type of loans, carrying high foreign exchange risk, is not at all acceptable in the growing pressure on the balance of payments.

Beyond these abovementioned three avenues, Bangladesh can also improve its non-debt creating foreign sources such as export revenue, remittance flow and foreign direct investment (FDI). Whatsoever, without higher level of access to foreign financing in FY2011-12, Bangladesh economy is going to undermine not only its growth prospect, but also weaken further its macroeconomic stability.

**Heavy bank borrowing.** The second most important destabilising factor for public finance in the current fiscal year is likely to be the high bank borrowing by the government. In fact, as mentioned in the earlier section of the review, this issue did emerge as a significant problem for macroeconomic management in FY2010-11; as high as 81.2 per cent of the fiscal deficit of FY2010-11 was financed through bank borrowing. If mitigating steps are not taken, this trend is apprehended to be heightened further in the current fiscal year.

The budget for FY2011-12 targets to finance 47.1 per cent (Taka 18957.0 crore) of the projected deficit through bank borrowing (Tk. 6253.2 crore less than actual borrowing in FY2010-11).

However, there is every likelihood that this target will be missed by a significant margin. According to Bangladesh Bank, the government has already borrowed Tk 9,470 crore till 10 October 2011 which is about 50 per cent of its total allocation for the year. In other words, the government has borrowed about Tk. 100.0 crore everyday to run its business.

Considerable rise in subsidy demand is likely to push up financing requirement. At the same time, existing high interest rates of the commercial banks undermines the potentials of mobilising fund from non-bank sources. If so happens, in this time of high inflation and high interests on credit along with weakened Taka against other currencies, further substantial rise in government borrowing from the banking system could lead to deterioration in all these indicators along with a crowding out effect for the private sector from their access to credit.

What are the options for the government in this regard? *First*, the government has to reign in its financing requirement, particularly by downsizing its subsidy demand (discussed later). *Second*, the government may augment offtake from the untapped domestic resources. Non-tax revenue sources constitute a potential source in this regard (discussed later). *Third*, the government may seek to meet its incremental borrowing need from non-banking sources by increasing the sale of national saving instruments through increasing their yield rates. If all these are not enough, it may have to cut down its development expenditures.

***Enhanced non-tax revenue collection.*** While overall revenue collection has been impressive in recent times, non-tax revenue collection has remained depressed. It may be recalled that in FY2010-11 non-tax revenue collection declined over that of FY2009-10 by (-)12.3 per cent. In FY2011-12, this source is programmed to contribute more than 19 per cent of the total revenue collection. Against a target of almost doubling its collection (92.1 per cent target growth), actual in-take during the first month (July 2011) had been (-)12.3 per cent less compared to that of the first month of FY2010-11.

However, collection of license renewal and spectrum fees from the mobile network operators had already started to flow in and the government is likely to get some relief in securing non-tax revenue from such fees this year. A total of Tk. 3,746 crore is to be paid by four telecom operators by 10 November 2011. Total revenue over the next one and half years, from these sources, is estimated at Tk. 8,000 crore, with the remaining to be paid.

As the NBR continued to deliver, achieving the overall revenue target for FY2011-12 will critically depend on improved non-tax revenue mobilisation and to a lesser extent on non-NBR taxes (accounting for about 5 per cent of the total intake).

Can the fiscal balance be strengthened given the realistic prospects of augmenting foreign aid flow, decreasing domestic borrowing requirement and fuller collection of revenue targets? Possibly not. One would possibly need to streamline elements of public expenditures to achieve the balance. Indeed, some of the adverse financing requirements are associated with the current public expenditure profiles, e.g., domestic borrowing and subsidy payments.

***Rising revenue expenditure.*** A significantly high growth of 20.5 per cent in revenue expenditure has been envisaged in the budget for FY2011-12. Besides Block Allocation, high expenditure growth is to take place in case of subsidies and transfer (23.8 per cent), interest payment (20.4 per cent), and goods and services (19.7 per cent). In the first month of the current fiscal year higher off-take in case of a number of important expenditure items is evident, e.g., pay and allowances (19.6 per cent) and interest payments (21.7 per cent).

**TABLE 3.3: REVENUE EXPENDITURE**

<i>Expenditure Category</i>	<b>Budget FY11</b>	<b>Actual FY11</b>	<b>Budget FY12</b>	<b>Difference Actual FY11 and Budget FY11</b>	<b>Actual Growth FY11</b>	<b>Target Growth FY12</b>	<b>Actual Growth (Jul FY12)</b>
<b>Pay and Allowances</b>	<b>20374.6</b> (26.5)	<b>19764.9</b> (27.1)	<b>21640.0</b> (24.6)	<b>-609.7</b>	<b>23.2</b>	<b>9.5</b>	<b>19.6</b>
Pay of Officers	1908.9 (2.5)	2071.4 (2.8)	2190.0 (2.5)	162.5	19.1	5.7	8.6
Pay of Establishment	8656.4 (11.3)	8649.6 (11.9)	9154.0 (10.4)	-6.8	14.7	5.8	4.5
Allowances	9809.3 (12.8)	9043.9 (12.4)	10296.0 (11.7)	-765.4	33.6	13.8	54.4
<b>Goods and Services</b>	<b>10413.3</b> (13.6)	<b>9837.2</b> (13.5)	<b>11772.0</b> (13.4)	<b>-576.1</b>	<b>11.2</b>	<b>19.7</b>	<b>97.1</b>
Supplies and Services	7522.2 (9.8)	6842.7 (9.4)	8610.0 (9.8)	-679.5	11.0	25.8	99.0
Repairs, Maintenance & Rehabilitation	2891.1 (3.8)	2994.5 (4.1)	3162.0 (3.6)	103.4	11.5	5.6	25.0
<b>Interest Payments</b>	<b>14708.8</b> (19.2)	<b>14942.5</b> (20.5)	<b>17997.0</b> (20.5)	<b>233.7</b>	<b>0.5</b>	<b>20.4</b>	<b>21.7</b>
Domestic	13270.7 (17.3)	13519.6 (18.6)	16519.0 (18.8)	248.9	0.2	22.2	21.7
Foreign	1438.1 (1.9)	1422.9 (2.0)	1478.0 (1.7)	-15.2	3.8	3.9	-
<b>Subsidies and Current Transfers</b>	<b>29793.3</b> (38.8)	<b>27972.2</b> (38.4)	<b>34642.0</b> (39.4)	<b>-1821.1</b>	<b>3.7</b>	<b>23.8</b>	<b>7.0</b>
Subsidies	7661.2 (10.0)	7933.7 (10.9)	9286.0 (10.6)	272.5	5.7	17.0	-
Grants in Aid	17951.8 (23.4)	14500.3 (19.9)	20290.0 (23.1)	-3451.5	-3.2	39.9	8.1
Contributions to Intl Organisation	86.4 (0.1)	28.0 (0.0)	91.0 (0.1)	-58.4	-63.8	225.0	-
Pensions/Gratuities/Write-off of loans/advances	4093.9 (5.3)	5510.3 (7.6)	4969.8 (5.7)	1416.4	25.4	-9.8	5.3
<b>Block Allocation</b>	<b>1472.5</b> (1.9)	<b>362.5</b> (0.5)	<b>1800.2</b> (2.0)	<b>-1110.0</b>	<b>29.8</b>	<b>396.6</b>	<b>-133.3</b>
Unexpected	1000.0 (1.3)	80.2 (0.1)	1100.0 (1.3)	-919.8	33.0	1271.6	-
Others	4725.3 (6.2)	282.3 (0.4)	7007.4 (8.0)	-4443.0	29.0	2382.3	-133.3
<b>Non-Development Revenue Expenditure (not adjusted for recoveries)</b>	<b>76762.5</b> (100.0)	<b>72879.3</b> (100.0)	<b>87851.2</b> (100.0)	<b>-3883.2</b>	<b>8.8</b>	<b>20.5</b>	<b>17.6</b>

Source: Ministry of Finance

What will be of crucial importance from revenue expenditure perspective in the coming months is the developments in subsidy requirements. Economic classification of revenue expenditure, as reflected in the above table, however shows low growth in subsidies. But this 'Subsidies and transfers' does not include subsidy sources such as BPC, PDB, agricultural and others in which major upturn in demand is noticeable.

**Upsurge in subsidy demand.** Total subsidy demand for the current fiscal year was initially estimated at about Tk. 22,500 crore, which is now anticipated to rise to about Tk. 47,400 crore if no price adjustments are made. If that be the case, share of subsidy expenditures may increase to 29.0 per cent instead of 12.5 per cent of the revenue budget for FY2011-12. It would imply that subsidy payments will be equivalent to 5.3 per cent of GDP instead of 2.3 per cent as foreseen in the budget for FY2011-12. This will be a remarkable increase from 2.2 per cent of GDP in FY2010-11 (revised budget). In other words, about half of what is collected as revenue will go for paying subsidy.

Bulk of this subsidy originates from BPC, the soul merchandiser of petroleum products in the country. While the budget for FY2011-12 kept only Tk. 3500 crore for BPC, it is now

apprehended that BPC alone might require over Tk 28,000 crore in subsidy. During FY2010-11, a whopping 69.7 per cent growth in total petroleum import was recorded. BPC report shows substantial increase in imports of furnace oil and diesel during FY2010-11, compared to FY2009-10. In volume terms, refined petroleum products (mostly diesel) contributed 55.5 per cent in the total petroleum import growth (incremental contribution) in FY2010-11. Another 20.5 per cent of the incremental growth came from import of furnace oil. In value terms as well, substantial part of the growth in FY2010-11 came from diesel (70.6 per cent) and furnace oil (9.6 per cent). To a large part, this growth structure reveals the additional demand originating from the rental and quick rental power plants. Starting from FY2009-10, 14 (quick) rental power plants became operational till October 2011, adding 1320 MW of power to the national grid. According to the original plan, a total of 24 rental plants are to be set up. Therefore, more liquid fuel demand will be adding up in near future, pushing subsidy demand further up.

It is pertinent to mention here that fertilizer subsidy is also on the rise due to over 100 per cent increase in international price. Besides, agriculture sector as a whole might require Tk. 6835 crore in FY2011-12, i.e. an additional Tk. 2,300 crore more in subsidy than the original projection.<sup>13</sup>

On the other hand, PDB placed a subsidy demand of Tk. 5,200 crore to the Ministry of Finance for the current fiscal year<sup>14</sup> in line with the budget allocation for FY2011-12. Similarly, Tk. 2,250 crore will be necessary for payment of various export incentives, Tk. 1,736 crore for food operations and Tk. 3,400 crore for the state-owned enterprises.

**TABLE 3.4: SUBSIDY REQUIREMENTS IN FY12**

Sector	(in crore Taka)			
	Revised Budget FY11	Budget FY12	revised requirements for FY12	% of total subsidy (revised requirement)
BPC	4000	3500	28014	59.1
Agriculture (fertilizer, Diesel and electricity)	5700	4500	6835	14.4
PDB	4000	5200	5200	11.0
Export	2000	2200	2200	4.6
Food	1653	1677	1736	3.7
BJMC and others	358	3400	3400	7.2
<b>Total</b>	<b>17711</b>	<b>20477</b>	<b>47385</b>	<b>100.0</b>
<b>% of Budget</b>	<b>13.3</b>	<b>12.5</b>	<b>29.0</b>	-
<b>% of GDP</b>	<b>2.2</b>	<b>2.3</b>	<b>5.3</b>	-

Source: Based on Ministry of Finance (various sources)

What are the options for the government to deal with this unsustainable subsidy payment situation? The government will not be able to underwrite this mounting expenditure by incremental revenue collection. It is also not a sustainable proposition to resort to more domestic borrowing – either from bank or non-bank sources – to pay the subsidy bills. Thus, the government, as such, is left with no other viable policy choices to adjust fuel and power

<sup>13</sup> Subsidy for agriculture sector include subsidy for fertilizer as well as for diesel and electricity used for irrigation.

<sup>14</sup> In its recent proposal for power price revision placed to the BERC (Bangladesh Energy Regulatory Commission), PDB projected that the subsidy demand may reach over Tk. 7,340 crore, if no price adjustments are made.

prices upward in a phased manner. The government may consider bringing up diesel, octane, kerosene and furnace oil prices in line with the prices in India (also to pre-empt smuggling out). Currently prices in India of these products are higher than those in Bangladesh by, on average, more than Tk. 10 per litre. Such price enhancement may further aggravate the prevailing spiralling price situation. However, part of it will be off-set by reduced government borrowing, and better access of the private sector to bank credits for productive purposes as well as stable agriculture production. However, in order to protect the farmers subsidy on diesel and electricity may be supplied through designated cards.

Only bulk and rental price adjustment of energy products alone will not do the trick. Concerns also emerge from the fact that the government is planning to phase out the rental plants not before 2014. This will require new public plants to take over the production deficit. Although there are plans for new public plants, no visible progress in this regard is evident. In fact, power generation from public plants (other than rental, quick rental and IPP) has declined by about 518 MW over the last one year. If the plan for new public plants does not materialise, than the heavy toll that the rental plants have had so far on the petroleum budget, and will continue to have over the next few years, will all go in vain.

It needs to be emphasised here that there is a serious lack of information on both subsidy allocation and expenditure by the government. The budget documents do not provide any comprehensive subsidy estimate, other than some scattered information on agricultural subsidy allocation. Actual subsidy expenditure is also not published. Given the fact that subsidy expenditure has emerged as the core destabilising feature of the economy, greater transparency is required in this area for the citizens to appreciate the problem.

**Check on interest payments and public debt.** Both domestic and foreign interest payments, as share of revenue budget, declined during the last two fiscal years (FY2009-10 and FY2010-11). This happened largely because interest rates were low for domestic loans during this period. The budget for FY2011-12, however, projects significant rise in interest payments (by 20.4 per cent). In the first month of FY2011-12, significant increase (21.7 per cent) in domestic interest payment has been recorded. Heightened bank borrowing that was made in FY2010-11, and is likely to be made again in the current fiscal year, could lead to an increase in the share of domestic interest payment in the coming years.

**TABLE 3.5: SHARE OF INTEREST PAYMENTS IN TOTAL REVENUE BUDGET**

	FY06	FY07	FY08	FY09	FY10	FY11	B FY12
Total Interest Payment	14.3	14.0	15.0	15.7	14.6	12.1	11.0
Domestic	12.1	12.0	13.4	14.2	13.3	10.9	10.1
Foreign	2.3	2.0	1.5	1.5	1.3	1.2	0.9

Source: Ministry of Finance

On the other hand, in the backdrop of much diminished flow of foreign aid, interest payment on foreign loans is eating up bulk of the inflow. For example, in FY2010-11 it was as high as 63.7 per cent of gross annual foreign aid.

While remaining concerned with the flow figures, one should not fail to look at the stock figures regarding foreign and domestic borrowings. Total public debt as a share of GDP from the recent peak of 53.7 per cent in FY2001-02 has come down to 38.7 per cent in FY2010-11. This encouraging trend is essentially underpinned by steady decline in Bangladesh's foreign debt. In contrast, domestic debt as a share of GDP is showing increasing trend. The

concerned figure was 19.9 per cent of GDP in FY2010-11, up from 18.9 per cent of GDP in FY2009-10.

Given the recent experience with public debt stock, particularly in the developed countries, Bangladesh government will be well advised not to lose the comfortable space in macroeconomic management which it currently enjoys regarding public debt situation.

**Delivering ADP.** ADP expenditure has increased during the initial months of FY2011-12 owing to certain improvement in its implementation rate – from 9 per cent in the first quarter of FY2010-11 to 11 per cent during the same period in FY2011-12. Expenditure on account of project aid declined further during the first quarter of FY2011-12 to only 4 per cent from 5 per cent recorded in the corresponding period of the previous year. Accordingly, the incremental part of the improvement, albeit marginally, implementation was underwritten by domestic resources, adding to the government’s borrowing requirement from the banking system.

**TABLE 3.6: AID UTILISATION BY THE TOP 10 MINISTRIES/DIVISION DURING JUL-SEP, FY12**

Ministry/Division	Allocation of aid	Expenditure of aid	Rate of aid utilization
Bridges Division	3452	6	0.2
Roads Division	1461	14	1.0
M/O Water Resources	820	12	1.4
Energy & Mineral Res. Division	679	14	2.0
Local Govt. Division	5461	142	2.6
Power Division	2727	104	3.8
M/O. Education	1503	90	6.0
M/O Primary & Mass Education	650	53	8.2
Railway Division	1245	141	11.4
M/O. Health & Family Welfare	61	17	27.8
<b>Total (10 ministries)</b>	<b>18059</b>	<b>594</b>	<b>3.3</b>
<b>Share in total ADP</b>	<b>39.3</b>	<b>3.2</b>	

Source: IMED

In spite of the heightened importance of ensuring project aid flow in the current fiscal year, a further deterioration in the situation is evident. Table 4.5 bears this out clearly, reflecting the low implementation of aid component by the largest 10 recipients of ADP allocation. On the other hand, 15 per cent (Tk 4,011 crore) of the Taka component has been utilised so far, which was 11 per cent (Tk 2,518 crore) during the first quarter of the previous fiscal.

**Sustaining NBR revenue earnings.** As was mentioned earlier, NBR continued with its robust performance in FY2010-11 (Table 3.7). For FY2011-12, a 16.2 per cent growth target has been set for the NBR. What is of concern is that during the first quarter (July-September) of the current fiscal year, some slowdown in NBR revenue collection is evident. This is particularly true for revenue collection at the local level, especially for VAT and supplementary duty collection, which could imply a slowdown in the domestic economy. Income tax collection, however, sustained its impressive trend.

**TABLE 3.7: NBR REVENUE COLLECTION**

Categories	Actual Growth FY11	Target Growth FY12	Growth Jul-Sept FY12
Import Duty	22.8	8.8	18.7
VAT (Import)	19.9	11.1	0.3
Supplementary Duty (Import)	28.4	10.5	26.3
VAT (Local)	28.9	15.7	11.4
Supplementary Duty (Local)	27.8	21.5	16.0
Income Tax	32.4	21.4	24.9
Others	25.9	25.0	21.5
<b>Grand Total (NBR)</b>	<b>27.2</b>	<b>16.2</b>	<b>15.2</b>

Source: NBR

While NBR tax collection at the import stage has been quite impressive so far, this growth may suffer in the coming months as can be predicted from the recent slowdown in imports. As against 41.8 per cent growth in imports in FY2010-11, only 16.5 per cent growth has been recorded during the first two months of FY2011-12 over the corresponding period of the previous month. Thus, it will be a matter of great interest to observe whether NBR continues to provide additional revenue to underwrite the government's increasing expenditure needs.

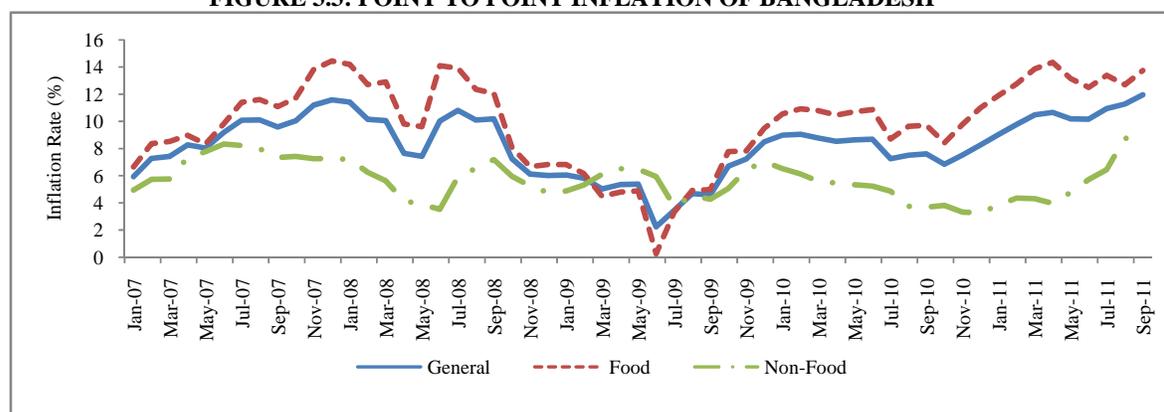
In fine, streamlining of public finance management has become an immediate priority so as to protect medium term growth prospect.

### 3.3 Unabated Price Inflation

#### Inflationary trends

Inflation appears to have emerged as a permanent phenomenon in the economic landscape of Bangladesh over the recent past. It has started to increase since the second quarter of FY2009-10 and continued to rise throughout FY2009-10 and FY2010-11. During the first three months of FY2011-12 there has not been any change in the direction of inflationary movements. The 12-month point to point consumer price index (CPI) inflation has reached as high as 11.97 per cent in September 2011 compared to 7.61 per cent in September 2010. This is the highest inflation in last one decade. As in most years, food inflation was higher than general inflation. Food inflation reached to 13.75 per cent in September 2011 as opposed to 9.72 per cent in September 2010 (Figure 3.3). High food inflation had a knock on effect on non-food inflation as well, pushing it upward to settle at 8.77 per cent in September 2011 from as low as 3.69 per cent in September 2010. This reflects that prices of food and non-food items tend to move along the same direction, though at a different pace. Another feature of recent inflation in Bangladesh is that rural food inflation has been closer to urban food inflation which was not the case in Bangladesh till August 2010. The likely causes for high rural inflation could be increasing demand due to higher purchasing power of the rural population through rising agricultural production, higher labour wages, expanded social safety net programme and inflow of remittances. If compared with other South Asian countries Bangladesh stands second, next to Pakistan, in terms of the record of inflation rate in the region. Despite higher food price in the international market, India has been able to keep its food price index down through higher production of major crops and by ensuring adequate supply in the domestic market. Pakistan epitomises the case of a conflict economy with a high inflation rate and a very low growth rate.

**FIGURE 3.3: POINT TO POINT INFLATION OF BANGLADESH**



Source: Bangladesh Bureau of Statistics (BBS).

### Underlying causes of high inflation

A widely discussed plausible cause of high inflation in Bangladesh is the impact of global price hike. As a food and petroleum importing country, Bangladesh has to bear the brunt of global price hike of these items. Since the beginning of the current decade and up to 2008 global prices of fuel and food followed an increasing trend which got transmitted into the country's domestic economy. There has been some respite from high inflationary pressure towards the end of 2008 and 2009 due to the global meltdown and the resultant price fall of major commodities in the global market. With the turn round of the global economy from the recession towards the end of 2009 and beginning of 2010, inflation started to shoot up. This trend was also observed in Bangladesh.

The other major source of high inflation in Bangladesh is high food inflation. The reason behind this assumption is that food carries a large weight in the CPI of Bangladesh. The weight of food items in the CPI commodity basket of Bangladesh is as high as 58.8 per cent, of which the share of rice is 20.1 per cent. Hence the rise in food inflation affects the overall inflation significantly. Based on BBS data, it has been estimated that the contribution of rice inflation to the overall inflation was 23.41 per cent in FY 2011-12 (Table 3.8).

**TABLE 3.8: CONTRIBUTION OF FOOD AND NON-FOOD ITEMS TO GENERAL CPI INFLATION**

Year	General Inflation	Food Inflation	Non Food Inflation	Food Contribution in Inflation	Rice Contribution in Inflation	Non Food Contribution in Inflation
FY2000-01	1.94	1.38	3.04	41.86	14.30	58.14
FY2001-02	2.79	1.63	4.61	34.38	11.74	65.62
FY2002-03	4.38	3.46	5.66	46.48	15.88	53.52
FY2003-04	5.83	6.93	4.37	69.94	23.89	30.06
FY2004-05	6.49	7.90	4.33	71.62	24.47	28.38
FY2005-06	7.16	7.76	6.40	63.77	21.78	36.23
FY2006-07	7.20	8.11	5.90	66.28	22.64	33.72
FY2007-08	9.94	12.28	6.32	72.69	24.83	27.31
FY2008-09	6.66	7.19	5.91	63.52	21.70	36.48
FY2009-10	7.31	8.53	5.45	68.66	23.45	31.34
FY2010-11	8.79	11.33	4.15	75.85	25.91	24.15
FY2011-12*	11.41	13.28	8.00	68.52	23.41	31.48

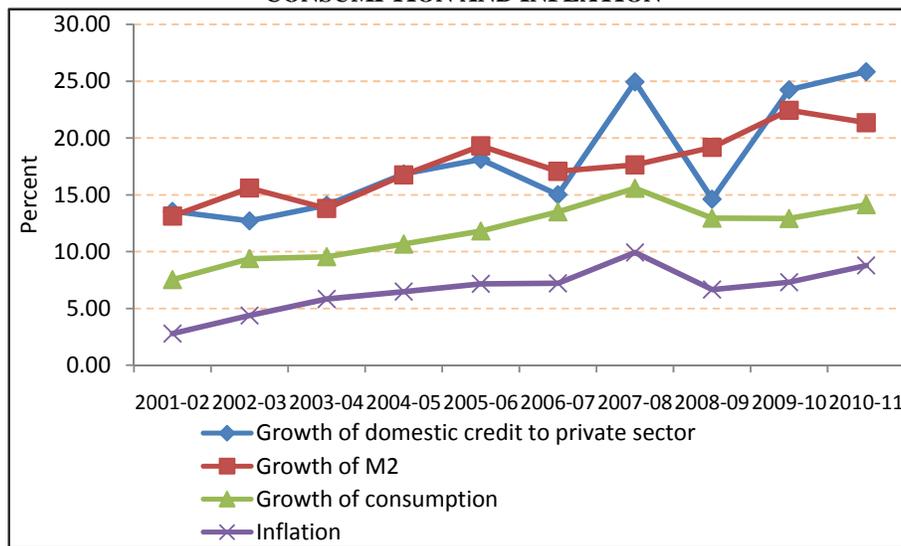
\*Up to September 2011.

**Note:** Base: 1995-96=100. Weight: General =100; Food = 58.84, Rice = 20.1; Non-food = 41.16. Contribution of food/rice/non-food is calculated as the share (weight) of food/rice/non-food in general CPI multiplied by food/rice/non-food inflation divided by overall inflation rate.

**Source:** Based on Bangladesh Bank data.

Growth in money supply is considered to be another contributing factor of high inflation in Bangladesh. An examination of the trends of these factors during the last 10 years reveals that the relationship between growth in money supply and inflation has not been unidirectional all along. Though they moved along the same direction over the major part of the period between 2001 and 2011, no causal relationship could be established between growth of money supply and inflation in the short run (Figure 3.4). However, in the long run a positive relationship is observed between these two variables (CPD 2010). The other two possible sources of high inflation could be growth in credit to the private sector and growth in consumption. As in the case of money supply these two factors do not follow the same growth path as inflation in the short period.

**FIGURE 3.4: GROWTH MONEY SUPPLY, CREDIT TO PRIVATE SECTOR, CONSUMPTION AND INFLATION**



Source: BBS and Bangladesh Bank.

### Food scenario: production, procurement and prices

Food production during FY2011-12 is projected to increase by 3.5 per cent, of which the growth of rice will be 3.6 per cent. This year procurement of boro rice by the government reached 8.12 lakh metric tonnes (MT) (during 05 June to 29 October 2011) exceeding the target of 6 lakh MT. Till 29 October 2011 storage of foodgrain was 15.18 lakh MT which is 97 per cent higher than that of the last year. There was a focus on public import of foodgrain instead of relying solely on private import. In FY2010-11, the share of foodgrain import by the government was approximately 41 per cent.

Prices of essential commodities have been on the rise since 2008 and the rice market in Bangladesh continues to remain volatile. However, the retail price of coarse rice in local market has shown a declining trend and has reached Tk 30-32/kg at present compared to Tk.35.3/kg in January 2011 and Tk 34.57/kg in April 2008. However, this is still higher than that of the recent past. In fact, since November 2009, rice prices started to decline and reached the lowest level at Tk20.42/kg in April 2010. Between July-May of FY08 and July-May of FY11 rice price increased by 23 per cent in the local market. However, prices crossed Tk30/kg again in July 2010 and the trend has persisted till now.

## Policy initiatives

### *Monetary measures*

In its Monetary Policy Statement (MPS) for the period July to December FY11, Bangladesh Bank targeted for an inflation rate of 7.0 per cent by the end of FY11 primarily through discouraging credit flow to unproductive sectors (Table 3.9). At the time of the announcement of the MPS, monetary aggregates were already on increasing trends. In a move to control diversions and unproductive use of funds Bangladesh Bank has been using its monetary policy tools more frequently in recent times than before. The Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) were increased twice, and rates of repo and reverse repo have been raised thrice in the last fiscal year. To discourage loans to unproductive sectors and to control inflation, Bangladesh Bank has also withdrawn the lending cap for most sectors. These moves were not immediately effective in controlling liquidity expansion due to delayed response on the part of the Central Bank. However, there has been a moderate decline of broad money and credit to the private sector in September 2011 as a result of restraining monetary policy stance of Bangladesh Bank. The growth of credit to the public sector has, however, been significantly high between September 2010 and September 2011. Increased borrowing by the government from domestic sources has contributed to continuing high inflationary trend notwithstanding reduction in money supply.

**TABLE 3.9: MONETARY POLICY STANCE OF THE BANGLADESH BANK**

Period	Monetary Policy Stance
Jan-Jun 2009	<b>Accommodative;</b> priority is given to providing credit support for creation and expansion of output capacities rather than for stoking of demand pressures.
Jul-Dec 2009	<b>Accommodative;</b> greater directional emphasis on the credit needs of sectors like agriculture and SME typically under-served by the market.
Jan-Jun 2010	<b>Accommodative;</b> special attention to programs pursuing fuller financial inclusion of the economic activity segments (including agriculture and SMEs) and population segments under-served by the markets, towards fostering inclusiveness of economic growth.
Jul-Dec 2010	<b>Accommodative;</b> special attention to financial inclusion of agriculture, SMEs, renewable
Jan-Jun 2011	<b>Accommodative;</b> in support of the government's goals of faster inclusive economic growth and poverty reduction besides maintaining monetary and price stability.
Jul-Dec 2011	<b>Restraining;</b> in the context of unfolding near term development and ensuring adequate credit flows.

Source: Monetary Policy Statement, Bangladesh Bank.

**TABLE 3.10: SELECTED MONETARY INDICATORS**

(In Million Taka)

Indicator	FY2010-11	FY2011-12	% Change Sept'11 over Sept'10	% Change Sept'10 over Sept'09
Domestic Credit	3,564,987(Sept'10)	4,499,301 (Sept'11)	26.21	20.33
Credit to Public Sector	692,561 (Sept'10)	995,551 (Sept'11)	43.75	-0.28
Credit to Private Sector	2872,426 (Sept'10)	3,503,750 (Sept'11)	21.98	26.65
Broad Money	3,790,956 (Sept'10)	4,533,976 (Sept'11)	19.60	21.48
Reserve Money	824,220 (Sept'10)	970,139 (Sept'11)	17.70	10.48

Source: Bangladesh Bank.

### *Fiscal measures*

Major fiscal policy of the government towards addressing the high inflation rate and ensuring food security has been reduction of import duty on rice and wheat, provision of credit to food importers at subsidized rates, cash transfer, allocation of funds to increase supply and

expansion of the operation of public food distribution system (PFDS). Total distribution under the PFDS has increased due to the higher level of distribution under priced channels, even though distribution under non-priced channels has decreased sharply. Distribution through priced channels has observed a significant rise due to government's intensive open market sale (OMS) and Fair Price drive. The government is also distributing food grain among the fourth-class government employees since February 2011. Foodgrain distribution is taking place among the Fair Price Card holders across the country through which each card holder can purchase up to 20 kilograms of foodgrain at a cheaper rate. During the period July to 20 October 2011 distribution of food grains amounted to 4.2 lakh MT which is reportedly an increase of 30 per cent compared to what was in the last year during the same period. During the last 3 fiscal years about 30 per cent of total budget for the social safety net (SSN) programmes has been allocated for food security (Table 3.11).

**TABLE 3.11: FOOD SECURITY BUDGET AS A PERCENTAGE OF TOTAL SAFETY NET BUDGET**

	Budget FY(2009-10)	Budget FY2010-11	Budget FY2011-12
Budget on Food security	5877.81	5726.25	7102.57
Total safety net budget	17327.33	19496.99	22556.05
Food security as % of total safety net	34	29	31

**Source:** Ministry of Finance (MoF).

There is no denying that PFDS has eased the pressure of high inflation on the low income households. However, given the large number of people living below the poverty line, and the limited nature of the effort of the government which is concentrated mostly within the periphery of urban centres, it is likely that significant numbers of the poor people remain outside the coverage of PFDS. While efforts are needed to expand programmes to ensure food security, preemptive and decisive monetary policy should also be in place to rein the high inflation in. In view of the slower growth of money supply in the recent period compared to the last fiscal, the effectiveness of the contractionary monetary policy adopted by the Central Bank has been proved. This, however, is not a panacea to contain inflation, particularly in the medium term as the demand for domestic investment by the private sector remains high and constraints to access credit will further affect the investment scenario which in turn will have adverse consequences for the overall growth of the economy. Monetary policy will also have to be coordinated with effective fiscal management (details in Section on Public Finance) if Bangladesh is to reduce the current inflationary pressure.

### 3.4 Increasing Pressures on the External Balance

#### Signs of Strains in Traditional Dependable Export Destinations

The extraordinary high export growth observed in FY2010-11 had started to slow down in the first quarter of FY2011-12, though the pace of growth is ahead of the target set for the current fiscal year. During the first three months of FY2011-12, total export earnings registered a 22.6 per cent growth (Table 3.12), which was impressive considering that this growth was attained over the aforesaid high benchmark.<sup>15</sup> A decomposition of export performance for the first quarter of FY2011-12 reveals that export growth of the dominant RMG sector was outpaced by that of non-RMG sector: RMG export increased by 21.2 per cent<sup>16</sup> while for non-RMG export the rate of growth was 27.6 per cent.

<sup>15</sup> During the first three months of FY2010-11, total export posted a 30.0 per cent growth.

<sup>16</sup> This was 31.0 per cent during first quarter of FY2010-11.

**TABLE 3.12: EXPORT PERFORMANCE**

Product	Growth Target for FY2011-12	Growth in FY2011-12 (Jul-Sep)	Growth in FY2010-11 (Jul-Sep)	Required growth for rest of the year to attain export target
<b>RMG</b>	<b>13.7</b>	<b>21.2</b>	<b>31.0</b>	<b>11.5</b>
Knit	13.9	18.3	31.9	12.6
Woven	13.4	24.8	30.0	10.3
<b>Non RMG</b>	<b>22.5</b>	<b>27.6</b>	<b>26.1</b>	<b>21.1</b>
Raw Jute	30.0	18.7	53.8	32.1
Leather	10.0	20.0	42.2	7.2
<b>Total</b>	<b>15.6</b>	<b>22.6</b>	<b>30.0</b>	<b>13.6</b>

Source: Estimated from the Export Promotion Bureau (EPB) data.

In the first quarter of FY2011-12, some progress was observed in case of export market diversification. Export earnings from new markets (other than US, EU and Canada) increased significantly<sup>17</sup>, by 36.0 per cent over the corresponding figure for last year. Over the same period, export to EU and Canada increased by 28.8 per cent and 16.4 per cent, respectively. Germany, United Kingdom, France, Spain, Italy, Belgium and Netherlands remained the major export destinations in EU27. In spite of the crisis engulfing the Eurozone, significant export growth was attained in such crisis-impacted economies as Spain (48.3 per cent) and Italy (47.4 per cent).<sup>18</sup> The revised rules of origin (RoO) under the EU GSP scheme may have contributed to this export boost in the EU, particularly favouring export of woven wear. Significant rise in exports to India, from USD 92.0 million to USD 143.1 million, may have originated from effective utilisation of the tariff rate quota (TRQ) of 10 million pieces.<sup>19</sup> Recently, India has downsized its sensitive list for LDCs under SAFTA granting duty-free import of 46 items of which 45 are RMG. Bangladesh's global export of these 45 products accounted for 87.5 per cent of her total RMG export and 68.5 per cent of its total export. Hence, given Bangladesh's competitiveness in export of these 45 items globally, Bangladesh may be able to harness benefit by exporting these items to India.

On the other hand, in 2010, Turkey imposed a countervailing duty of 17.0 per cent on imports from LDCs. During the first quarter of FY2011-12, Bangladesh's export to Turkey decreased by (-)0.4 per cent. Given the fact that Turkey is the fourth largest export destination for Bangladeshi products, there is a need for renewed attention to this particularly important export destination. It is important to note that, export to US, the second largest export destination for Bangladeshi products, decreased by (-)1.7 per cent during the first three months of FY2011-12 when export of RMG declined by (-)0.8 per cent<sup>20</sup> and that of non-RMG declined by (-)12.4 per cent<sup>21</sup>.

<sup>17</sup> During the first quarter of FY2011-12, total export to Japan increased by 72.1 per cent, India by 55.5 per cent, Australia by 56.6 per cent and China by 94.0 per cent.

<sup>18</sup> Export to Ireland and Portugal also increased by 16.6 per cent and 17.6 per cent respectively in first quarter of FY2011-12. However, export to Greece, the country in most fragile situation, declined by (-)0.6 per cent.

<sup>19</sup> In 2010, India enhanced the duty-free TRQ from 8 million pieces to 10 million pieces for Bangladesh.

<sup>20</sup> Export of knitwear declined by -16.8 per cent and export of woven wear increased by 6.0 per cent.

<sup>21</sup> Despite the fact that growth of global RMG import by US in the current year is somewhat lower than that of the previous year, other competitors of Bangladesh in the US market have performed much better in knitwear export. Total RMG import by US increased by 9.2 per cent during July-August FY2011-12 which was 17.8 per cent during the same period of the previous year (Annex Table 1). During July-August 2011, Bangladesh's growth in knitwear export was 0.6 per cent whereas Cambodia and Sri Lanka attained 20.8 per cent and 30.5 per cent growth during the same period. Even China, India, Pakistan and Vietnam managed to attain double digit growths. However, regarding export of woven wear, Bangladesh has performed much better than other exporters in the US market.

It is notable that September export performance is transmitting some disquieting signals. Month-on-month analysis shows that in September FY2011-12, RMG export declined by (-) 6.6 per cent; indeed, export of knitwear decreased by (-)12.3 per cent (Table 3.13). As a result, growth of export earnings in September 2011 was a mere 2.4 per cent. RMG export to US was particularly bad in September 2011, declining by (-)17.0 per cent; export of knitwear declined by (-)37.4 per cent.<sup>22</sup> As a matter of fact, Bangladesh's global export of knitwear for the month of September 2011 had declined in EU, her traditional market, as well as to the rest of the world. Such gloomy situation in RMG export (particularly knitwear) might have originated from lower price of cotton<sup>23</sup> which has reduced the price of garment products (particularly knitwear) in all important markets. RMG export shock came at a time when uncertainty is looming as regards any speedy recovery of the global economy. At the same time new threats also evolved as India and Peru moved away from their position against Pakistan's claim for duty-free access to the EU under special consideration as part of the EU-GSP scheme.<sup>24</sup> Bangladesh needs to analyse the impacts of these developments taking place at the global level and formulate appropriate strategies to deal with attendant concerns.

**TABLE 3.13: BANGLADESH'S EXPORT GROWTH**

Products	World		US		EU		Rest of the World	
	FY12 (Jul-Sep)	FY12 (Sep)	FY12 (Jul-Sep)	FY12 (Sep)	FY12 (Jul-Sep)	FY12 (Sep)	FY12 (Jul-Sep)	FY12 (Sep)
<b>Total Export</b>	<b>22.6</b>	<b>2.4</b>	<b>-1.7</b>	<b>-15.0</b>	<b>29.8</b>	<b>2.8</b>	<b>32.4</b>	<b>17.5</b>
<b>RMG</b>	<b>21.2</b>	<b>-6.6</b>	<b>-0.8</b>	<b>-17.0</b>	<b>30.0</b>	<b>-0.9</b>	<b>30.7</b>	<b>-5.9</b>
Knit	18.3	-12.3	-16.8	-37.4	25.7	-4.1	20.3	-21.1
Woven	24.8	0.5	6.0	-8.4	39.2	6.4	42.8	14.0
<b>Non-RMG</b>	<b>27.6</b>	<b>30.1</b>	<b>-12.4</b>	<b>6.6</b>	<b>28.2</b>	<b>24.6</b>	<b>34.1</b>	<b>35.8</b>

Source: Estimated from the Export Promotion Bureau (EPB) data.

### High growth of Import payments inevitable

While the export earnings started to peak, demand for raw materials, capital machineries and fuel rose dramatically resulting in higher growth of import (41.9 per cent) in FY2010-11. The high import growth overshadowed the robust export sector performance resulting in a deterioration of the trade balance. This also put the BoP situation under pressure. However, during the first two months of FY2011-12, import growth somewhat slowed down to 16.5 per cent while imports of food grains, petroleum products and raw cotton saw a decrease (Annex Table 2). Major share of the food grains import was carried out by the government.<sup>25</sup> With public food grains procurement running well, in line with the target<sup>26</sup> and promising outlook for the food grains production, it may be assumed that in the coming months, import of food

<sup>22</sup> Total export to US declined by (-)15.0 per cent.

<sup>23</sup> International price of cotton is declining since March 2011. In last six months, it declined by 49.1 per cent.

<sup>24</sup> Recently, according to a plea made by Pakistan, EU proposed for waiving tariff on 75 products originating from Pakistan. Eight out of these 75 items will be subjected to TRQ for 2 years; the rest 67 items were proposed to be exempted from any customs duty. A number of countries including India and Peru lodged official objections at the World Trade Organization (WTO) against the EU, opposing the waiver proposal. If Bangladesh's export to EU for those 75 products is considered, only 2 out of the top 10 are found to be protected by the TRQ. In view of this, Bangladesh proposed another list of 8 tariff lines for exclusion from the EU proposed list for Pakistan or at least considering quota limits. Subsequently, EU proposed to add 5 more items in addition to the already included 8 tariff lines to the list of products under TRQ. This newly proposed list of 13 tariff lines under TRQ now covers 6 of the proposed 8 Bangladeshi export items.

<sup>25</sup> As of October 20, 2011, Bangladesh had imported 373.4 thousand MT of rice, 92 per cent by the Government.

<sup>26</sup> As of October 20, 2011, 800.26 thousand MT of Boro rice had been procured and 810.14 thousand MT contracted. The achieved procurement represents 97.8 per cent of the target, compared to a 46.9 per cent achievement of the target last year at the same time.

grains is not likely to see a sharp upturn. Opening of import L/Cs for food grains also shows similar pattern.<sup>27</sup> Import of fertilizer increased by 76.5 per cent; however, this growth was mainly driven by higher international price of fertilizer.<sup>28</sup> On the other hand, declining import growth of petroleum products is likely to increase in future as L/Cs opening for petroleum increased by 107.3 per cent in the first quarter of FY2011-12.<sup>29</sup> It also needs to be noted that four liquid fuel-based (quick) rental power plants come into production in the course of the current fiscal year, which is likely to significantly increase the demand for imported petroleum.<sup>30</sup>

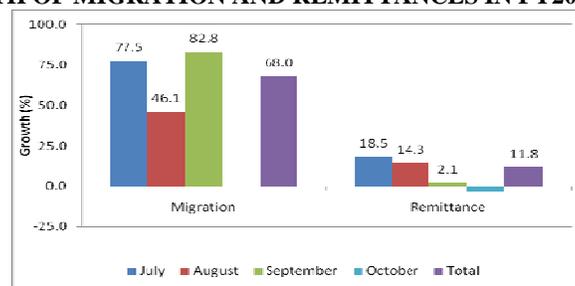
Import of capital machineries increased by 36.4 per cent during the first two months of FY2011-12 mostly due to higher demand from new power plants. Nevertheless, import L/Cs opened for capital machineries decreased by (-)37.3 per cent in the first quarter of FY2011-12, indicating a possible stagnation of the investment sector in the coming months. Import of intermediate goods such as yarn and textiles and articles thereof also increased over the same period of FY2011-12.<sup>31</sup>

To maintain import growth within the target of 14.0 per cent for FY2011-12, growth of import in next 10 months of fiscal year needs to slow down further to 13.5 per cent. As it stands, it will be difficult to contain import growth within the target set for FY2011-12.

### Overseas Employment Picks up but Remittances Slowdown

Remittance inflow during the first four months of the current fiscal stood at about USD 4.0 billion (Tk. 30,064 crore) which was 12.0 per cent higher than that of the comparable period of the previous fiscal.<sup>32</sup> Average monthly flow of remittances during the second half of FY2010-11 was USD 1.0 billion, which was maintained in the current fiscal year. In October, remittance inflow increased by 12.8 per cent. Growth of remittance inflow in the coming eight months of the fiscal year will need to be maintained over robust performance achieved during second half of FY2010-11. Thus maintaining growth performance of remittance inflow would be required to achieve the target. To achieve the projected target of USD 12.7 billion for the current fiscal, inward remittances will need to register an average growth of 7.7 per cent during the remaining eight months of FY2011-12.

**FIGURE 3.5: GROWTH OF MIGRATION AND REMITTANCES IN FY2011-12 OVER FY2010-11**



Source: Estimated from Bangladesh Bank and BMET data.

<sup>27</sup> Opening of import L/Cs for food grains declined by 62.7 per cent during the first three months of FY2011-12.

<sup>28</sup> International price of urea fertilizer increased by 60 per cent between September 2010 to September 2011.

<sup>29</sup> Interview with concerned officials hinted that at present a number of vessels with imported petroleum are ready to offload.

<sup>30</sup> BPC projected that oil import bill for FY2011-12 may reach to USD 6.3 billion.

<sup>31</sup> New relaxed RoO in EU GSP partially explains higher demand of imported yarn.

<sup>32</sup> In BDT terms, the growth of remittances is higher at 20.3 per cent, thanks to accelerated depreciation of BDT against USD.

The number of migrant workers going abroad during the first quarter of FY2011-12 was about 150 thousand, which was about 68 per cent higher than that of the comparable period of the previous fiscal. On average, 50 thousand people have gone overseas in the first three months indicating a positive start for the current fiscal, a trend which has been missing since FY2008-09. Number of migrant workers from Bangladesh has increased in countries such as United Arab Emirates (UAE), Oman, Singapore, Saudi Arabia (KSA) and Jordan.<sup>33</sup> During July-September period of FY2011-12 about 80 per cent of Bangladeshi migrant workers went to the first three of abovementioned countries. It is assumed that it takes three to four months for a migrant worker to get settled in the host countries; presumably, the remittance inflow is not likely to increase till the last quarter of fiscal year. Hence, the remittance target for the current fiscal year also appears to be uncertain, even though in the medium term this is likely to bring positive results for Bangladesh.

According to the World Bank, remittance inflow in the developing world is likely to increase in 2012 and 2013, in a more sustainable way, compared to the period prior to the global financial crisis, with an annual projected growth of 7.4 and 7.9 per cent respectively.<sup>34</sup> In case of Bangladesh, if the current situation persists, and no other external shock effects overseas employment, remittance growth is likely to be more than 10 per cent in FY2011-12 compared to FY2010-11.

It is good to note that the cost of sending remittances from KSA and Singapore has declined by 12.7 and 3.9 per cent respectively in the third quarter of calendar year 2011 compared to the first quarter of same calendar year. According to the World Bank, cost of sending remittances has been declining for South Asian countries like Bangladesh and Nepal owing to greater competition. However, anecdotal information suggests that due to higher spread between official and kerb market figures, sending of remittances to Bangladesh through *hundi* or *hawala* appears to have substantially increased in recent times. This needs further investigation and calls for an immediate policy attention.

### **No Promise Coming from Foreign Aid Front**

Slowdown in foreign aid inflow has been a major concern for Bangladesh in FY2010-11. The trend continues this year as well. Since project aid is the overwhelmingly large component of foreign aid, its inflow is now directly linked to ADP implementation capacity. Availability of project aid should not be the main concern<sup>35</sup>. During the first quarter, inflow of net foreign aid was only USD 74.4 million, whereas it was USD 173.0 million in the comparable period of the previous fiscal year. It appears that achieving the ambitious budget target of net foreign aid inflow to the tune of USD 2.5 billion will remain a far cry. Recently it has been proposed that the World Bank, the planning ministry and the concerned ministry should sit together every three months to resolve contentious issues related to project implementation. On the other hand, government has urged the World Bank officials to negotiate with its headquarter so that their local offices could get more power to expedite decision. At the same time, the latest indications suggest that USD 1.0 billion budgetary support from World Bank is not

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<sup>33</sup> Government to government initiative between Bangladesh and Jordan has facilitated migration of workers at a reduce cost of Tk. 10,000, which was previously Tk. 110,000. Heavy recruiting of female workers for RMG sector in Jordan (along with Mauritius) has been a major contributing factor.

<sup>34</sup> The corresponding growth figures for South Asia are estimated to be lower at 5.8 and 6.5 per cent respectively, reported due to slowdown in remittance inflow to India and Pakistan. For Bangladesh, outlook is more promising.

<sup>35</sup> It is estimated that foreign aid to the tune of USD 13.5 billion is awaiting in the pipeline.

likely to be finalised in the current fiscal year. The ongoing debacle over financing of the *Padma Multipurpose Bridge Project* is also likely to have an adverse impact in terms of foreign aid inflow to Bangladesh. For Only 10 per cent of total planned expenditure for the *Padma Bridge* (Tk. 20,507 crore) was actually earmarked for FY2011-12. However, project aid component of the Bridge accounted for 38.7 per cent of the total project aid planned for the transport sector and 9.1 per cent of total project aid in ADP for FY2011-12. With uncertainty looming over the project's future, one may speculate that foreign aid inflow for the *Padma* bridge project may not be realized any time soon. Overall, it can be hardly expected that the BoP situation is not likely to get any respite with the help of its foreign aid component in FY2011-12.

### **Pressure on Balance of Payments Likely to Sustain**

FY2010-11 ended with a negative overall balance and it was apprehended that this pressure would continue during FY2011-12. Monetary Policy Statement (July-December, 2011) of Bangladesh Bank projected even a wider deficit of trade balance for FY2011-12 coupled with low remittance growth. As a result, the statement projected deficits in the current account balance and also overall balance (of (-) USD 884 million and (-) USD 439 million respectively). To contrast, the Sixth Five Year Plan (SFYP), prepared earlier, had forecasted a strong surplus in overall balance of payments (USD 902.3 million) anticipating higher inflow of FDI and foreign aid.<sup>36</sup>

In FY2011-12 (July-August), a low import growth had restrained, the trade balance at (-) USD 409 million. This, along with the increasing pace of remittance inflow helped to attain a current account balance surplus of USD 1194 million (which was USD 625 million during the comparable months of FY2010-11). Negative balance in financial account continued, owing to a large extent, to the lower net inflow of foreign aid. Net foreign direct investment (FDI) inflow registered promising growth of 66.4 per cent during the first two months of FY2011-12 but its volume was inadequate to restrain deterioration of financial account balance<sup>37</sup>. Overall balance managed to maintain positive balance, for now, at USD 89 million. The government has once again sought for faster realization of proposed IMF support to the tune of USD 1.0 billion for three years under the Extended Credit Facility (ECF) to tackle the apprehended uncomfortable BoP situation.<sup>38</sup> However, without acceleration in foreign aid utilization, improvement in BoP situation can hardly be expected at this moment.

### **Weakened BDT May Fall Further**

Growing balance of payments pressure got transmitted into depreciating exchange rate during last fiscal year. The exchange rate of BDT against USD has been going down further and at a faster rate in recent months. Additionally, exchange rate management has become more difficult due to volatility in international exchange rate markets. BDT was appreciating

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<sup>36</sup> SFYP projected a trade balance of (-) USD 9,699.9 million and current account balance of (-) USD 192.1 million. The SFYP however looks forward to improve the balance of payments position by reducing deficit in trade balance through slashing dependence on imports and promoting export along with higher inflow of remittances.

<sup>37</sup> During July-August period of FY2011-12, net FDI inflow increased to USD 188 million which was USD 113 million in the corresponding period of the previous fiscal year.

<sup>38</sup> Government is expected to ask for a mission from the fund to discuss the credit agreements soon. One may recall that the credit was tagged with a number of conditionalities by IMF including rationalization of petroleum price. A number of these are already implemented by Bangladesh.

against Euro between July-September 2011 period. However, in view of Euro's strengthening in October, BDT experienced marginal depreciation in October 2011. With a more acceptable agreement on debt crisis by EU leaders<sup>39</sup>, the value of Euro has become more stable at the end of October 2011. As of end October 2011, BDT depreciated against all major currencies<sup>40</sup> (USD, Euro, GBP and CNY) except for INR<sup>41</sup>. Depreciation of BDT would imply that export to US and EU will be benefited. However, greater depreciation against CNY would also mean costlier intermediate and capital goods imported from China.<sup>42</sup> Ceteris paribus, exporters may switch to importing raw materials from India (particularly for export of RMG products). Falling value of BDT put some pressure on prices of most of the imported consumer goods other than rice<sup>43</sup>. Accordingly, it may also create further strain on domestic price levels in the coming months. Currently, foreign exchange reserve is maintained at around USD 10.0 billion which is equivalent to 3.6 months of import payments. Hence, there is hardly any room to use forex reserve to contain BDT's value. The volatility in international foreign exchange market made foreign exchange policymaking only harder.

### **Higher Utilisation of Foreign Aid Holds the Key**

In the backdrop of falling growth of exports and remittances in September and lower levels of foreign aid disbursement in the first quarter, along with projected higher impacts in the coming months, the balance of payment is expected to remain under pressure in the coming months of FY2011-12. In this backdrop, BDT may witness further depreciation towards the end of FY2011-12. In the short term, it appears that higher utilisation of foreign aid will be key to maintaining balance in the external sector.

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<sup>39</sup> On 26 October 2011, the EU leaders agreed to make a 50 per cent cut on the Greek debt. They also agreed to boost the European rescue fund (EFSF) from 440 billion Euros to 1 trillion Euros. The measures also included recapitalization of European banks and the IMF agreed to deploy its next installment of 2.2 billion Euro to Greece's original bailout.

<sup>40</sup> During last four months (between end of June to end of October) BDT lost its value vis-à-vis USD by 2.8 per cent, Euro by 0.8 per cent, GBP by 3.2 per cent and CAD by 0.5 per cent.

<sup>41</sup> Between end of June to end of October, BDT appreciated against INR by 6.6 per cent.

<sup>42</sup> China is the single largest source of imported capital machinery for Bangladesh.

<sup>43</sup> In Bangladesh, rice is generally imported from India. Prices of rice have also stabilized in international market in recent months.

#### 4. Growth Prospect and Current Challenges

The current fiscal year kicked off on a relatively strong growth platform, although a number of tensions were becoming evident in the economy since the second half of the elapsed year. In its pre-budget analysis of economy in June 2011, CPD identified a number of risks that loomed in the horizon as the country approached towards FY12. The four risks that CPD pointed at were (i) financing risk, (ii) macroeconomic balance risk, (iii) institutional risk, and (iv) political risk. Our above observations validate that these risks are becoming stronger as the economy is moving forward in FY12. Analyses presented in the foregoing sections suggest that Bangladesh economy from the initial months in FY12 has increasingly come under a complex set of stresses and strains emanating from multiple sources. Some of these growing pressures are manifestation of the structural problems of the economy, often aggravated by the nature of macroeconomic management; while some of the other pressure points are underpinned by adverse developments in the global economic environment. Under the circumstances, keeping the economy on a sustainable and inclusive growth trajectory and consolidating macroeconomic stability will be a very challenging task. Indeed, for Bangladesh economy, FY12 will be, on many counts, one of the relatively difficult years in the recent past.

How does the economic growth prospect for the year look like, based on the performance indicators of the first quarter of FY12? Early signals are not necessarily adequate predictors for overall economic growth for the full year. However, as the final GDP estimates for FY11 are awaited, a number of reasonable assumptions lead us to suggest that attaining the target growth rate of 7 per cent in FY12 will be quite difficult. Indeed, a number of international financial institutions have expressed similar view. The World Bank has maintained that it is “uncertain” that the target GDP growth rate for FY12 will be achieved, while the IMF has projected it to be 6.3 per cent. Nonetheless, it should not be missed that a 6 per cent plus growth rate is a pretty respectable figure given all the visible risks afflicting the Bangladesh economy.

What message does the present review send to the top policymakers of the country? Indeed, the first and foremost message is that the policymakers have to take into cognisance that the economy has entered a difficult period from the perspective of economic management. A denial syndrome will not help. This entails drawing up a transitional work programme and taking hard decisions. Given the electoral cycle, the government has little time in the margin to make mends before the next general election.

To operationalise the transitional work programme, the government would need to revisit at the earliest its targets for the current fiscal year relating to public finance. In fact, it should not wait till mid-year to produce the revised budget. Such a review of the public finance programme should identify a number of priorities, beyond the obvious ones.

While revising the budget, the government has to take note of the evolving trends in global economic recovery. Indeed, if a second dip actually takes place, the government has to be ready with a response plan. Admittedly, the government has much less fiscal space at this moment to finance counter-cyclical policies. This has been made more difficult by the prevailing high inflationary trend.

One of the overriding priorities should be to undertake all out efforts to increase the disbursement of the committed foreign aid, particularly for the on-going projects. Such an

approach will have multiple objectives including maintaining the growth momentum, reducing pressure on domestic borrowing and alleviating pressure on the balance of payment. Budget support or balance of payment support may be negotiated with the IFIs at reasonable terms. Foreign financing on commercial terms, even for high profile national projects, may be avoided for the time being.

The other equally high priority should be to reduce the demands on subsidy payments. In fact, the country's subsidy basket needs to be scrutinised closely from the perspectives of both efficiency and distributive justice. Whatsoever, the government needs to adjust upward, in a transparent phased manner, the prices of all types of liquid fuel. Same applies to electricity prices. To support the poorer sections of the population, including the farmers, the government may pursue targeted approach in a manner which is efficient and effective. As the subsidy burden has become fiscally unsustainable, rationalisation of prices of energy products will help strengthen the fiscal balance. The consequent cost escalation-driven possible inflation will be partly offset by reduced government borrowing from the banks; banks will then have more resources to finance productive investment.

The government's claim on funds in the banking system has to be moderated and kept within the programmed target. Given the very low level of sales of national saving instruments, the government should consider revising their yield rates and thus borrow from non-banking sources.

With a view to augment revenue intake, the government must concentrate on collections from non-tax sources as well as from non-NBR tax heads. The government also needs to remain vigilant regarding maintaining the robust performance of the NBR, particularly on the income tax front.

It has been mentioned by CPD on an earlier occasion that there is no "magic bullet" for combating inflation. It may be expected that currently imposed restraints on credit growth, particularly on credit to government, may eventually have some sobering impact on overall price situation. However, government will have to continue with public procurement of foodgrains, maintain adequate food stock, undertake open market operations when necessary and broaden safety net programmes to keep the food (rice) market stable. Nonetheless, inflation, particularly food inflation will continue to remain high in the remaining part of the current fiscal year. The creeping upward trend in non-food inflation may also gain momentum in the near-term.

As the export growth rate decelerates, efforts to diversify markets have to be intensified including by taking advantage of the recently announced trade concessions in the Indian market. Exploiting the new RoO in the EU, Bangladesh should also try to diversify its export basket.

In view of the slowdown of remittance growth, the government needs to take additional measures for market development and reduction of transaction cost of migration. The balance of payment situation may get some relief due to slowdown of imports. Higher disbursement of foreign aid, greater inflow of export revenue and remittance income by expatriate workers could alleviate the situation further.

The government will need to keep under watch two other issues (not discussed in the report), namely (i) the situation in the capital market and (ii) issuance of new bank licences.

Regarding the first, it needs to be pointed out that the current attempts to rejuvenate the market are based on a misperceived “liquidity approach”. The recent attempts to inject money into the market through launch of the “Bangladesh Fund” and “Stabilisation Fund” are going to yield little results. Indeed, such attempts and decisions like delayed adjustment of single borrower’s exposure limit are only going to further complicate the interface between the banking sector and the capital market. Although, there had been, in the recent times, some initiatives to reform the market regulation and management, none of these touched upon the basic issues relating to transparency and accountability including strengthening of the surveillance capacity of the body responsible for oversight, i.e. SEC. The demand for implementation of the recommendations of the Probe Committee has now become a far cry.

The other subject of issuance of new bank licences is also a debatable proposition. Arguably, there is hardly any need for new banks – what the banking sector needs is strengthened oversight relating to compliance of Basel III and possibly improvement of efficiency through competition and scaling up. Bangladesh Bank has drawn up a sound set of eligibility criteria for any new banks. If new licence(s) has/have to be awarded it should not be based on “political consideration”, but on rigorous fulfilment of the eligibility criteria. In view of the revealed attempts to relax those criteria, particularly the requirement relating to Tk. 400 crore tax paid sponsors’ fund, the Central Bank should remain committed to the criteria that it itself has set. Under all circumstances there should be full disclosure regarding the applications and the award, as and when made.

Under the fiscal transparency requirements, the Finance Minister in FY10 started the quarterly practice of reporting on the state of the economy to the Parliament. Curiously, the Minister has not introduced such reports to the Parliament during the last three quarters (two, if we exclude the Budget Speech). One may expect that the Minister will use his next reporting opportunity to deliberate on the package of measures that he thinks necessary to reboot the economic management for FY12.

## Annex Tables

**ANNEX TABLE 1: RMG IMPORT GROWTH OF US IN FY2011-12 (JULY-AUGUST)**

Exporters	Knitwear	Woven Wear	Total RMG
World	10.5	7.5	9.2
Bangladesh	0.6	26.4	18.5
Cambodia	20.8	4.8	15.8
China	9.4	0.1	4.8
India	8.7	11.5	10.2
Pakistan	11.0	11.1	11.0
Sri Lanka	30.5	4.2	15.4
Vietnam	10.3	11.8	11.0

Source: Estimated from USITC data.

**ANNEX TABLE 2: IMPORT GROWTH OF SELECTED COMMODITIES (%)**

Items	FY2010-11 (Jul- Aug)	FY2011-12 (Jul- Aug)
<b>A. Food Grains</b>	317.4	-19.0
Rice	7020.0	13.7
Wheat	104.9	-55.0
<b>B. Other Food Items</b>	104.3	34.8
<b>C. Consumer &amp; Intermediate Goods</b>	90.9	6.1
Crude petroleum	-	-30.1
POL	16.8	-5.9
Fertilizer	539.4	76.5
Raw cotton	67.6	-21.8
Yarn	89.9	25.7
Textile and articles thereof	50.5	11.1
<b>D. Capital Goods &amp; Others</b>	0.6	43.1
Capital machinery	21.8	36.4
<b>E. Others n.i.e.</b>	2435.6	9.1
<b>Total (A+B+C+D+E)</b>	132.5	17.0
<b>F. Import by EPZ</b>	78.0	7.6
<b>Grand Total (A+B+C+D+E+F)</b>	128.8	16.5

Source: Estimated from Bangladesh Bank data.