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**MACROECONOMIC MANAGEMENT IN THE FACE OF  
GLOBAL CHALLENGES**

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## **Abstract of the Report**

The global financial crisis has already started to have a negative impact on the increasingly globalising economy of Bangladesh. Export growth rate has slowed in recent times, particularly during October 2008 – January 2009 period – indeed, the second quarter of FY2008-09 (October-December 2008) experienced a first time negative growth of Bangladesh's export in recent history; export of non-apparels items has seen significant deceleration in growth. Depreciation of currencies by competing countries ranging from 6-30 per cent over the last one year and their stimulus packages that provide wide ranging incentives to export-oriented sectors, have led to erosion of Bangladesh's competitive strength in the global market in recent times. Remittance earnings, whilst robust till now, could be adversely affected in near future as number of job-seekers leaving in January and February 2009 has halved compared to the same period of last year, and some countries such as Malaysia have revoked earlier job-contracts and yet others have stopped (Saudi Arabia, UAE) issuing new visas. The resultant adverse affects are likely to have negative implications for GDP growth, labour market and consequently attainment of poverty alleviation targets and MDGs by Bangladesh. In view of falling commodity prices, import-dependent domestic revenue mobilisation has suffered in recent months. Proxy indicators such as industrial output, import of capital machineries, L/Cs opened for industrial raw materials and term loan disbursement, when taken together, allude to signs of weakening macroeconomic performance. In view of these emerging disquieting signals, it is argued in the paper that it will be both timely and appropriate for Bangladesh to design her own stimulus package. It is reckoned that in the context of the falling commodity prices in the global market and the resultant low subsidy burden on account of fertiliser and fuel, some fiscal space will be created in this year's budget which could provide additional resources for the stimulus package. This is a time to infuse confidence and inject cash into the economy. Policy makers may consider pursuing a moderately expansionary monetary policy to stimulate domestic investment, and domestic demand, providing fiscal incentives and stimuli to incentivise export-oriented sectors, and injecting cash to enhance coverage and deepen entitlement under the various safety-net programmes so that Bangladesh remains on track with regard to poverty alleviation and MDG attainment. The paper argues that such measures could be time-bound in nature but to be fine-tuned in response to the emerging scenario. Such a stimulus package could include sector-specific cash subsidy scheme, tariff rationalisation particularly for industrial inputs and capital machineries, setting up of a dedicated fund for credit disbursement at reduced rate, establishing a technology upgradation fund, compensation against export earnings, special package for exports to new markets, and a dedicated fund for skill upgradation of migrant workers.

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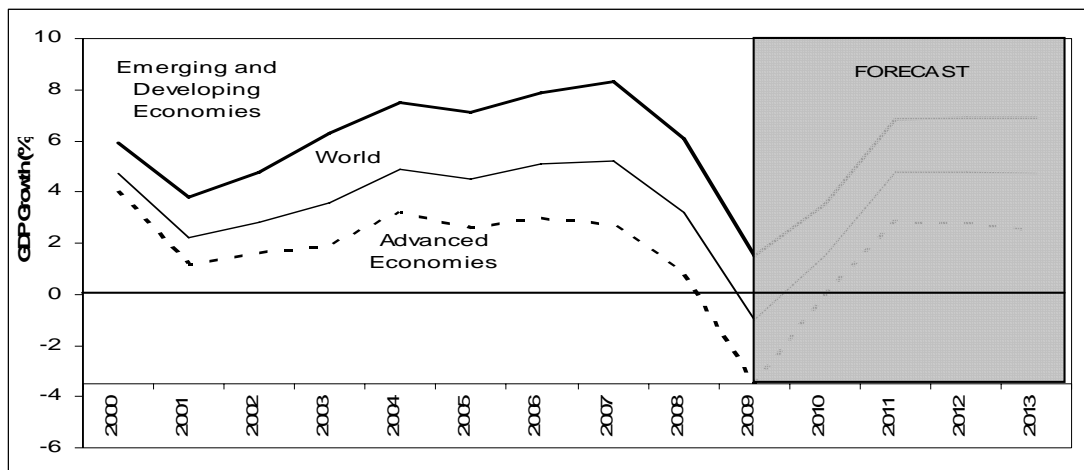
# 1. Introduction

## Nature of the Crisis

Developing countries, particularly low-income countries such as Bangladesh, in view of the adverse impacts and consequences of the ongoing global economic crisis, have been confronted with a number of critical challenges, particularly in the area of macroeconomic management. There is hardly any country which has been immune from a global shock of such wide and deep scale. Indeed, the scenario is still continuing to develop and unravel, requiring countries to design and adjust their strategies accordingly. All projections made by various sources give clear indication that the global economic meltdown, which started in 2008, is likely to continue and further deepen in 2009 (Table 1). The financial crisis which developed into liquidity and solvency crises has afflicted the real economy and has now degenerated into an economic crisis of global scale, hurting growth, job and income to varying degrees. Countries which did not feel the impact of the first shockwave originating from the financial crisis, are now coming to be adversely impacted by the second wave (through impact on credit) and third wave (through impact on consumer economy). IMF's analysis published in March, 2009 portrayed a bleak picture of global economic growth for 2009, with the situation improving only in the next year (-1.0 to -0.5 per cent in 2009 and 1.5 to 2.5 per cent in 2010).<sup>1</sup> Although the US and the Euro area, two major economies, registered lower but positive growth in 2008 (1.1 per cent and 0.9 per cent respectively), both were likely to experience negative growth in 2009 (-2.6 per cent and -3.2 per cent respectively), before they start to pick up in 2010.<sup>2</sup> It is to be noted that the US has registered a significant negative growth of (-) 6.2 per cent in the fourth quarter (Q4) of 2008.

Whether it is L, V or U shaped,<sup>3</sup> the downturns observed in the developed countries have started to progressively affect advanced and subsequently emerging, developing and low income economies as well (Figure 1). Economic growth of Middle-East countries was likely to be 3.9 per cent in 2009, about 2.2 per cent lower compared to that in 2008, mainly as a consequence of lower crude oil price, drying up of foreign capital and declining demand of the region's energy-intensive industrial and building materials.<sup>4</sup>

**Figure 1: Achieved and Forecasted Growth for the World, Advanced Economies and Emerging and Developing Economies**



Source: IMF, World Economic Outlook, various issues

<sup>1</sup> Indeed, a recent World Bank projection maintains that world economy will experience negative growth rate in 2009, for the first time since World War II.

<sup>2</sup> Within the EU, all major economies have registered low level of growth in 2008 and were likely to face negative growth in 2009: Germany (1.7 per cent and -0.80 per cent), the UK (0.8 per cent and -1.3 per cent), and Italy (-0.2 per cent and -0.6 per cent).

<sup>3</sup> Meaning whether it will be a prolonged recession, a recession that reaches the bottom line soon and the economy picks up or whether the recession runs for 1-2 years before the global economy sees an upturn.

<sup>4</sup> GCC Economics and Strategy Report for the fourth quarter of 2008. The report was released by leading Islamic investment bank Gulf Finance House (GFH).

**Table 1: Growth Projections for Major Economies**

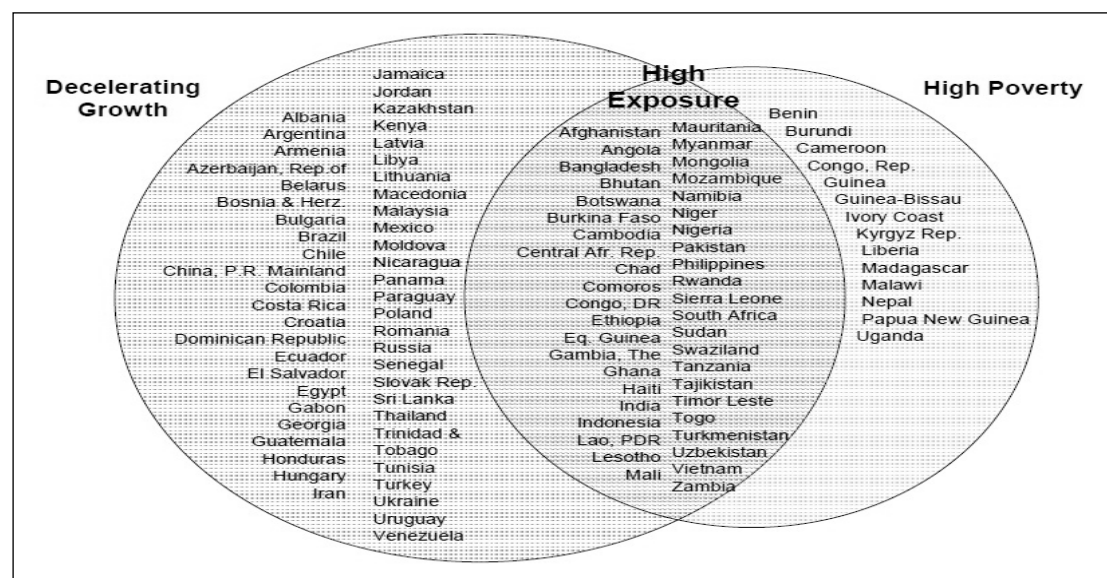
	Actual 2007	Actual 2008	January 2009 Report		March 2009 Analysis	
			2009	2010	2009	2010
<b>World Output</b>	5.2	3.4	0.5	3	-1.0 to -0.5	1.5 to 2.5
<b>US</b>	2	1.1	-1.6	1.6	-2.6	0.2
<b>Euro area</b>	2.6	1	-2	0.2	-3.2	0.1
<b>Germany</b>	2.5	1.3	-2.5	0.1	--	--
<b>France</b>	2.2	0.8	-1.9	0.7	--	--
<b>Italy</b>	1.5	-0.6	-2.1	-0.1	--	--
<b>UK</b>	3	0.7	-2.8	0.2	--	--
<b>Middle East</b>	6.4	6.1	3.9	4.7	--	--
<b>China</b>	13	9	6.7	8	--	--
<b>India</b>	9.3	7.3	5.1	6.5	--	--

Source: IMF, World Economic Outlook Updates

According to the January report, South East Asian major economies were expected to experience slower economic growth in 2009 compared to that in 2008: Malaysia (from 5.8 per cent in 2008 to 4.8 per cent in 2009), and Singapore (3.6 per cent to 3.5 per cent). Economic growth of China and India was also expected to decline in 2009 (to 6.7 per cent and 5.1 per cent respectively). LDCs are likely to experience a 5.1 per cent growth in 2009 against the 6.4 per cent attained in 2008<sup>5</sup>. Recovery was likely to start only in the second half of 2010, according to some projections; some analysts have projected that upturn would kick off only in early 2011, much of it depending on how the stimulus packages actually work on the ground.<sup>6</sup>

According to a recent policy note prepared by the World Bank, the global economic crisis is exposing households in virtually all developing countries to increased risk of poverty and hardship (Figure 2). Almost 40 percent of developing countries are highly exposed to the poverty effects of the crisis (with both declining growth rates and high poverty levels) and an additional 56 percent of countries are moderately exposed (these face either decelerating growth or high poverty levels), while only less than 10 percent face little risk.

**Figure 2: Exposed Countries**



Source: World Bank, 2009

<sup>5</sup> World Economic Situation and Prospects 2009, United Nations, 2009

<sup>6</sup> Professor Nuriel Rubini, one of the very few who saw it all coming and who predicted about an ensuing crisis back in 2006 (gaining him 'notoriety' as 'Mr Doomsday') predicts that the recession could as well be an 'L-shaped one' (meaning a prolonged recession) instead of an 'U-shaped one' (a quick recovery), depending on the efficacy of the bailout packages of developed countries to stimulate their economies.

It is to be noted that this particular report places Bangladesh in the group of countries that are highly exposed to the poverty effects of the crisis (with both declining growth rates and high poverty levels).<sup>7</sup>

Some of the general features of the ongoing economic crisis can be summarised in the following manner: (a) the crisis come on the back of sharp fall in commodity prices; (b) the crisis has evolved from financial crisis to credit contraction to crisis of confidence; (c) global financial markets continue to remain volatile; (d) global imbalances are unwinding in disorderly fashion, heightening the risk of exchange rate volatility; (e) unemployment is increasing worldwide at an alarming pace; (f) many countries have seen their fiscal position deteriorate significantly; (g) crisis-driven countries are trying to cope with the emergent situation through various fiscal-monetary measures and stimulus packages. Indeed, what started as a crisis in the sub-prime housing market in the US, soon took the shape of systemic failure.

### Bangladesh Context

As evidence indicate, Bangladesh economy has been increasingly integrated with the global economy over the recent past years, through trade, flow of remittances, and to some measure, flow of FDI and portfolio investment. Degree of openness of Bangladesh economy was about 43.4 per cent towards the end of FY2007-08,<sup>8</sup> with the extent of globalisation being equivalent to 56.6 per cent of GDP.<sup>9</sup> Net exports account for about 10 per cent of GDP and net export and remittance are equivalent to 20 per cent of GNI (Table 2). About 85 per cent of Bangladesh's exports are destined to developed economies and about 60 per cent of her imports are sourced from those countries. If India, China and other emerging economies are also taken into consideration, the extent of exposure of the Bangladesh economy to crisis-driven developed and developing economies will be quite significant.

**Table 2: Bangladesh's Degree of Openness and Extent of Globalisation**

	(million US\$)				
	FY 1981	FY1991	FY 2001	FY 2007	FY2008
1. Export (X)	725	1718	6467	12154	14088
2. Import (M)	1954	3472	9335	17157	20217
3. Remittance (R)	379	764	1882	5978	7915
4. ODA Disbursed	1146	1733	1369	1565	1873
5. FDI (net)	n.a.	24	550	793	650
Total (1-5)	4204.0	7710.5	19603.4	37646.3	44743.8
GDP (Current Price)	19811.6	30974.8	47306.0	67714.0	78996.9
Degree of Openness (Export + Import as % of GDP)	13.5	16.8	33.4	43.3	43.4
Extent of Globalisation	21.2	24.9	41.4	55.6	56.6

Source: CPD-IRBD Database

Consequently, it is to be expected that the increasingly globalising economy of Bangladesh will not be able to avoid being affected by the global crisis, through various transmission mechanisms. However, projections with regard to Bangladesh's GDP growth tend to vary (Table 3). Bangladesh Bank (BB), in its monetary policy statement of January-June, 2009, had earlier reconfirmed GDP projection made in the national budget for FY2008-09 (6.5 per cent growth), which was subsequently revised downward (6.0 per cent). The latest monetary statement mentions a high case of 6.6 per cent and a low case of 6.3 per cent. World Bank had come up with two alternate scenarios; under best case scenario Bangladesh GDP would grow by 5.4 per cent, while under worst case scenario GDP growth could come down to 4.8 per cent. ADB in its December, 2008 issue of Quarterly Economic Outlook on Bangladesh

<sup>7</sup> Based on 'The Global Economic Crisis: Assessing Vulnerability with a Poverty Lens' prepared by Cord, L. et al, World Bank, March 2009.

<sup>8</sup> Share of export and import in GDP.

<sup>9</sup> Share of all types of external flows in GDP.

projected the growth rate to range between 5.5 to 6.0 per cent. It may be pointed out that most of these projections were not based on real time data.

Admittedly, any slow-down of the Bangladesh economy is likely to have knock-on impact on resource mobilisation, poverty alleviation and employment creation. It is thus imperative to examine and investigate the performance of the various transmission channels (export, import, remittance, FDI, PFI and ODA) in order to understand their likely impact on growth prospects of the economy in 2009 and their possible social dimensions. It is to be further noted that crisis-driven countries are taking various proactive measures with the goal to address the adverse impact of the ongoing crisis. Accordingly, it is also important to evaluate and assess how policies of other countries, having market linkages with Bangladesh, are likely to impact on performance of her domestic economy in general and export-oriented sectors in particular. Possible consequence for domestic resource mobilisation is an area that merits close scrutiny.

In view of the above, it is vital to examine and analyse which policy stance Bangladesh should take in order to best accommodate the possible negative consequences of the crisis. This will likely pose formidable challenges in macroeconomic management. No doubt, how far Bangladesh will be able to cope with the possible adverse impact of the crisis will critically hinge on her ability to pursue appropriate fiscal, monetary and overall macroeconomic management policies in view of the emerging situation and challenges. At the same time, these policies are also important from the perspective of realising potential opportunities which could originate from the crisis.

**Table 3: GDP Growth Projections for Bangladesh for FY2008-09**

	GDP Growth (per cent)	
Bangladesh Bank (Monetary Policy Statement, H2)	6.5 (high case 6.6 per cent; low case 6.3 per cent)	
IMF <sup>1</sup>	5.6	
World Bank <sup>2</sup>	Scenario 1	Scenario 2
	5.4	4.8
Country Report, EIU <sup>3</sup>	5.5	
ADB <sup>4</sup>	Scenario 1	Scenario 2
	5.5	6.0

**Source:**<sup>1</sup>World Economic Outlook, IMF published in October 2008 (year ending December 31);<sup>2</sup>Media Briefing (Likely Implications of the Ongoing Global Financial Crisis for Bangladesh) by the World Bank November 26, 2008; <sup>3</sup>Economist Intelligence Unit (EIU), February 2009; <sup>4</sup>Quarterly Economic Outlook, December 2008

It is reckoned that with adverse implications of the global crisis for government revenues, as a consequence of falling commodity prices, and slowing down of economic activities, budgetary position of low income countries could be significantly weakened. Potential decline in donor support and tighter financing conditionalities could impose heightened pressure on budgets of these countries. Spending in support of social safety net programmes could go up and currency depreciation to enhance export competitiveness could raise debt servicing liabilities. In the face of restrained flow of aid from developed countries-in-crisis and binding fiscal constraints, there will be a need for renewed emphasis on rationalising spending and increasing the efficacy of resource allocation and use. This will be required to create the fiscal space for social protection programmes, poverty alleviation efforts and MDG attainment activities. Strengthened effort may be required for more domestic resource mobilisation in view of such scaled-up activities. Maintaining macroeconomic stability would be crucial. Declining inflationary pressure could help, as would flexible exchange rates that could act as shock-absorbers. Particularly, the health of domestic financial institutions will need to be carefully monitored for any signs of gathering weakness, and if this be the case, the need for the situation to be addressed through quick proactive interventions.

In other words, the possible adverse impact of the ongoing crisis will require sound macroeconomic management on the part of economies that are particularly exposed to the global economy. Where does Bangladesh stand in view of the above? Is there any need for revisiting the policies? Should these be reflected in current policies and in the context of the upcoming budget, work on which must have begun in earnest by now? These are questions that merit serious consideration.

### *Design of the Paper*

This paper first traces the performance of the Bangladesh economy particularly focusing on the major transmission mechanisms of the impact of global economic crisis on the domestic economy. Secondly, an analysis of the state of the economy has been undertaken (particularly relating to fiscal, monetary and real economy sectors) to assess the strengths, weaknesses and vulnerabilities of the Bangladesh economy as it faces the global crisis; this is important since it will determine policy space at the disposal of the government and its ability to act. Thirdly, some suggestions have been put forward with regard to policy options which merit consideration by policymakers in view of the emergent situation.

## **2. Bangladesh Economy and Global Economic Crisis: Transmission Channels and Initial Impact**

### **2.1 Export: Gradual slowdown in growth**

With deepening of the ongoing crisis, most countries have seen their exports go down significantly. China's exports declined by 17 per cent in January 2009, that of Singapore by 44 per cent. Compared to many other countries Bangladesh's export performance, if the first few months of the current fiscal year are considered, has been quite remarkable – growth during first seven months of FY2008-09 (July-January) has been a robust 18.2 per cent (which was only 0.45 per cent lower than the target set before). Two major contributors, Knit and Woven RMG, maintained impressive figures, posting 26.2 per cent and 20.6 per cent growth respectively over the corresponding period. Export of apparels, which contributes about three-fourths of export earnings, is still holding. Demand for low-end product has registered overall growth in the first seven months over the corresponding period (to a significant extent, thanks to the so-called *Wal-Mart* effect).<sup>10</sup> If the US market is considered, total imports by the US during the last quarter (Oct-Dec) of 2008 (which represents the most affected quarter of the year from economic shock), declined by (-) 8.8 per cent. The US import from China and Sri Lanka increased only marginally, while imports from India and Cambodia experienced negative growth (over the last quarter of the previous year). However, imports from Bangladesh and Vietnam increased impressively by 18.1 per cent and 20.1 per cent respectively (Table 4), mostly on account of higher import of lower-end apparels.

**Table 4: Growth in US Imports during Q4 of 2007 and 2008**

Country of Origin	Oct-Dec 2007	Oct-Dec 2008
<b>WORLD TOTAL</b>	10.1	-8.8
<b>AFRICA Subtotal</b>	35.4	-18.1
Cambodia	6.7	-8.5
China	6.8	0.1
India	14.7	-3.2
Pakistan	-1.5	7.5
Sri Lanka	-11.4	0.4
Vietnam	33.9	20.1
<b>Bangladesh</b>	<b>-3.4</b>	<b>18.1</b>

**Source:** Computed from USITC Database

<sup>10</sup> Demand for lower-end products tend to be relatively less impacted in times of economic downturn because of distributional effects of income on patterns of demand.

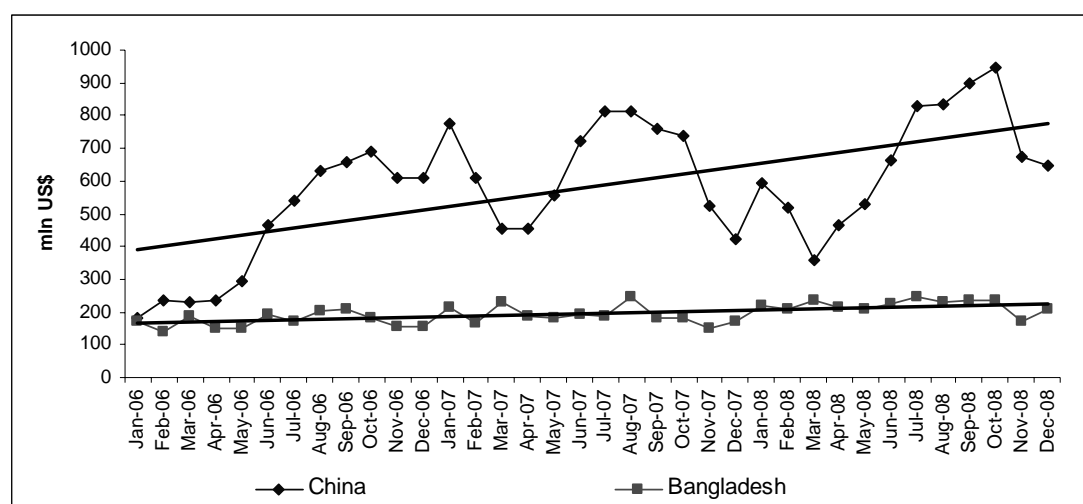
If top 14 RMG products of Bangladesh (products for which Bangladesh's export was over US\$40 mln in FY2007-08 which include 8 Woven items and 6 Knit items) is considered, during Q4 of 2008 (October-December) the US imports from Bangladesh increased by 22.1 per cent (Table 5); export of these particular items from China increased by 34.4 per cent over the same period (when China's overall growth was only about 0.1 per cent) (Figure. 3).

**Table 5: Growth in US Imports of Major RMG Export Items (>40 MLN USD) of Bangladesh**

	Oct-Dec 2007	Oct-Dec 2008
<b>Bangladesh</b>	<b>2.6</b>	<b>22.1</b>
Cambodia	7.9	-7.3
<b>China</b>	<b>-11.5</b>	<b>34.4</b>
India	-6.5	-4.1
Pakistan	-1.5	-2.3
Sri Lanka	-17.8	1.8
Vietnam	74.7	10.9

Source: Computed from USITC Database

**Figure 3: Import By the US: Bangladesh's Major RMG Export Items Vis-À-Vis China**



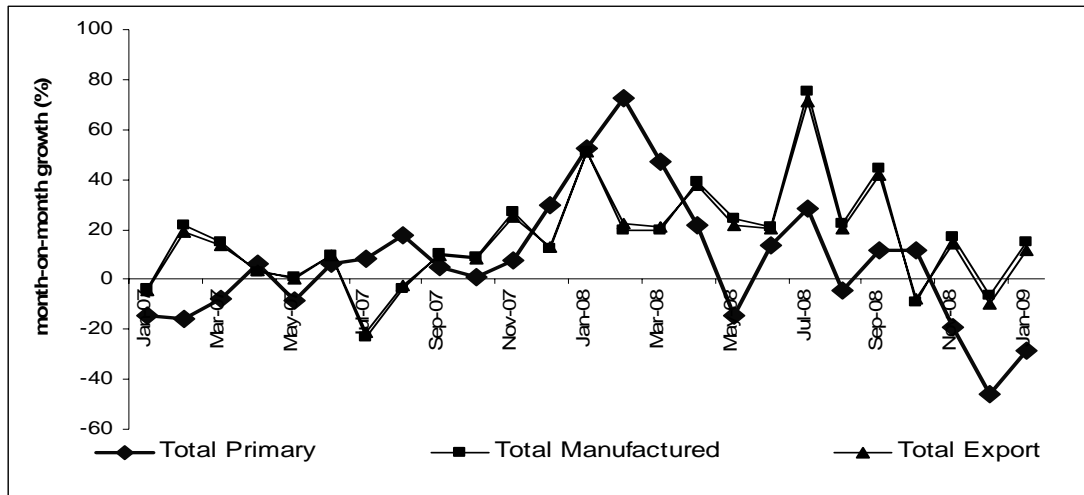
Source: Computed from USITC Database

Withdrawal of the US quota restriction on China's imports from January 2009 combined with China's response to the global shock (e.g., raising tax rebates on certain exports along with other export incentives), could put exports of these items from Bangladesh under further increasing pressure in the coming months.<sup>11</sup>

While the overall export of Bangladesh during the first seven months of FY2008-09 was impressive, some slowdown is visible when performance in recent months is considered. Monthly export data bear this out quite clearly. Growth in Q2 of FY2008-09 (October-December, 2008) was negative (-) 1.2 per cent, for the first time in recent times. Particularly for the month of December, overall export declined (-) by 10.1 per cent compared to the December export of the previous year. Indeed, month-on-month growth figures for exports show a gradual decline during the last few months (Figure 4). However, export has picked up once again in January, 2009 by 11.9 per cent, underwritten by growth of apparels and indicating the increasing volatility in the global market.

<sup>11</sup> It is to be borne in mind that the US imports for January-December 2008 does not include Bangladeshi export for the month of December 2008, as the Bangladeshi exports takes about a month to reach the US.

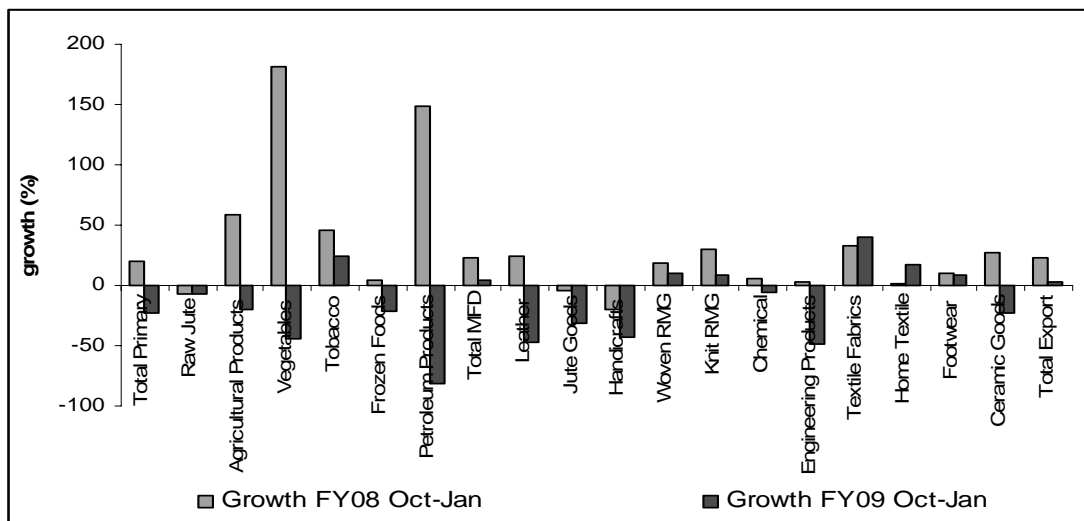
**Figure 4: Gradual Decline of Bangladeshi Exports in Recent Months**



Source: Export Promotion Bureau (EPB)

From the October-January data of FY2008-09 it is evident that export of Bangladesh's primary products has been relatively more affected because of the global economic slowdown (Figure 5). Total export of primary products declined significantly by (-) 22.9 per cent. Exports of tea (-37.0 per cent), agricultural products (-19.7 per cent) and frozen foods (-21.7) bear marks of significant slowdown. Exports of Vegetable (-44.3 per cent) and Petroleum Products (-81.5 per cent) in particular declined sharply. Among the major seven primary export items, only Tobacco (24.7 per cent) managed to post positive growth.

**Figure 5: Growth in Major Export Items of Bangladesh during Oct-Jan in FY08 and FY09**



Source: Export Promotion Bureau (EPB)

Manufactured products posted a marginal positive growth of 4.3 per cent during this quarter, only due to the slower but positive growth recorded by Woven (10.0 per cent) and Knit (9.0 per cent) RMG. Apart from these two items, only textile fabrics (39.6 per cent), home textiles (16.8 per cent) and footwear (9.1 per cent) recorded positive growths. All other major manufacturing items recorded significant decline in exports during October-January period of FY2008-09, over the same period of FY2007-08. Particularly hard hit was the leather sector which posted a negative growth of (-) 47.3 per cent during this period.

As was noted above, following the disturbing developments of Q2 export picked up in January with a month on month increase of 11.86 per cent. However, there are a number of disquieting signals: volatility appears to have increased; China continues to remain a major

threat for Bangladesh in traditional apparels market; higher discounts are being asked for by buying houses and buyers; orders are being deferred and at times cancelled; profits are being squeezed.

It needs to be underlined here that prices offered for Bangladesh's products, particularly for apparels, have been on the decline in recent years, seriously undermining the country's terms of trade situation. As table 6 shows, Bangladesh's terms of trade has deteriorated significantly in the recent past. If only apparels price dynamics is taken into consideration, this fact becomes quite evident. In view of this, from a medium-term perspective, there is a growing need for renewed initiatives to promote export diversification and strengthen backward linkage industries.

**Table 6: Declining Terms of Trade**

FY1996	Export Price Index	Import Price Index	Apparels Price Index	Terms of Trade	API/MPI*100 (ToT Apparels)
FY2000	100	100	100	100	100
FY2001	102	108	101	95	94
FY2002	105	116	85	91	73
FY2003	107	125	83	86	67
FY2004	115	130	80	89	62
FY2005	119	134	78	89	58
FY2006	121	139	74	87	53
FY2007	127	145	71	88	49
FY2008	132	150	71	88	47

Source: CPD-IRBD Database

It is also to be noted that the emerging shipbuilding industry of the country which is considered to have great potential and received export orders of about US\$500 million for about 40 vessels to be delivered by 2010, is also at present experiencing difficulties. These relate to receiving fewer orders consequent to slower growth of trade and significant fall in shipping traffic and freight incomes; some of the orders placed earlier have now been cancelled.<sup>12</sup>

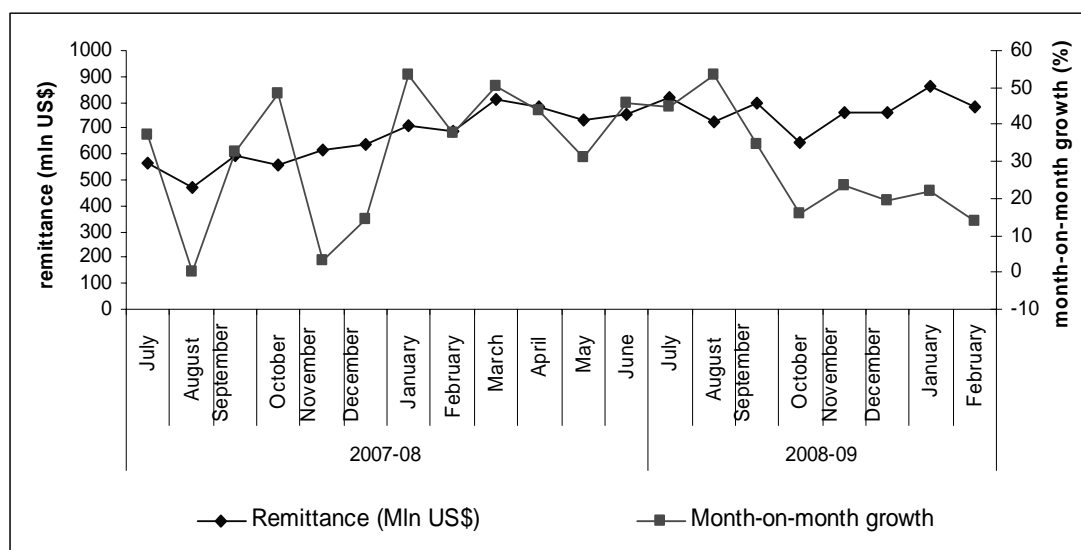
To summarise, although export earnings for the first few months (July-January) of FY2008-09 remain high, both month by month performance and record of performance at disaggregated sector-level, allude to disquieting developments.

## 2.2 Remittance: Robust inflow, but deceleration in number of workers leaving

Over the last two years, a record number of Bangladeshi workers (1.7 million) had left the country in search of jobs abroad (total number of migrant workers is estimated to be about 6.1 million at present; they are estimated to have sent about US\$ 7.9 billion in FY2007-08). Remittance flow plays a crucial role on three counts: (a) ability to pay for import payments, (b) sustaining foreign exchange reserves, and (c) household income of remitters. Remittance flow till now has been quite robust. During July-February of FY2008-09, remittance earnings increased by 27.1 per cent compared to the corresponding period of last year. Indeed, US\$ 865.3 mln was remitted in the month of January, 2009, which is a new record; another US\$ 784.4 million was sent in February which was 13.8 per cent higher than the comparable month of FY2007-08 (Figure 6).

<sup>12</sup> Production of ship, in terms of metric ton, declined significantly in September, 2008 (273 metric ton) compared to that in August, 2008 (409 metric ton).

Figure 6: Remittance Inflow during FY08 and FY09



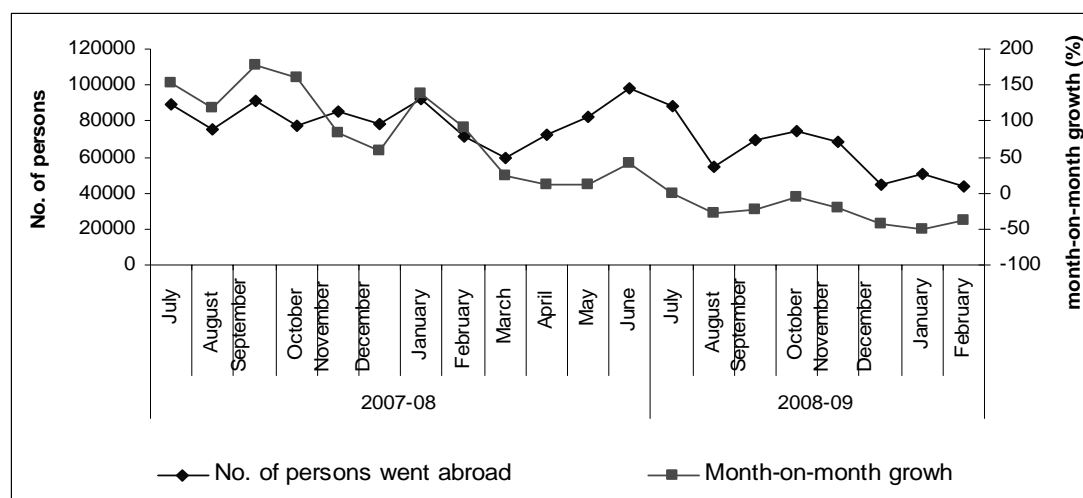
Source: Bangladesh Bank

However, in all likelihood, the number of workers going abroad will be significantly lower in 2009 compared to the recent past. One important impact of the ongoing crisis has been the significant slow down in the number of people going abroad in recent months. Already some of the traditional destination countries including UAE, Saudi Arabia, Malaysia and Singapore have indicated caution with respect to recruitment in the face of sluggish economic growth and lower demand for construction and other services.<sup>13</sup> According to recent data, during July-February period of FY2008-09, number of people migrating abroad in search of jobs declined by (-) 26.2 per cent compared to the same period of FY2007-08. In the month of February 2009, number of persons going abroad for jobs was only 43,856 compared to 71,716 in February 2008 (38.8 per cent fall) (Figure 7). It is to be noted that at present Saudi Arabia and Kuwait have virtually stopped issuing new work permits to Bangladeshi workers; these two destinations account for 39.7 per cent of total migrant workers from Bangladesh. The UAE, another major destination for Bangladeshi workers, has also shown lower demand for migrant workers with the number of workers going to the UAE in February 2009 being lower by 5000 compared to January 2009. Falling demand in Dubai, particularly in view of stoppage of ambitious construction works may make the UAE picture gloomier in near future. However, it is to be kept in mind that many workers leaving the country now are going against work permits which were issued earlier; slow-down of issuance of new contracts and work-permits could reduce the number of future migrants significantly.<sup>14</sup> Slowdown in growth of the US and the UK economies (accounting for 17 per cent and 11 per cent remittances) could also have adverse impact on remittance in near future.

<sup>13</sup> Malaysia has an estimated 2.2 million foreign workers. Recently, it has slashed work permits for foreign workers by about 70 per cent – in January and February 2009 on an average only 250 permits were approved daily compared to corresponding period of 2008 when about 500-600 work permits were approved. In recent times Malaysia has introduced more stringent vetting of foreign workers and adopted policies to encourage recruitment from its own job market

<sup>14</sup> Recently, the Malaysian government, under pressure from labour organisations, has revoked the work visas of 55 thousand Bangladeshi workers issued earlier. The government has banned hiring of new workers after reports that 45 thousand jobs could be lost over the next few months. Of the three million Asian migrant workers, staying legally and illegally in Malaysia, about 500 thousand are Bangladeshi workers.

**Figure 7: Number of Persons Leaving for Jobs Abroad during FY08 and FY09**



Source: Bangladesh Bank

There is dearth of adequate information about returnee migrants – information regarding expatriates is not maintained in a systematic manner. Returnees could include both retrenched workers and natural returnees (who would have come back anyway). Nevertheless, evidence suggests that workers in the affected countries are experiencing retrenchment (though on a limited scale).<sup>15</sup> Some Middle East employers are not issuing new job permits (*akamas*). Malaysia has announced retrenchment of about 45,000 workers by January, 2009, of which a substantial number appears to be migrant workers from countries such as Bangladesh. BMET figures show that over the last three months 13,540 Bangladeshi workers have returned: 701 in December, 2008, 4,817 in January, 2009 and 8,022 in February, 2009. Though there are indications of migrant workers coming home losing their jobs, this is yet to be reflected in the remittance figures, at least in the short-term, since the number of returnees do not constitute a significant share in the total number of people still working abroad (flow as a small percentage of stock). This would perhaps be reflected in remittance statistics, gradually, over the medium-term. Record high remittance inflow in January 2009 in the face of growing number of people losing jobs abroad raises concern whether this is because of terminal returnees coming back with whatever savings they had. Workers are being sent back from Middle East countries such as the UAE, the country with the largest Bangladeshi workforce, at around 0.9 million. These countries are sending back workers on long vacation or reducing salary due to slowdown of work in construction projects. An intensive diplomatic initiative will need to be undertaken to safeguard the interests of the Bangladeshi workers and to ensure that Bangladesh does not miss out on any remaining opportunities.

Gloomy growth projections for major destination of Bangladeshi migrant workers (both developed and developing) would indicate that the current downward trend in the demand may continue over the near term, in 2009 and perhaps 2010. If that be the case, remittance growth could slow down in future, beyond 2010.

In the recent past, large outflow of migrant workers have eased the employment situation in Bangladesh. Lower number of people going abroad could exacerbate the unemployment situation. This will have important implications for domestic job market and social safety net programmes-related expenditure. In view of the emergent situation, efforts should now be strengthened so that Bangladesh is able to cater to the needs of the new markets for migrant workers in the developed countries which relate, to a large extent, to the caring sectors (nurses, medical technicians etc.). It will also be important to negotiate with host-countries, particularly in the Middle-East, to allow extension of work permits even when Bangladeshi

<sup>15</sup> For example, due to slowdown of the Singapore economy, especially in the shipping and construction sectors, 55 Bangladeshis employed by construction sub-contractor Tunnel & Shaft have returned home after working there for seven months or less. The workers were recruited last year in anticipation of two major projects estimated to be worth \$20 million.

workers lose their jobs because their respective companies have discontinued their operations. This is also an opportunity to curb and discipline the activities of unscrupulous middlemen in the 'manpower business'. A comprehensive regulation with strict guidance as regards charges/fees, guarantee of work, wages to be received by the migrant worker, etc. will need to be designed and strictly enforced.

In view of the difficulties faced in the overseas job market, and also in response to needs to diversify the market, Bangladesh will require a comprehensive plan for training and skill development. A time-bound plan should be put in place so that all workers travelling abroad have an opportunity to undergo skill upgrading training. In this context need to tap the emerging opportunities in the medicare sector of developed countries and in East European markets should merit special attention of Bangladesh. For this to happen public-private partnership will need to be encouraged through appropriate incentives. A dedicated fund may be created for this. The government has taken plans to make the vocational training system more market-oriented through public-private partnerships. A more involved engagement with trade associations may be considered in this context.

### 2.3 ODA: Decline, but perhaps not related to crisis

Aid is a *soft target* in any crisis. Whilst earlier commitments could hold, new pledges in view of the growing needs in crisis-driven developing economies may not be forthcoming. Though aid's role has been on the decline over the past years, it still accounts for about half of Bangladesh's expenditure on development budget. However, till now no adverse affect is visible in this regard. The figures for July-December FY2008-09 indicate a decline of (-) 8.0 per cent in the net foreign aid disbursement in Bangladesh, with gross disbursement falling slightly from US\$ 903.2 mln in FY2007-08 (Jul-Dec) to US\$ 898.3 mln in FY2008-09 (Jul-Dec) (Table 7). Commitment figures for FY2008-09, however, looks promising with highest ever commitment of US\$ 1.34 bln by the World Bank for the current fiscal year.

**Table 7: Flow of Foreign Aid during July-December of FY08 and FY09**

*(Mln US\$)*

	Food Aid	Commodity Aid	Project Aid	Total Aid	Payment (Principal)	Net Foreign Aid
Jul-Dec FY08	54.3	0.0	848.9	903.2	273.2	630.0
Jul-Dec FY09	2.4	0.0	895.9	898.3	318.6	579.6
<b>Growth (Jul-Dec) FY09</b>	<b>-95.6</b>		<b>5.5</b>	<b>-0.5</b>	<b>16.6</b>	<b>-8.0</b>

Source: Bangladesh Bank

It is to be borne in mind that a major part of the aid flow in Bangladesh comes as project aid, through the channel of Annual Development Programme (ADP). Actual project aid disbursement under the ADP is subject to implementation status of different projects. Therefore, actual disbursement will depend more on Bangladesh's capacity for utilisation than being constrained by availability of aid itself. However, as is known only 30 per cent of the project aid allocation could be utilised during the first seven months of FY2008-09. Slow implementation of the donor-funded ADP projects in the current fiscal year could be a reason for lower aid disbursement of aid so far this year. In view of the need to generate more local demand through enhanced economic activities, as a consequence of the crisis, it is crucial that both quality and quantity of aid disbursement and ADP implementation are significantly improved this year.

### 2.4 Flow of FDI: No impact so far

Flow of FDI to Bangladesh was considerably higher during July-December, 2008 compared to the same period of the previous year. Net FDI increased to US\$ 706 mln during this period which was only US\$ 285 mln in the previous year (Table 8). It is to be noted here, however, that traditionally FDI inflow to Bangladesh has been rather low even compared to her South Asian counterparts. Worrying sign, though, relate to registration of FDI in 2008. Number of units registered with the Board of Investment (BOI) in 2008 was only 13 (with total investment proposal of US\$60 million) while in 2007 it was 75 (with a total of US\$327

million investment). As would be expected, global meltdown has particularly affected the flow of portfolio investments in the capital market: net flow was negative (US\$ -48.0 mln) during July-December period of FY2008-09, implying higher amount of withdrawal of capital by foreign investors.<sup>16</sup>

**Table 8: FDI and PFI in Bangladesh**

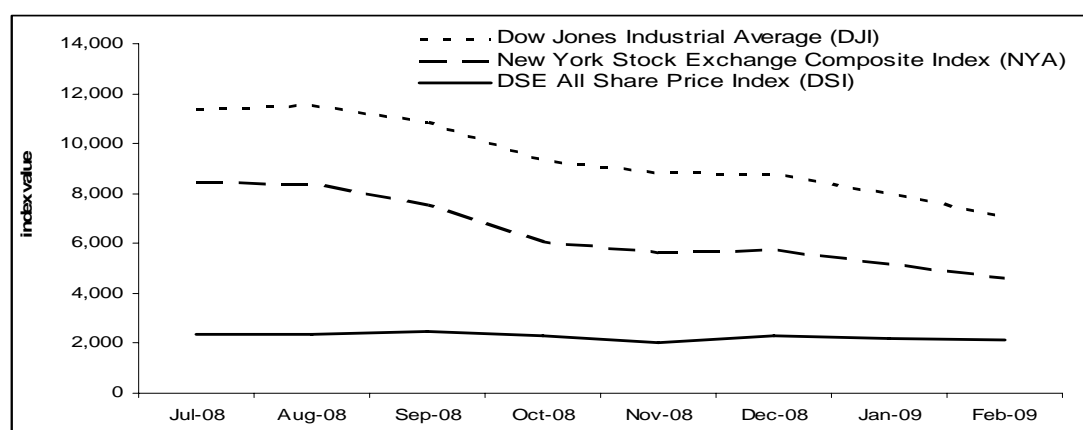
	(Million US\$)			
	FY2006-07	FY2007-08	FY2007-08 July-Dec.	FY2008-09 July-Dec.
Foreign direct investment	793	650	285	706
Portfolio investment	106	48	48	-48

Source: Bangladesh Bank

## 2.5 Capital Market: Sluggish growth mainly owing to domestic reasons

A sluggish trend has been observed in the capital market for the period between July, 2008 and February, 2009. However, in view of insignificant role played by foreign capital in the capital market of Bangladesh, it was mainly the domestic factors rather than the negative affect of global shock that contributed directly to this trend. Movement of Dhaka Stock Exchange (DSE) indices did not correspond to the sharp downward movement of major global indices in the aftermath of global financial meltdown (Figure 8). However, it needs to be highlighted that all the indices in the DSE experienced negative growth during the first few months of FY2008-09 (Table 9).

**Figure 8: Movement of Major World Indices and DSE all Share Price Index in the Recent Months**



Source: New York Stock Exchange website and Dhaka Stock Exchange (DSE)

**Table 9: Movement of Share Price Index at DSE during July- February, FY2008-09**

Indices	July	August	September	October	November	December	January	February
DSE (All)	2369	2389.2	2498.5	2278.2	2040.2	2309.4	2196.96	2144.3
DSE (20)	2526.2	2441.5	2466.1	2351.9	2090.1	2328.7	2175.11	2085.9
DSE (Gen)	2761.1	2791.2	2966.8	2748.6	2468.9	2795.3	2649.49	2571.0
Market Capitalisation (US\$ billion)								
FY2009	13.95	14.15	15.18	14.37	14.01	15.21	14.75	14.50

Source: Dhaka Stock Exchange (DSE)

<sup>16</sup> Underdevelopment of the country's capital market and low exposure to global financial markets (only 2.5% market capitalisation is accounted for by PFI) may have saved Bangladesh from large outflow of capital from her share market, with consequent adverse affect on the economy (as happened in India).

### **3. Bangladesh Economy and Global Economic Crisis: Macroeconomic Balances and Real Economy**

Trends in external sector aggregates imply that global economic meltdown is gradually affecting Bangladesh's performance; these adverse impacts are likely to intensify in the coming months. At the same time, policies of other countries, most importantly Bangladesh's competitors in global export markets are having direct implications on the country's export-competitiveness and also performance of domestic sectors. What is the state of macroeconomic fundamentals of Bangladesh economy in this backdrop? How feasible is the idea of a stimulus package of her own? An analysis of the current state of Bangladesh economy will help decide which policy options and flexibilities Bangladesh actually has in view of the emerging situation and the attendant challenges. The following discussion focuses on the state of the fiscal, monetary and real sectors of the Bangladesh economy at this crucial juncture.

#### **3.1 Fiscal Balance: Strengths and Weaknesses**

The budget for FY2008-09 presented in June 2008 was relatively large, prepared in the backdrop of high inflation, high commodity prices, high import burden and high subsidies. A large deficit projection of Tk 30,623 crore, equivalent to 5.0 per cent of GDP<sup>17</sup> made the task of balancing the budget challenging. This higher deficit was to be met by higher revenue generation and higher financing by the development partners which was to be replenished by increased government borrowing from domestic sources, both banking and non-banking.

Subsequent developments had repercussions for the budget in FY2008-09, both ways, some bringing comfort, and some adding to the challenges. With the onslaught of the financial crisis and the consequent decline in global demand, global commodity prices experienced significant fall. This was true particularly for petroleum products which was the single largest contributor to the demand for subsidy in the budget. Budget 2008-09 had kept Tk 6,106 crore for BPC alone and also Tk 540 crore as diesel and electricity subsidy for agriculture. The over 72.8 per cent fall in the price of petroleum in the international market has now created an opportunity to have significant savings on account of budgetary allocation for fuel subsidy, inspite of the some downward revision in prices. As may be recalled here, the BPC had made its last profit in FY1998-99 following which there was an uninterrupted string of losses over the subsequent years. In the first seven months of the current fiscal year (July-January) the BPC had incurred a net loss of around Tk 1,600 crore. However, this was due to losses incurred during the first 4 months (July-October, 2008). Thereon, BPC had started to make profit - during the months of November 2008 to January 2009, BPC made a profit of Tk 553 crore in view of the falling fuel prices in the global market and inspite of the aforesaid reduction in the managed price level of fuel products.

In view of the crisis and the consequent fall in demand in the near future, oil price in the international market is likely to hover around the current level of US\$ 40-45 per barrel during the remaining months of FY2008-09. This would allow the BPC to continue to make profit in the coming months as it has done in December and January, if prices are not significantly revised further downward. It is estimated that at current rate, for the entire fiscal year, total subsidy on account of the BPC is likely to be about Tk 600 crore. This would be about Tk 5,500 crore less than the budgetary allocation for subsidy on account of BPC. At the same time, prices of various types of fertiliser in the international market have also fallen sharply (barring MoP). This is likely to further reduce subsidy demand for the fiscal year 2008-09 on account of fertiliser. Thus, a significant amount of the Tk. 13,641 crore subsidy kept in the FY2008-09 budget will be saved.

The fall in commodity prices are reflected in the revenue expenditure account of the government<sup>18</sup>. These show 12.7 per cent growth in total revenue expenditure (not accounting

<sup>17</sup> This deficit was 15 per cent higher than the previous year.

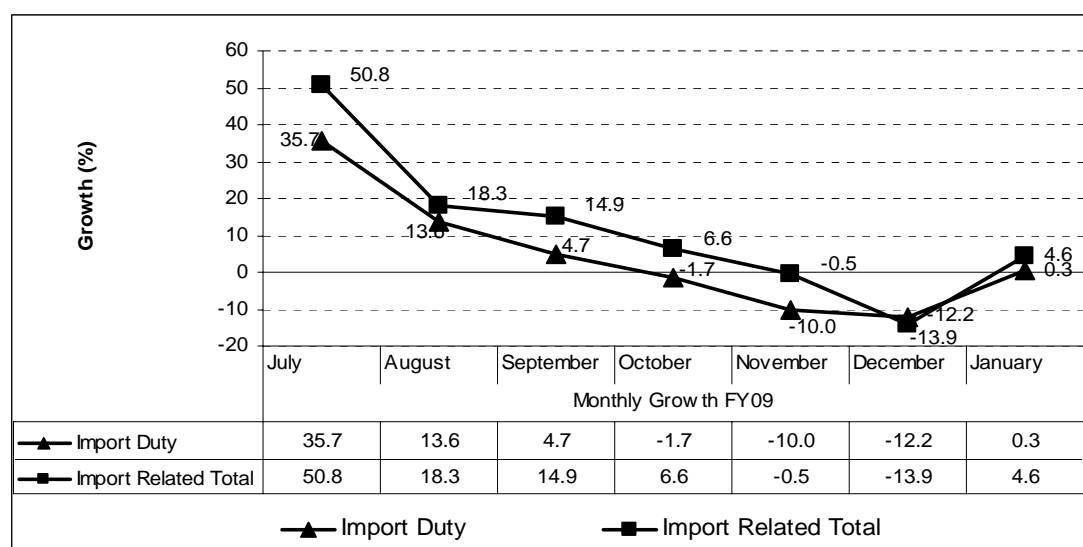
<sup>18</sup> Oil prices have gone down from its peak of about \$140/barrel to \$40/barrel at present. Prices of a wide range of commodities have fallen. On February 24, 2009 the Economist's commodity price dollar index had fallen by 42 per cent compared to a year ago-the index for food was 30 per cent down, for non-food agricultural products 45 per cent down and for metal 60 per cent down.

for BPC, PDB, Agriculture and export related subsidies) during July-December period of FY2008-09, against an annual growth target of 19.5 per cent. These figures are for the first and second quarter of the fiscal year only; since then the prices have gone down further and new contracts made at present should be able to take advantage of the falling price. It is to be noted that implementation of the ADP (only 31 per cent during July-January) is also indicative of the possible lower government expenditure by the end of the fiscal year. Even if FY2007-08 performance record of ADP utilisation was attained for the current fiscal, about Tk. 19,000 crore of the total Tk. 25,600 crore allocated for the ADP in FY2008-09 will be utilised. This will result in approximately Tk 6,000 crore of reduced expenditure from the projected expenditure budget of FY2008-09. To be true, fiscal space created by the non-implementation of ADP will be somewhat less because, based on recent trends, a part of it (around Tk 2000 crore) will not be actually available since unutilised project aid will not be available to the government. However, this will still leave the government with some comfort zone.

True, the government is likely to face formidable challenges from the perspective of domestic resource mobilisation. Revenue earnings data for July-January period of the current FY2008-09 confirms these suspicions. With the fall of imports, in value and in many instances volume terms, there had been adverse impact on import duties collected during July-January period of FY2008-09. These have posted only a 3.4 per cent growth in the first seven months against the annual target of 13.1 per cent for FY2008-09.

Month-on-month comparison shows that collection of import duty experienced a sharp fall in recent months (Figure 9), with only marginal improvement in the month of January 2009. Import duty and other import related duties together constitute around 42 per cent of the total NBR revenue collection in Bangladesh. Thus, it is likely that revenue collection in FY2008-09 will fall short of the target by a significant margin.

**Figure 9: Recent Decline in Import Duty Collection (month-on-month basis)**



Source: National Board of Revenue (NBR)

However, overall growth in NBR revenue collection (12.4 per cent) is still hovering around the target set for FY2008-09 (14.9 per cent), mostly due to higher than targeted income tax growth and high import stage duty collection achieved in the initial months of FY2008-09, when the international prices were way higher compared to their current level (Table 12).<sup>19</sup>

<sup>19</sup> NBR revenue accounts for about 80 per cent of Bangladesh's total revenue; thus, import related duties account for about 35 per cent of total duties in Bangladesh, a significantly high share by any measure.

**Table 12: NBR Revenue Collection (Jul-Jan) FY09**

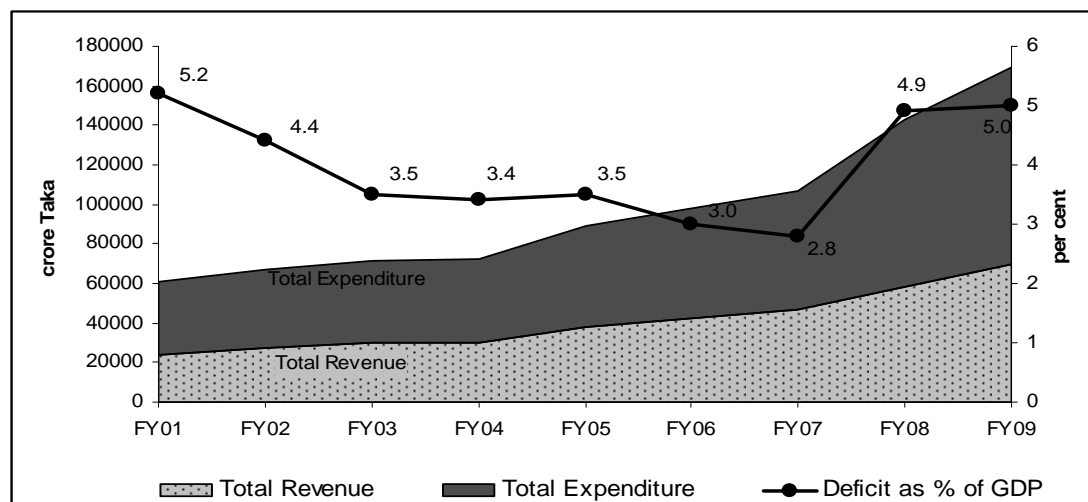
(Crore Tk)

	Annual Growth Target FY09	Growth Jan, FY09	Growth Jul-Jan FY09	Jul-Jan as % of Actual FY08	Jul-Jan as % of Target FY09
Import Duty	13.1	0.3	3.4	43.2	39.8
VAT Import	12.6	8.3	15.3	41.7	42.7
Supp Import	20.4	8.1	26.0	49.1	54.0
Import Related Total	13.5	4.6	10.6	43.1	42.4
Excise Duty	17.1	-80.9	-78.4	3.9	1.5
VAT Local	16.4	13.8	19.7	43.1	42.5
Supp Local	23.6	4.4	3.1	46.9	39.0
Turn Over Tax	17.2	-32.0	-14.1	42.8	53.0
Local Total	19.2	5.2	12.0	44.0	40.5
Income Tax	11.1	19.0	17.8	35.7	37.2
Travel Tax	24.9	9.7	-5.4	53.2	40.6
Others	1566.7	100.0	14.3	550.0	9.5
Total Direct Tax	11.7	18.7	16.6	36.3	37.3
Grand Total	14.9	7.7	12.4	41.6	40.5

Source: National Board of Revenue (NBR)

The other source of financing, ODA, have recently shown some downward turn as net foreign flow of foreign aid declined by (-) 8 per cent during July-December period of FY2008-09. However, commitments made by the development partners for the rest of the fiscal year look promising. In fact, as was noted earlier, the World Bank had committed the highest ever aid to Bangladesh (US\$ 1.34 bln) in FY2008-09. Recent commitments of Euro 50 mln by EU and US\$ 90 mln by the World Bank for food security and safety nets along with US\$ 440 mln by Japan in power and infrastructure, will contribute to resource envelope of the government in the current fiscal year.

Since FY2000-01, Bangladesh has been experiencing a fall in deficit-GDP ratio; however, in FY2007-08 the ratio climbed to 4.9 per cent from 2.8 per cent in FY2006-07 (Figure 10). Thus, the 5 per cent GDP equivalent deficit that was targeted for FY2008-09 was rather high compared to recent trends, though it approximated the FY2007-08 deficit.

**Figure 10: Trend in Budget Deficit**

Source: Ministry of Finance

It is reckoned that between the gains from the falling subsidy expenditure and the losses in the revenue account, there is likely to be some net gains in the budget for FY2008-09. As the latest available figures show, net domestic financing has declined by (-) 28.9 per cent and net foreign financing has also declined by (-) 8.0 per cent during the first six months of FY2008-09. Thus, overall, deficit financing of the government has decreased by (-) 23.0 per cent during the July-December period of FY2008-09, compared to the corresponding period of the previous fiscal year (Table 13). This is a cushion that the government is likely to continue to build on over the rest of the fiscal.

**Table 13: Growth in Deficit (July-December) in FY2008-09**

<i>(Core Taka)</i>					
Period	Net Bank Borrowing	Net Non-Bank Borrowing	Total Domestic Financing	Net Foreign Financing	Total Financing
July -December, FY08	9478.4	1557.28	11035.68	4324.58	15360.26
July-December, FY09	5569.3	2273.89	7843.19	3977.19	11820.38
Growth (Jul-Dec) FY09	-41.2	46.0	-28.9	-8.0	-23.0

Source: Bangladesh Bank

It is also to be kept in mind that the remaining months of FY2008-09 may show month-on-month decline in the expenditure account, owing to the absence of the high rehabilitation costs associated with mitigating the consequences of the natural catastrophes (two floods and the cyclone Sidr) that was seen in the previous year. For the same reason, flow of foreign financing may also show some decline in the coming months as a substantial part of the aid received by Bangladesh in FY2007-08 was dedicated towards rehabilitation efforts. Subsidy expenditure for fertiliser will increase in the backdrop of the higher amount of subsidy announced by the government on fertiliser in view of the critically important Boro season.

However, as was noted, the continuing fall in fertiliser prices and its positive impact for government's subsidy expenses could result in a net gain and ease the overall fiscal situation in FY2008-09. In view of the need to undertake any additional expenditure for mitigating adverse impacts of the ongoing crisis, the government may also seek for resources that were not allocated in the original budget. Tk. 1,200 crore which was recovered from the anti-graft drive undertaken by the immediate past CTG, which is now lying with the Bangladesh Bank, could be a possible source. This, along with the net budgetary gains, could create some fiscal space which would allow the government to go for higher expenditure, without overshooting the projected deficit of 5.0 per cent of GDP. Mode of financing the deficit remains a concern though. While borrowing from the banking system has the advantage of being less costly in terms of interest payment burden, it has the disadvantage of being inflationary. Crowding-out effect on private sector credit remains a concern, though a contrary view is that in view of the surplus liquidity in the system, this should not be a concern. On the other hand, non-bank borrowing, which is non-inflationary, involves higher interest payment obligations; availability of such borrowing could also be a problem. The government will need to decide on options and policy choices in this regard through careful consideration of the needs, priorities and possible implications for the economy.<sup>20</sup>

### 3.2 Monetary Developments: Decreasing inflationary pressure and some freedom to act

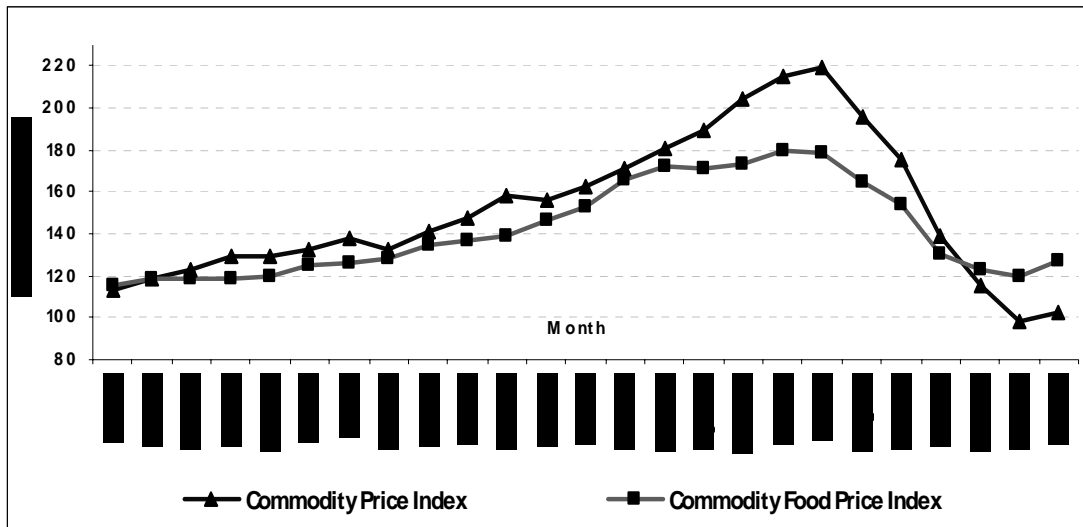
#### *Trends in Inflation rates*

In the context of concern over rising price of commodities, particularly essential commodities, experienced in the recent past, restoring macroeconomic stability and curbing high inflation were perceived as major policy goals by policymakers. One important feature of the current economic situation is that inflationary pressure has started to ease in recent months. Inflationary pressure is expected to come down further in response to falling global

<sup>20</sup> Since part of the fertiliser distributed in the first six months was purchased at higher prices, the subsidy burden during the first six months was perhaps higher. However, later purchases should have been able to take full advantage of falling prices with subsequent positive impact on government expenditure on account of fertiliser subsidies.

commodity prices and good harvests. Significant devaluation in India, the major import source for consumer products, is also expected to have positive impact on the general inflationary situation (Figure 11).

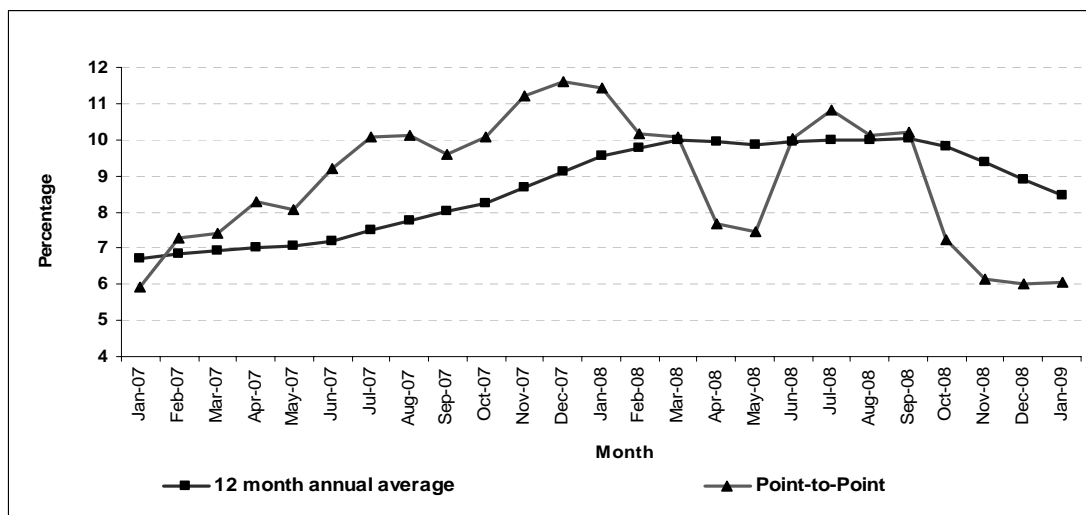
**Figure 11: World Commodity Price Index**



Source: IMF

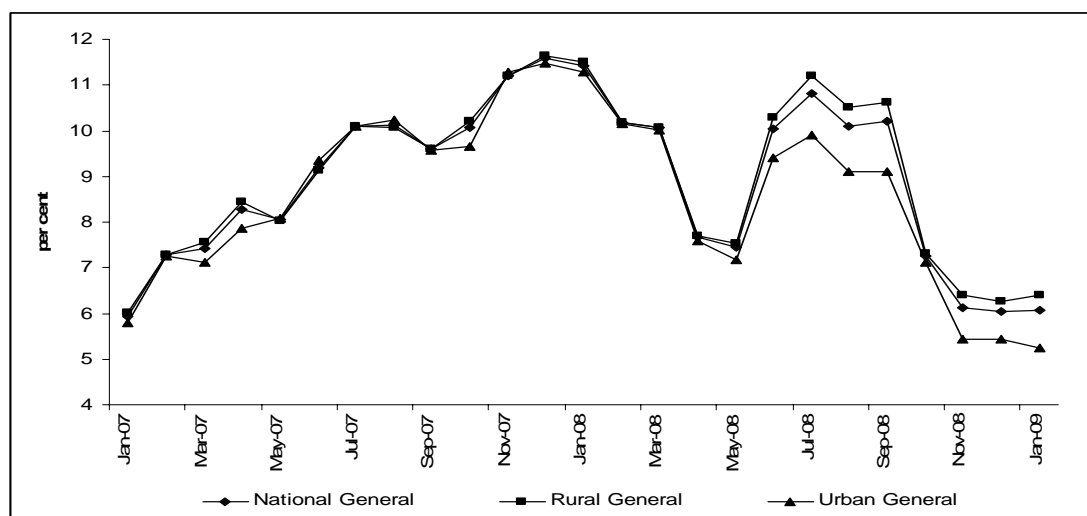
There has been some respite thanks to the declining trend of inflationary pressure during July-January FY2008-09. Annual average rate of inflation (12-month annual average CPI, 1995-96 = 100) decreased to 8.5 per cent in January 2009 from 9.6 per cent in January 2008 (Figure 12). The 12-month point-to-point inflation declined to 6.1 per cent in January 2009 compared to 11.4 per cent in January 2008. This deceleration in the inflationary trends is visible both for food and non-food items, and for both rural and urban areas (Figure 13). This would indicate that overall inflation rate could be below the projected rate of 9.0 per cent for FY2008-09 which has been mentioned in the budget for FY2008-09. Maintaining moderately high growth rates with low levels of inflation could thus be an attainable target. Given the trade-off between growth and stability, the government appears to be somewhat better placed at present for pursuing active growth financing policies.

**Figure 12: Inflation Rate**



Source: Bangladesh Bureau of Statistics (BBS)

**Figure 13: National, Rural and Urban Inflation Rate (P2P)**

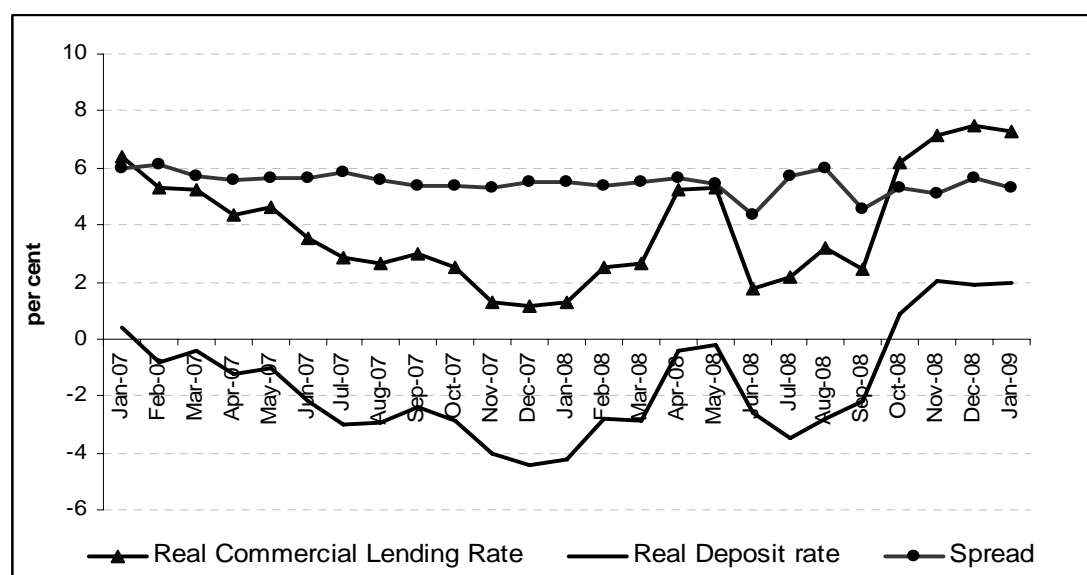


Source: Bangladesh Bureau of Statistics (BBS)

*Interest rates*

As was noted, commercial lending rate is considered to be high in Bangladesh. In recent times the rate has risen further – in January 2009 lending rate was 13.33 per cent, about 0.71 percentage points higher compared to September 2008. Real lending rate was 7.27 per cent (Figure 14). Higher spread between lending and deposit rates has continued to be a major concern for Bangladesh’s policymakers. Investors have often mentioned high interest rate as a major disincentive from the perspective of undertaking entrepreneurial activities. Indeed, this conflict of interest has persisted for quite some time now. The Bangladesh Bank has often tried to convince the commercial banks to reduce the interest rate spread. However, the situation has not changed much. Indeed, in January FY2008-09 the spread was higher at 5.33 compared to 4.58 in September FY2007-09.

**Figure 14: Real Interest Rates and Spread**



Source: Bangladesh Bank

*Classified Loan scenario*

The share of non-performing loans (NPL) has been on gradual decline over the last couple of years; this was particularly evident in the first half of FY2008-09 (Table 14). At the end of December 2008, percentage share of classified loan to total outstanding loan declined to 10.8 per cent, compared to 13.2 per cent of the corresponding period of previous year. Percentage share of net classified loan to total loan also decreased to 2.8 per cent at the end December 2008 from 5.1 per cent at the end December 2007. The government has corporatised three large state owned banks with an objective to improve the quality, efficiency and performance of these institutions. The loan default scenario of these banks has started to show some positive improvements in recent times. State owned commercial banks were able to reverse earlier trends and were able to reduce the amount of classified loans (by 7.45 per cent). These banks account for the largest share in total classified loans. However, a significant rise of classified loan portfolio of Private Commercial Banks (PCBs) and Foreign Commercial Banks (FCBs) has emerged as a cause for concern. It needs to be examined why this is happening and whether corrective measures are required. Nevertheless, overall, the data suggests some improvements in banking sector efficiency.

**Table 14: Classified Loan Scenario**

Banks	As of Dec-07 (Crore Tk.)	As of Dec-08 (Crore Tk.)	Growth
SCBs	13791.17	12764.15	-7.45
PCBs	4921.70	5698.60	15.79
FCBs	194.30	286.30	47.35
DFIs	3716.90	3732.30	0.41
<b>Total</b>	<b>22624.07</b>	<b>22481.35</b>	<b>-0.63</b>

Source: Bangladesh Bank

Maintaining good health of banks will be critical to addressing possible adverse impact of the crisis. Some of the commercial banks are having to defer settlement of credit lines in view of difficulties faced by importers who had made import contracts before the slump in commodity prices. Of importance will be to monitor whether this is having adverse implications on trade financing, and if required take, remedial measures.

*Money supply, credit flow and liquidity*

Broad money supply (in terms of M2) has started to slow down in recent times. Outstanding M2 posted a growth of 19.83 per cent at the end of January 2009 in the backdrop of around 16.9 per cent growth projected in the PRSP II for FY2008-09. Growth of outstanding M2 was 23.50 per cent in September, 2008. Growth of domestic credit and its major components have also somewhat slowed down in recent times. Outstanding net domestic credit registered 19.53 per cent growth at the end of January 2009 on a point-to-point basis over the corresponding benchmark figure of FY2007-08 (Figure 15); in September 2008, the corresponding figure was 24.58 per cent. Such deceleration originated from lower growth of net credit to the public sector, at 15.33 per cent at the end of January 2009; although growth in net credit to the government was 22.5 per cent, net credit to other public sector in fact declined by 6.36 per cent at the end of the same period.

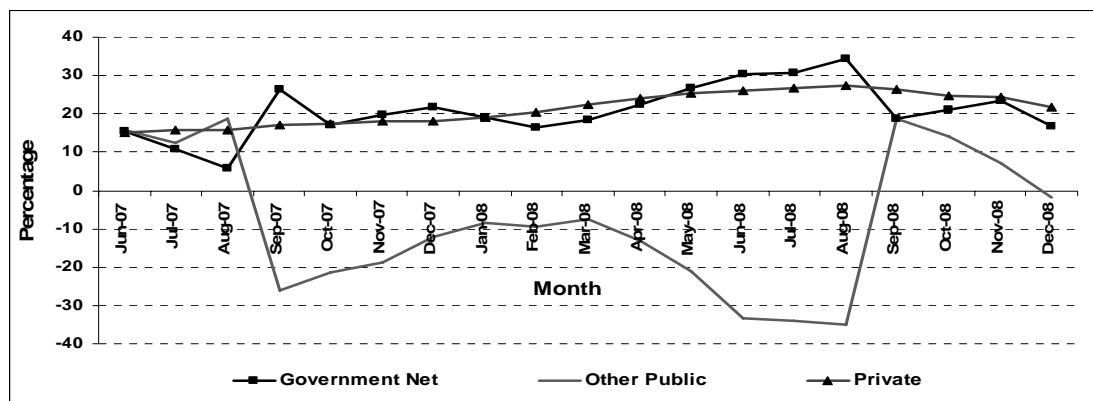
Growth of net domestic credit to the private sector also slowed down considerably, posting a growth of 19.53 per cent, which was 26.6 per cent in September 2008. An increase of Repo and reverse Repo rates during second quarter of FY2008-09 may have discouraged credit flow in subsequent months.<sup>21</sup> This move indicated some tightening of monetary policy by the Bangladesh Bank, a departure from the accommodative monetary policy of the recent past. However, in the latest half-yearly monetary policy statement (announced on 14 January, 2009), the central bank indicated pursuance of a policy of monetary accommodation for achieving the GDP growth target by supporting adequate credit growth for activities that facilitate production and supply of goods and services. Subsequently, Repo and reverse Repo rates were re-fixed to their earlier rates (8.50

<sup>21</sup> Bangladesh Bank raised the interest rate of Repo to 8.75 per cent on 17 September 2008 from 8.50 per cent and then re-fixed interest rate on reverse Repo at 6.75 per cent on 19 November 2008 from 6.50 per cent.

per cent and 6.50 per cent respectively) on March 11, 2009. Bangladesh Bank also indicated that it would provide refinance against lending in priority sectors (SME, agriculture, low cost housing etc.) which are not appropriately served by the market. Bangladesh Bank also has indicated that it would discourage excessive expansion of non-essential, life-style related, consumer credit and other demand-side lending.

It is, however, to be noted that the scheduled banks had excess liquidity to the tune of Tk. 20275.55 crore as of end December, 2008, against Tk.12988.58 crore as of end June, 2008. The current deceleration in the growth of domestic credit provides an opportunity to once again go for monetary expansion, if required, in view of the global crisis.

**Figure 15: Trends in Net Domestic Credit**

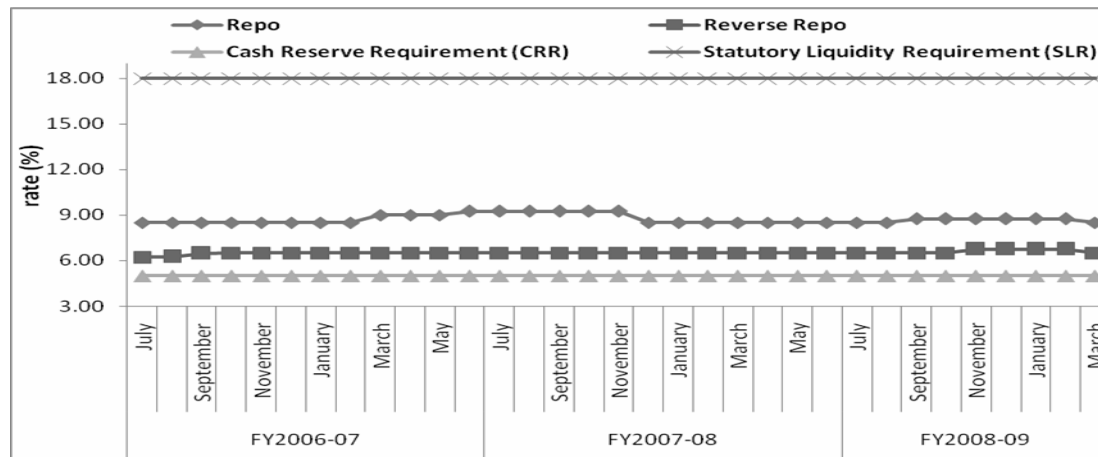


Source: Bangladesh Bank

On March 17, 2009 the central bank increased loan disbursement limits for the four SCBs which will allow them to lend more aggressively. These banks will now be able to increase the amount of lending by 10 per cent over the preceding year (previously the growth was limited to 5 per cent). Additionally, the ceiling on single borrower exposure has been raised by another 5 per cent of paid up capital. Together with the reduced repo and reverse repo rates introduced earlier these measures are expected to enhance credit flow to productive sectors of the economy.

As in many other countries, in recent times Bangladesh has been using indirect instruments such as repo and reverse repo as the major monetary policy instruments as distinct from direct instruments of cash reserve requirement (CRR) and statutory liquidity ratio (SLR). These latter two ratios have tended to remain constant over the past years. A survey on monetary policy instruments in developing, emerging and developed countries has observed that in recent years a majority of countries have abandoned the use of direct instruments as vehicles of monetary policy (Buzeneca and Maino 2007).

**Figure 16: Trends in Repo, Reverse Repo, CRR and SLR**

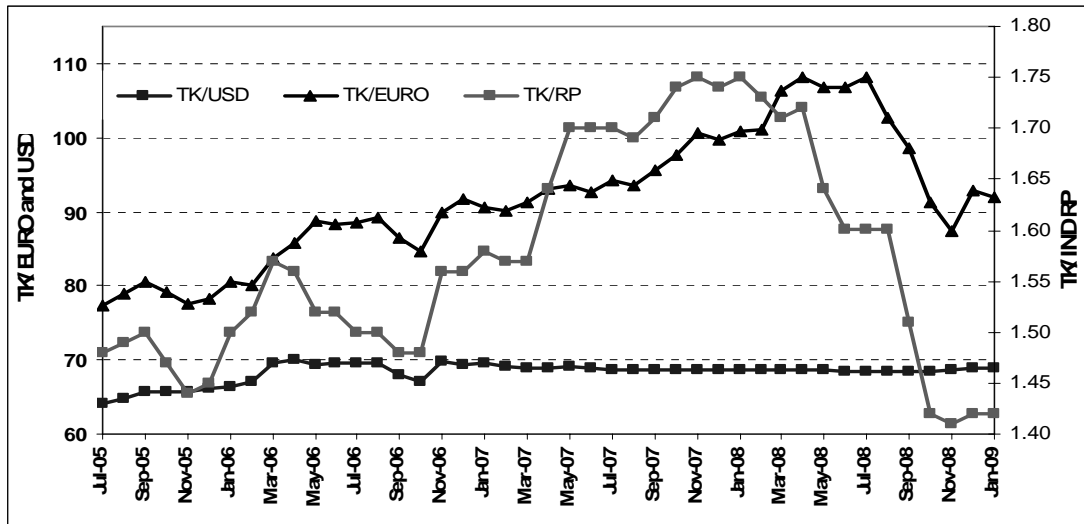


Source: Bangladesh Bank

Exchange rate

At the global level, all major currencies have become weaker against the USD (Figure 17). On the contrary, Bangladesh Taka (BDT) has continued to remain stable against the USD. Consequently, the BDT has appreciated considerably against other currencies including the EURO and INR<sup>22</sup>. Depreciation of both Indian Rupee and Euro against USD resulted in appreciation of Taka by 21.5 per cent and 13.4 per cent respectively between February 2008 and February 2009. In view of the apprehension about weakening competitiveness of Bangladesh’s exports in the global market in recent times, the idea of dual exchange rates and proactive interventions towards depreciation of the currency have been floated.

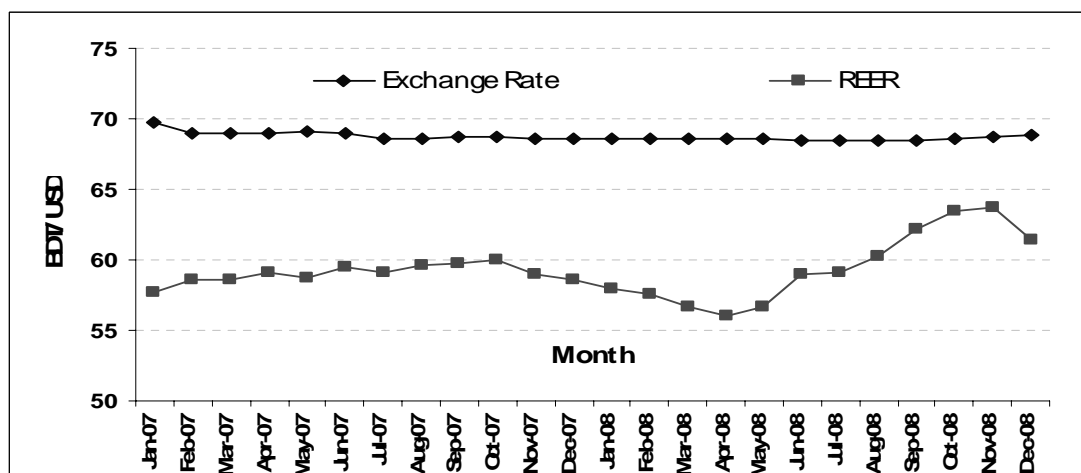
Figure 17: Movements of Taka against USD, Euro and Indian Rupee



Source: Bangladesh Bank

Movements of real effective exchange rate (REER) (Figure 18) would not, however, support the idea of further depreciation of taka. Indeed, in recent times Bangladesh Bank’s policy appears to be geared to maintain stability of the price of dollar against taka. The apprehension is that policy-induced depreciation could lead to higher prices for export-oriented inputs as also imports in general, and have negative impact on the expected decline in inflationary pressure.

Figure 18: Exchange Rate and REER



Source: Bangladesh Bank

<sup>22</sup> EURO/BDT and INR/BDT rates are calculated from the traded rates of USD/BDT.

### 3.3 BoP: Still Healthy, but Concerns for Near Future

Over 19 per cent growth in exports and around 30 per cent of higher remittance flow helped Bangladesh to maintain a healthy BoP situation at the end of December, 2008. High growth in imports, driven by high commodity prices in the initial months of FY2008-09, however, resulted in a deteriorated trade balance compared to July-December, 2008 period of the previous year (Table 10). While trade balance during July-December period of FY2007-08 was US\$ -2227.0 mln, during the same period it stood at US\$ -2974.0 mln in FY2008-09. But thanks to higher remittance inflow, current account balance maintained a surplus of US\$ 232.0 mln during July-December, FY2008-09, albeit lower compared to US\$ 298.0 mln surplus during the matching period of the previous year. Combined with a surplus of US\$ 213.0 mln in the financial account (which was a deficit of US\$ 130.0 mln in July-December, FY2007-08), the overall balance experienced a higher surplus of US\$ 489.0 mln in the first six months of the current fiscal compared to US\$ 44.0 mln for the corresponding period of previous year.

**Table 10: Balance of Payment Situation**

	(Mln US\$)			
	FY2006-07	FY2007-08	FY2007-08 July-Dec.	FY2008-09P July-Dec.
<b>Trade balance</b>	<b>-3458</b>	<b>-5541</b>	<b>-2227</b>	<b>-2974</b>
Exports f.o.b(including EPZ) 1/	12053	13945	6421	7708
Imports f.o.b(including EPZ)	-15511	-19486	-8648	-10682
<b>Current transfers</b>	<b>6554</b>	<b>8743</b>	<b>3839</b>	<b>4874</b>
<i>of which : Workers' remittances</i>	5979	7915	3441	4505
<b>Current account balance</b>	<b>936</b>	<b>672</b>	<b>298</b>	<b>232</b>
<b>Capital account</b>	<b>490</b>	<b>576</b>	<b>338</b>	<b>130</b>
Capital transfers	490	576	338	130
<b>Financial account</b>	<b>762</b>	<b>-431</b>	<b>-130</b>	<b>213</b>
i) Foreign direct investment(net)	793	650	285	706
ii) Portfolio investment	106	48	48	-48
iii) Other investment	-137	-1129	-463	-445
<b>Errors and omissions</b>	<b>-695</b>	<b>-213</b>	<b>-462</b>	<b>-86</b>
<b>Overall balance</b>	<b>1493</b>	<b>604</b>	<b>44</b>	<b>489</b>

Source: Bangladesh Bank

In the coming months, import payments are likely to further slow down as recent trends suggest. During July-December of FY2008-09, total import payments posted 23.25 per cent growth compared to corresponding period of the last year. But this high growth was, to a significant extent (42.4 per cent of the incremental contribution), accounted for by high growth in imports of crude and refined petroleum products and fertiliser, prices of which have come down sharply in the international market over the recent past few months. This has resulted in a gradual slowdown in import growth as seen from recent data. Import growth for July-November period of FY2008-09 was 29.7 per cent, which came down to 23.25 per cent for July-December period because of significantly lower growth in the month of December, 2008 (Table 11). Aggregate import figures available for July-January period of FY2008-09 reveals that this growth rate has further declined to 18 per cent, indicating further dip in imports. With lower import demand of fertiliser for the rest of the fiscal year with plantation of Boro coming to an end soon, import payments may further slowdown over the rest few months of FY2008-09. It is also to be noted that increasingly it is production related imports, rather than consumption related imports, which are having a larger share in the incremental import payments of Bangladesh.

**Table 11: Growth in Import Payments during July-December of FY08 and FY09**

	<i>(Min US\$)</i>			
	<b>FY08 Jul-Dec</b>	<b>FY09 Jul-Dec</b>	<b>Growth</b>	<b>Incremental Contribution</b>
<b>Food Grains</b>	<b>612.9</b>	<b>394.1</b>	<b>-35.7</b>	<b>-9.8</b>
Rice	314.6	195.6	-37.83	-5.3
Wheat	298.3	198.5	-33.46	-4.5
<b>Other Food Items</b>	<b>952.6</b>	<b>853.5</b>	<b>-10.4</b>	<b>-4.4</b>
<b>Consumer &amp; Intermediate Goods</b>	<b>4227.5</b>	<b>5831.2</b>	<b>37.93</b>	<b>71.9</b>
<i>of which</i>				
Clinker	163.1	143.8	-11.83	-0.9
<b>Crude petroleum</b>	<b>279.9</b>	<b>403.1</b>	<b>44.02</b>	<b>5.5</b>
<b>POL</b>	<b>881.2</b>	<b>1206.1</b>	<b>36.87</b>	<b>14.6</b>
<b>Fertiliser</b>	<b>258</b>	<b>756.5</b>	<b>193.22</b>	<b>22.3</b>
Dyeing and tanning materials	98.6	145.5	47.57	2.1
Plastics and rubber articles thereof	371.8	428.9	15.36	2.6
Yarn	308.3	423.7	37.43	5.2
Textile and articles thereof	915.5	1048.1	14.48	5.9
Staple fibre	48.8	61.1	25.2	0.6
<b>Capital Goods &amp; Others</b>	<b>3231.2</b>	<b>4104.7</b>	<b>27.03</b>	<b>39.1</b>
Iron, steel & other base metals	545.3	718	31.67	7.7
Capital machinery	752.2	760.5	1.1	0.4
Others	1933.7	2626.2	35.81	31.0
<b>Total</b>	<b>9024.2</b>	<b>11183.5</b>	<b>23.93</b>	<b>96.8</b>
<b>Import by EPZ</b>	<b>575.7</b>	<b>648</b>	<b>12.56</b>	<b>3.2</b>
<b>Grand Total</b>	<b>9599.9</b>	<b>11831.5</b>	<b>23.25</b>	<b>100.0</b>

Source: Bangladesh Bank

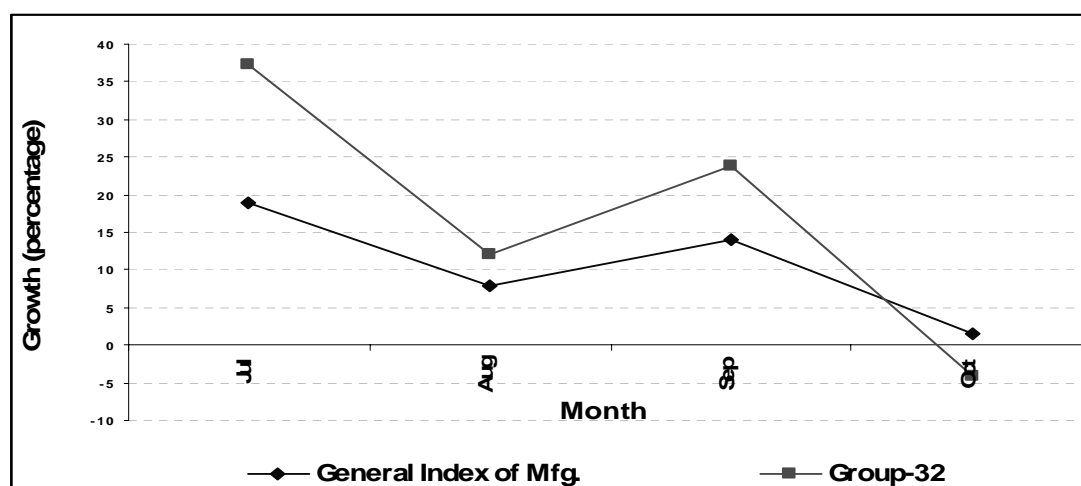
How the BoP situation will develop, and whether the trade balance and current account balance will further improve, will hinge on the extent of deceleration in import payments in view of falling global commodity prices, and the impact of the ongoing crisis on export earnings and remittance flow of Bangladesh, and also the aid situation.

### 3.4 Real Sector: Weak investment may expose the medium term outlook

Production of rice during Aus and Aman season of FY2008-09 had been satisfactory which helped Bangladesh to keep inflationary pressure under control in recent months. Preliminary estimates of Aus production indicate a 25.7 per cent annual growth in FY2008-09. Despite the fact that some areas were affected by flood in 2008, and there were reports of insect attacks in some pockets of production in Bangladesh, field level information is indicative of an overall satisfactory Aman production in FY2008-09. If potential benefits of measures initiated for Boro season (e.g., revision of fuel and fertiliser price and subsidies and greater availability) can be effectively realised on the ground, a good Boro harvest could be expected this year which will be critical to ensuring food security and help further reduction of inflation.

While good harvests in the agricultural sector could provide a cushion of comfort to the government during these troubled times, slowdown in the industrial sector is likely to become a major concern in the near term. During the first four months of FY2008-09, production estimates based on quantum index of production (QIP) of large and medium scale manufacturing industries has recorded a moderate growth of 10.6 per cent (Figure 19). Within the general index, Group 32 that includes major export related industries (e.g. jute, cotton, apparels and leather etc. with 38.16 per cent weight), registered a 17.4 per cent growth. However, growth of this group appears to have decelerated in October, 2008 with adverse implications for the performance of the manufacturing sector.

**Figure 19: Growth in Industrial Production**



Source: Bangladesh Bureau of Statistics (BBS)

However, it is the growth achieved in the first three months that is still holding the growth figure up. While the first quarter (July-September) of FY2008-09 showed a growth of 13.5 per cent, the first month in the second quarter (October, 2008) achieved only 1.5 per cent month-on-month growth over October, 2007 (Table 15). For most of the categories of industries, production had slowed down in October 2008 which was a rather disquieting development (Table 16). Industrial growth performance also has important implication for export sector performance and should be carefully monitored to see whether the observed slow pace of growth is connected with the global crisis.

**Table 15: Industrial Production Situation**

	Unit	Production	
		Growth Oct FY09	Growth Jul-Oct FY09
Jute Textile	mt.	-14.24	-8.03
Yarn	mt.	2.63	3.33
Cloth	000' metre	10.04	9.58
Garments	mIn Tk	-7.32	26.78
Tanning & finishing	000' sq. m.	-49.39	-35.11

Source: Bangladesh Bureau of Statistics (BBS)

Proxy indicators suggest that the declining trends in the manufacturing sector could continue in the near future. Indeed, L/C figures show that during the first quarter of FY2008-09 (July-October), both opening (37.5 per cent) and settlement (40.1 per cent) of L/Cs for industrial raw materials did maintain high growth. However, quite disturbingly, during the second quarter (October-December) of FY2008-09, L/C opening for industrial raw materials posted a negative (-) 12.0 per cent growth. L/C settlement of the same, however, posted a positive growth (26.8 per cent), owing perhaps to high growth in opening of L/Cs during the previous quarter. L/C opening for capital machineries also declined by (-) 39.8 per cent in the second quarter, which was already negative (-3.0 per cent) in the first quarter. What is noteworthy in this connection is that term loan disbursement fell quite sharply during the second quarter of FY2008-09 when disbursement declined significantly by (-) 32.1 per cent; to compare, disbursement was 30.8 per cent higher in the first quarter of FY2008-09 (amounting to Tk 4950.93 crore), over the first quarter of FY2007-08. This significant fall in disbursement in the second quarter was accompanied by 20.3 per cent growth in recovery during the second quarter. This resulted in a net disbursement of a mere Tk 4.35 crore (against Tk 2567.02 crore net disbursement in the second quarter of the previous year), a 99.8 per cent fall!

**Table 16: Proxy Indicators for Manufacturing Outlook and Their Recent Trends**

Indicators	Amount		Quarterly Growth (%)	
	Jul-Sep FY09	Oct-Dec FY09	Jul-Sep FY09	Oct-Dec FY09
Average Industrial Output (QIP)	419.6	352.1	13.5	1.5*
LC Opening for Industrial Raw Material (mln US\$)	2740.5	1837.4	37.5	-12.0
LC Opening for Capital Machinery (mln US\$)	397.4	230.1	-3.0	-39.8
Term Loan Disbursement (Gross) (crore Tk)	4950.9	3989.6	30.8	-32.1
Term Loan Disbursement (Net) (crore Tk)	1072.6	4.3	-7.5	-99.8

Source: Bangladesh Bureau of Statistics (BBS), Bangladesh Bank

\* for the month of October, 2009 only

L/C opening data for the first month of the third quarter of FY2008-09 (January, 2009) portrays a further dismal picture. L/C opening for industrial raw materials declined by (-) 34.6 per cent, compared to the L/C opening figure for January, 2008. For capital machineries also, opening of L/Cs declined by 39.7 per cent in January, 2009.

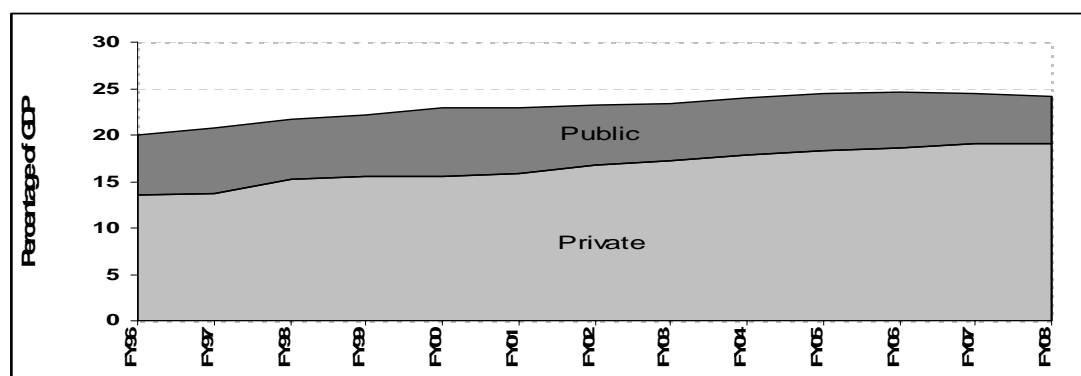
Opening of L/Cs for capital machineries experienced negative growth for all major groups of industries during the last few months, particularly those related to export (Table 17). Such a significant decline in import of capital machineries is likely to have negative implications for investment and could emerge as a major concern in the medium term.

**Table 17: Growth of L/C Opening (FY2007-08 vs. FY2008-09, month to month)**

Month	Jul	Aug	Sep	Oct	Nov	Dec	Jan
Capital Machinery	13.9	-39.4	26.8	-46.5	-34.9	-38.7	-39.7
Textile	-23.5	-6.8	-26.3	-59.1	-49.2	-57.6	-67.1
Jute Industry	-52.0	-67.2	203.0	-53.4	253.4	-98.0	-94.8
Garment Industry	71.0	-41.2	-0.9	-43.3	-9.3	-44.1	-46.6

Source: Bangladesh Bank

Along with the sharp deceleration of manufacturing sector growth, another emerging concern in the real sector of the economy relates to the stagnating investment scenario (Figure 20). For the second consecutive year, gross investment rate as per cent of GDP has declined in FY2007-08. Following an insignificant improvement in FY2005-06, to 24.7 per cent of GDP (from 24.5 per cent of GDP in FY2004-05), gross investment rate fell back to 24.5 per cent in FY2006-07 and then to 24.2 per cent of GDP in FY2007-08.<sup>23</sup>

**Figure 20: Investment as Percentage of GDP**

Source: Ministry of Finance

<sup>23</sup>This was, however, lower than the Medium Term Macroeconomic Framework (MTMF) target of extended PRSP which was set at 24.9 per cent in FY2007-08.

Public investment has continued to decline and has scored a historic low rate of 5 per cent of GDP in FY2007-08, lower when compared to the earlier low levels of 5.5 per cent in FY2006-07. Low implementation of ADP is a major reason for the slowdown in the pace of public investment which in turn explains the fact of stagnating gross investment in recent times. Implementation of ADP did not improve during FY2008-09 either; only 31 per cent of the ADP could be implemented during the first seven months. Lack of availability of power has been a major problem severely limiting growth potentials of the country. Significant public sector investment will be required to address the situation; however, power division has managed to implement only 30 per cent of total ADP during July-January FY2008-09 which will adversely impact on gross domestic investment in FY2008-09. In this regard, it is worth underlining here that, as suggested by a Bangladesh Bank analysis, public sector investment has positive crowd-in effect for private sector investment in Bangladesh context.<sup>24</sup>

Private investment, which covers four-fifths of total investment of the country, as a share of GDP increased marginally from 19.0 per cent in FY2006-07 to 19.2 per cent in FY2007-08. However, as signs of political transition became clear, private sector started to show renewed interest in investment. Board of Investment (BOI) received some 1,217 local investment proposals with total investment registration amounting to Tk. 17,684 crore for January-October period of 2008, against only 286 investment proposals with investment registration of Tk. 1,966 crore in the 12 months of 2007. Majority of these investment (953) proposals were made in the apparel/textile sector, of which 643 were in textile industries. However, as the aforesaid trends of proxy indicators such as import of capital machineries, term credit and import data would suggest, these registered investment proposals have perhaps remained mostly unrealised.

#### **4. Bangladesh Economy and Global Economic Crisis: Implications of Stimulus Packages of Other Countries**

Both advanced and emerging economies have initiated various fiscal and monetary measures in the form of bailouts and stimulus packages in view of the current economic meltdown. The objectives of such initiatives appear to be primarily five-fold: (a) to restore confidence in the financial system and revamp and stabilise the financial market, (b) to stimulate domestic demand, (c) to create new job opportunities, (d) to support domestic industries, and (e) to safeguard export interests. However, in today's globalised context, initiatives taken by one country are expected to have consequences for their competitor countries, through knock on impact on consumer confidence and demand for imports, relative change in export-competitiveness strength and availability of resources for aid, FDI and PFI. A review of these is important from the perspective of designing Bangladesh's own stimulus package if and when such an initiative is considered.

For example, in response to the global financial crisis, the Indian government has announced three rescue packages. On December 2008, India declared the first stimulus package, worth US\$4.0 billion with several fiscal measures and support for infrastructure development. The Indian government adopted an across-the-board 4 per cent cut in Central Value Added Tax (CENVAT) that was aimed at bringing down the prices of both consumers' as well as producers' goods (cars, cement, textiles and others). Export support measures included: i) Pre- and post-shipment export credit for labour intensive exports, i.e., textiles (including handlooms, carpets and handicrafts); leather, gems & jewellery and marine products and SME sectors were provided incentives through an interest subvention of 2 per cent up to March 31, 2009 subject to minimum rate of interest of 7 per cent per annum, ii) Additional funds of Rs. 1,100 crore was to be provided to ensure full refund of Terminal Excise duty or Central Sales Tax (CST), iii) An additional allocation for export incentive schemes of Rs 350 crore was to be made, iv) Government back-up guarantee was to be made available to Export Credit Guarantee Corporation of India Ltd (ECGC) to the extent of Rs. 350 crore to enable the organisation to provide guarantees for exports to difficult markets or products, v) Exporters were to be allowed refund of service tax on foreign agent commissions of up to 10 per cent of FOB value of exports. They were to be also allowed refund of service tax on output services while availing benefits under Duty Drawback

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<sup>24</sup> Majumder (2007).

Scheme. Incentive for textiles sector included (a) an additional allocation of Rs 1,400 crore to be made to clear the entire backlog in Technology Upgradation Fund (TUF) Scheme, and (b) all items of handicrafts were to be included under 'Vishesh Krishi & Gram Udyog Yojana' (Special Agriculture and Village Industry Scheme). The package also contained full exemption from basic customs duty on industrial intermediate naphtha to give relief to power sector and withdrawal of export duty on iron ore fines while cutting down the levy on export of iron lumps from 15 per cent to 5 per cent. The Government declared that it would accord the highest priority to supporting medium, small and micro enterprises (MSMEs) sector which was perceived to be critical for employment generation. To facilitate the flow of credit to MSMEs, Reserve Bank of India (RBI) announced a refinance facility of Rs.7000 crore for Small Industries Development Bank of India (SIDBI) which would be available to support incremental lending, either directly to MSMEs or indirectly via banks, Non-Banking Financial Companies (NBFCs) and State Financial Corporations (SFCs).

In addition, the following steps were also taken in the first stimulus package of the Indian government: (a) To boost collateral free lending, current guarantee cover under Credit Guarantee Scheme for Micro and Small Enterprises on loans was to be extended from Rs. 50 lakh to Rs. 1 crore with guarantee cover of 50 per cent, (b) Lock-in period for loans covered under the existing credit guarantee scheme would be reduced from 24 to 18 months in order to encourage banks to cover more loans under the guarantee scheme, (c) Government would issue an advisory to Central Public Sector Enterprises and request State Public Sector Enterprises to ensure prompt payment of bills of MSMEs. Easing of credit conditions was likely to help Public Sector Undertakings (PSUs) to make such payments on schedule. The RBI has announced that in near future it will put in place a refinance facility of Rs. 4,000 crore for the National Housing Bank. As a further measure of support to the housing sector, public sector banks would announce in the immediate term a package for borrowers of home loans in two categories: (i) up to Rs. 5 lakh and (ii) Rs. 5 lakh to Rs. 20 lakh.

Following the announcement of the first stimulus package there was criticism on the ground that not enough was done to address the liquidity crisis that had deterred banks from lending to their clients and to face the adverse impact of global recession. In January 2009, the Indian government announced that another US\$4.0 billion would be pumped into the economy over the next two years. The second stimulus package had five elements which included a strong focus on interest rate reduction, additional liquidity injection to productive sectors, financial aid to export sector, a boost to infrastructure sector and easier access to external commercial borrowings (ECBs) and foreign institutional investors (FIIs). The stimulus package announced an additional expenditure to the tune of Rs. 20,000 crore during the current year, mainly for critical rural, infrastructure and social security sectors and measures to support Exports, Housing, Micro, Small & Medium Enterprises (MSME) and Textile sectors. The RBI had reduced the Repo and the Reverse Repo rate and, in addition, the cash reserve ratio (CRR) has been reduced with a view to injecting additional liquidity into the system. The reduction in the policy interest rates and the CRR is expected to further encourage banks to lower interest rates and provide additional credit infusing more liquidity in the market. Credit targets of Public Sector Banks are to be raised by an increase in the provision of sectoral credits which the Government would monitor closely. Duty Entitlement Passbook (DEPB) rates were to be restored to those prevailing prior to November 2008. The DEPB Scheme would be extended till December 31, 2009 which would provide predictability and stability in the short term for future contracts. Duty drawback benefits on certain items including knitted fabrics, bicycles, agricultural hand tools and specified categories of yarn were being enhanced. These changes would take effect retrospectively from September 1, 2009. EXIM Bank would provide pre-shipment and post-shipment credit to the Indian exporters at competitive rates from a line of credit worth Rs. 5,000 crore obtained from RBI. The stimulus package also included measures to boost infrastructure spending, small and medium businesses, and labour-intensive export sectors such as textiles and handicrafts. Several other initiatives including tax rebate, credit facilities and devaluation of rupee were also being pursued. It was envisaged that in the short term these expenditure of the central Government would induce budgetary expansion and may lead to higher budget deficit. However, it was felt by the Indian policymakers that these initiatives were necessary to boost domestic demand, enhance investment and create employment opportunities and hence, were justified. Furthermore, as is known, between July 2008 to February 2009, Indian rupee depreciated by about 18.4 per cent.

At the end of February, 2009 the Indian government came up with the third stimulus package. This included a 2 per cent cut in excise duty and service tax. Service tax was reduced to 10 per cent from the prevailing level of 12 per cent and excise duty was reduced by a similar magnitude for items presently subject to 10 per cent. Tax concessions would entail a revenue sacrifice of about Rs. 30,000 crore for the economy or about 0.5 per cent of GDP. The package also includes an extension of 4 per cent across-the-board excise duty cut beyond March 31, 2009 and excise duty on bulk cement to be 8 per cent or Rs. 230 per metric ton, whichever is higher.

A special package of Rs. 325 crore for the employment-intensive industries was unveiled on February 26 this year. The package includes incentive for leather and textile sectors, removal of import curbs on gems and jewellery, relaxation in export obligations and a five per cent duty credit for exports of handmade carpet under the Focus Product Scheme, against 3.5 per cent that was given earlier.

China announced a US\$586 billion stimulus package in November, 2008 which would be implemented over the next two years to boost domestic demand in view of sluggish global demand and significant fall in Chinese exports.<sup>25</sup> This stimulus package was equivalent to about 7 per cent of China's annual GDP. In the stimulus package, four trillion *Yuan* was to be spent on upgrading infrastructure, particularly roads, railways, airports and the power grid, on raising rural incomes via land reform, and on social welfare projects such as affordable housing and environmental protection. China indicated a shift to 'moderately easy' monetary policy, where lending limits on commercial banks were being lifted. The stimulus package also involved a cut in value-added tax (VAT). One of the stimuli to boost the Chinese economy was raising tax rebates for certain exports to help producers cope with falling profit margins as a result of slacking market demand, and rising cost of production. The adjustment involves 3,486 items from labour intensive industries such as textile, garment, toy, and hi-tech and high value added sectors such as anti-AIDS drugs and tempered glass.

Vietnam announced a US\$1 billion demand stimulus plan in December, 2008 focusing mainly on manufacturing sector and infrastructure development. The budget deficit of the country is likely to rise to 7 per cent from the current 5 per cent of the GDP. Vietnam has initiated a programme that encourages its people to use locally made products. The government would use economic stimulus package to help small and medium sized businesses, especially those engaged in processing agricultural products and providing jobs for workers particularly those involved in building rural infrastructure. The Government would spend significant resources to assist poorest districts to implement social welfare policies. Supportive policies involving value added tax, export duties for oil and coal, and import taxes on car components are being pursued. To boost purchasing power of the poor the package included allowances for these groups of population, who were severely affected by inflation which was as high as 19.9 per cent in December 2008. Vietnam has depreciated the *Dong* by 4.1 per cent between July 2008 and February 2009.

The Indonesian Government has come up with a plan to launch a fiscal stimulus package worth about US\$6.1 billion (73.3 trillion rupiah) in March 2009 in view of the ongoing global financial crisis. The government estimates that up to three million new jobs will be created in the current year. Part of the fiscal stimulus relate to tax which was already being implemented since January 2009, when a new income tax law began to take effect. Infrastructure expenditure was raised by another 2.0 trillion rupiah. The 73.3 trillion rupiah package included taxation stimulus worth 56.3 trillion rupiah and state expenditure stimulus worth 17.0 trillion rupiah. Taxation stimulus part included reduction of tariffs, government-borne value added tax and import duties, and incentives related to income tax. The state expenditure stimulus part consisted of infrastructure expenditure worth 12.2 trillion rupiah (US\$ 1.02 billion) and direct subsidy and energy subsidy worth 4.8 trillion rupiah (US\$ 400 million). The stimulus package is expected to increase the deficit in the 2009 state budget to 2.5 percent of the gross domestic product (GDP) from 1 percent of the GDP. During last eight months, the Indonesian Rupiah was depreciated by about 30 per cent in order to boost the country's export earnings.

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<sup>25</sup> The *Yuan* appreciated marginally in recent period which also had some negative impact on China's exports.

In response to the financial crisis, ASEAN finance ministers have come up with a proposal to set up a multilateral fund of US\$120 bln to boost the regional economy. Japan, China and South Korea have also joined the scheme; the agreement with regard to the fund will be finalised in May this year.

A review of the aforesaid stimulus packages would reveal some common policy stands: (a) boosting domestic demand through additional investment in infrastructure and productive sectors; (b) fiscal stimuli by way of reduced duties and taxes; (c) aggressive monetary policy through rate cuts and reduced interest rates; (d) readiness to go for higher deficits to stimulate economy; (e) fiscal-financial incentives in the form of cash compensation schemes, income tax rebates, credit at reduced interest rates in support of export-oriented sectors; (f) competitive devaluation of the currency ranging from 6 to 40 per cent.

For Bangladesh, these cross-country evidences have relevance in two ways: firstly, these provide an insight into the thinking of policymakers of neighbouring countries in the area of macroeconomic management in the backdrop of the ongoing crisis; secondly, they provide an idea about how export-competing sectors of these countries are being supported, with consequent impact on Bangladesh's own relative competitiveness situation in the global market.

Initiatives of competing countries in the form of currency depreciation, tax rebates and duty drawbacks, lower interest rate, cash compensation schemes, availability of additional funds and other fiscal-monetary incentives are likely to undermine competitive strength of Bangladesh's export quite significantly in the global market. As was noted earlier, for example, in the US and the EU apparels market, China, India and Vietnam are some of Bangladesh's major competitors. The aforesaid stimulus packages have significantly enhanced competitive edge of these countries, vis-à-vis Bangladesh. Till now, Bangladesh's performance record has been maintained mainly thanks to readiness of exporters to accept lower cut and make (C&M) charges and profit margins. Yet another example relates to the adverse impact on backward linkage sectors such as yarn/spinning which have now lost a large part of its competitiveness as a consequence of stimulus-induced lower import price of Indian yarns. It may also be recalled in this connection that in the recent past a number of large-scale buyers, particularly from Japan, have shown interest in sourcing apparels from Bangladesh in view of higher prices offered in China. The stimulus packages put in place by China has now limited Bangladesh's opportunity to avail of these new opportunities. In view of the above, and in the backdrop of the warning signs in the country's external sector performance, it is time that Bangladesh's policymakers starts to apply their minds to come up with their own stimulus package in order to support the country's export-oriented and also other sectors which have come to be affected by the crisis. Such a package is also required to help realise the emerging opportunities in the global market.

## **5. Bangladesh Economy and Global Economic Crisis: Policy-stance, Alternatives and Tradeoffs**

It is worth noting that the Bangladesh Bank had taken a number of energetic steps when the financial sector crisis first kicked off in October, 2008. Central bank reserves were safeguarded through withdrawal from risky investments and transfer to reliable central bank accounts, and private sector financial institutions were immediately advised by the Bangladesh Bank to protect their respective deposits. It helped that the capital market was exposed to foreign portfolio investment only to a limited scale (2.4 per cent of market capitalisation) and exotic but toxic derivatives were not traded in the country's capital market. This enabled Bangladesh to avoid the consequences of the first wave of the adverse impact. However, as the analysis indicates, Bangladesh has not been immune to the second wave of impact, when financial crisis hit the real economy. The adverse impacts have started to be transmitted through various channels to the domestic economy.

The discussion above indicates that whilst Bangladesh economy has thus far been able to avoid the worst adverse consequences of the ongoing global crisis, a number of disquieting developments do transmit cautionary signals and should be of concern to policymakers. Macroeconomic performance indicators relating to the first seven months of current fiscal year do not appear to be off the recent trends. However, when month-on-month performance is put

under scrutiny, one does not fail to locate some disquieting developments. When these are considered and analysed in the light of the ongoing global economic crisis, there is much reason to be concerned about. Slowdown in export growth, lower number of workers leaving for jobs abroad, declining industrial growth, negative growth of import of capital machineries, slow growth of term loans, lower domestic resource mobilisation and adverse impact of policies pursued by competing countries, are disquieting developments indeed. As the analysis indicates, to a large extent these can be related to the adverse consequences originating from the global economic crisis.

As was noted in the text, countries which have been adversely affected by the crisis have been taking an array of proactive measures in order to mitigate the negative fallouts of the crisis and to address the challenges in the area of macroeconomic management. These countercyclical policies relate to exchange rate management, export incentives, tariff rates, credit and interest rates, domestic demand stimulation through investments in infrastructure development and policies to promote job creation.

It is reckoned that as policymakers get on with the task of designing the budget for FY2009-10, they will weigh the policy options at their disposal to best accommodate the emergent situation.

**BOX: SUGGESTIONS AND DEMAND PUT FORWARD BY PRIVATE SECTOR ORGANISATIONS**

***Bangladesh Garments Manufacturers and Exporters Association (BGMEA)***

- 10 percent cash incentive for readymade garment (RMG) exporters on total export value.
- As an alternative, BGMEA suggested that the government could maintain a separate exchange rate for the sector and give Tk 10 more against US\$ 1, for 30 percent of total export value.
- Withdrawal of VAT from utility and other services (electricity, telephone etc.) for the sector.
- Lower commercial lending rate of 7 per cent (which is currently 13.3 per cent).
- Reschedule of three-year loans to five-year loans and seven-year loans to 10-year loans.
- Subsidized diesel for the RMG sector in view of the rising cost of power supply occurring from the use of generators due to frequent power failure.

***Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA)***

- 10 per cent cash subsidy to the knitwear industries on total export value.
- Reduction in interest rates to 10 per cent.

***Federation of Bangladesh Chambers of Commerce and Industry (FBCCI)***

- A Tk. 6,000 crore rescue package for the export sector (Tk. 3,500 crore for garment exporters, Tk. 1,400 crore for textile spinners and Tk 1,100 crore for jute, leather, frozen food and vegetable exporters).
- Rescheduling and 1-2 year moratorium facility on bank loans.
- Relaxation of Credit Information Bureau (CIB) rules by the Bangladesh Bank which bars loan-defaulting companies from transacting export and import orders.

***Metropolitan Chamber of Commerce and Industry (MCCI)***

- A supportive monetary policy and conducive tariff regime rather than direct cash incentive to exporters as part of the government's effort to tackle the recession. Supportive monetary policy and conducive tariff regime include reviewing and keeping the exchange rate stable and competitive, keeping interest rate supportive to export and production, ensuring priority distribution of bank credit to agriculture, manufacturing and service sectors and limiting government's borrowing from the banking sector.
- If cash subsidy is an absolute necessity, it is to be given after a thorough analysis by the government, only to the affected businesses.
- Rescheduled term loans and creation of a contingency fund.
- Opportunity to whiten black money paying relevant taxes and 5 percent extra penalty tax.
- Reduced corporate tax rate and widened tax-holiday facility as a tool to encourage more investments.

***Bangladesh Finished Leather, Leather Goods and Footwear Exporters Association (BFLFEA) and Bangladesh Tanners Association (BTA)***

- Increase in cash subsidy to 25 per cent on the total export value. The national budget has a provision of 15 per cent cash subsidy to the sector.
- Credit flow in a lower interest rate of 5 per cent.

- Waiver of interests and penalties for loans taken since January 1, 2008.
- Withdrawal of duties and VAT on inputs and machineries used by the tanneries along with abolishment of the provision of 25 per cent tax at source for leather and leather products.
- A temporary suspension of recovery of interests on loans for two years.

### *Exchange Rate*

Exchange rate management is an important tool that policymakers have at their disposal; however, it involves various tradeoffs. A depreciation of exchange rate of Taka will basically work in the same manner as cash incentives for exporters and remittances earners. However, it could adversely affect imports, domestic prices and inflation. While a BDT depreciation could have positive impact on export competitiveness and profits, the net impact in view of Bangladesh being a net-importing country remains questionable. In the context of the recent high inflation, the need for transmitting the positive impact of falling commodity prices to consumers and constraining inflationary pressure also remains a concern. Also, BDT depreciation will result in higher import cost of raw materials for export-oriented sectors.

As was pointed out earlier, REER appears to be below the nominal rate of BDT. Additionally, in a managed float system the capacity to influence the exchange rate depends on various factors including access to adequate resources to intervene in the market. Till now Bangladesh's policy appears to have been mainly focused on maintaining stability of the dollar. Towards this, intermittently the Bangladesh Bank has been purchasing dollars from the market. Between January 15 and March 11, 2009 Bangladesh Bank purchased about US\$ 269.2 million from the market which helped to restrain BDT from appreciating against the USD. The current level of reserves (US\$ 5513.65 mln on 9 March, 2009) amounts to about 2.8 months of import payments, implying there is further room to purchase USD from the market in order to replenish dollar reserves.

Since exchange rate manipulation is likely to have economy-wide impact, it is argued that a better policy option would be to have sector-specific intervention mechanisms in place rather than pursuing a proactive policy that induces exchange rate to depreciate. As was pointed out earlier, because of significant depreciation of currencies and other support measures put in place by many of Bangladesh's competitors, competitive strength of Bangladesh's exports in the global market have seen significant erosion in the recent past. In view of this, there is an immediate need for measures to be put in place in support of Bangladesh's export-oriented sectors and also domestic demand stimulation.

### *Interest Rate*

The issue of interest rate on lending has come under scrutiny in Bangladesh in the recent past. With high interest rates on deposits, induced by high inflation, lending rate has also tended to remain high. As was noted, notwithstanding this, the spread between lending and deposit rate is considered to be high and thereby, discouraging investment. In spite of repeated attempts by the Bangladesh Bank through moral suasion not much has happened in this context. As is known, since 1990s Bangladesh gradually shifted towards market driven policy making in determining the interest rate. Bangladesh Bank routinely uses the repo and reverse repo interest rates and open market operations to regulate levels of reserve money, and influence growth of broad money and its components on the asset (credit) and liability (currency and deposit) sides, rather than impose direct influence on the interest rate.

Changes in Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) for scheduled banks are the other monetary policy tools that are used albeit less often. However, the extent to which interest rate is able to stimulate investment and economic activities in Bangladesh context, has been questioned. Results of an empirical study by Bangladesh Bank suggest that investment spending at the aggregate level is non-responsive to interest rates.<sup>26</sup> Investment spending at disaggregated level is responsive to interest rate, to a limited scale, for private sector investment category. Conducive business environment and overall good governance remain critically important and necessary factors; lending rate appears to be a

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<sup>26</sup> Ahmed and Islam, 2006.

sufficient factor in stimulating investment. However, in view of strengthening competitive strength of both export-oriented and domestic market oriented activities, availability of credit at lower interest rate remain an important issue. In the backdrop of high liquidity in the system, it would appear that there are scopes to reduce this high spread.

#### *Reduction in Duties, Taxes and Bank Charges*

The rate of duty on capital machinery imports and spare parts was reduced from 5 per cent to 3 per cent in the FY2008-09 budget. In this regard the CPD observed at the time that given the depressed investment scenario, import of capital machinery and spare parts may be made duty-free to stimulate industrial investment.<sup>27</sup> At present, export oriented industries import capital machinery and spares on payment of 1 per cent customs duty – the indemnity bond system was abolished and replaced with a concessionary rate of 1 per cent in the FY2008-09 budget. The aforesaid CPD report pointed out that this has raised exporters' production costs. This concessionary rate of 1 per cent could be revisited by the government in the upcoming budget. In the budget of FY2008-09, customs duty on basic raw materials was reduced to 7 per cent from 10 per cent. At the same time duty on intermediate raw materials was also reduced from 15 per cent to 12 per cent. In view of the current financial crisis a number of countries have adjusted their duty levels. The Government may think about further rationalisation of these rates.

In July 2008, the Government relaxed import conditions to enable producers to take advantage of the low-cost Indian yarn. To protect the interests of local spinning sector, the Government has now tightened rules on yarn import, particularly from India. Imports are subject to more rigorous check on yarn-count and chemical tests. The present move by the government in tightening the rules is expected to benefit local yarn industries. However, additionally, local spin millers are demanding a rescheduling of the loan payback time. In view of this, the idea of extension of loan settlement could be considered.

A number of fiscal measures were proposed in the budget for FY2008-09 in support of the SMEs. For example, the SME sector has been given income tax relief by defining SMEs as entities having annual turnover below Tk 2.4 million. The upper limit of investment in capital machinery, in order to enjoy cottage industry benefit (i.e., no VAT), was increased from Tk 700 thousand to Tk 1.5 million and turnover limit was raised from Tk 2 million to Tk 2.4 million. This measure is expected to help growth of the SME sector. At the same time VAT was set to be withdrawn from the production stage for some items including fabrics produced from artificial fiber, and thread using handloom. Tax holiday was given to agro-processing industries. In view of the crisis, many countries such as India and Vietnam are now putting in place new initiatives in support of small and medium domestic industries, particularly to boost domestic demand. Various industries, as was noted, received support through duty cuts and access to funds at lower cost. Whilst designing the budget for FY2009-10, the Bangladesh government may consider revisiting the existing tax and duty structure and undertake further adjustments in the backdrop of the gloomy investment outlook.

Earlier, Bangladesh's exporters and importers had raised concern about high bank charges for various services offered. To mitigate the situation, the Bangladesh Bank issued a circular through which banks were asked to undertake certain disciplines in making service charges.<sup>28</sup> The Government will need to strongly monitor adherence to what is stipulated by this circular.

#### *Credit Line*

In the budget for FY2007-08, the government has allocated an endowment fund of Tk 100 crore for the SME Foundation to provide credit to Small and Medium Enterprises (SMEs) through private commercial banks. Government has decided to provide more funds to the Foundation in the FY2008-09 budget; an additional amount of Tk 100 crore was allocated in support of the SMEs. The SME Refinancing Scheme of Bangladesh Bank has allocated Tk 500 crore in FY2008-09, up from Tk 300 crore of the previous year. Other than this, allocation

<sup>27</sup> State of the Bangladesh Economy and An Analysis of the National Budget for FY2008-09, June 17 2008.

<sup>28</sup> The circular was issued on September 30, 2008; charges to be imposed for a number of services were fixed through this circular.

from Equity and Entrepreneurship Fund in the FY2008-09 budget (Tk 100 crore) has been targeted to the IT-related industries.<sup>29</sup> The Bangladesh Bank has also indicated earlier to establish a fund, under a refinancing scheme, in support of the country's emerging shipbuilding industry in a bid to help it to graduate into an important export earning sector.<sup>30</sup>

Many of Bangladesh's competitors have come up with initiatives to establish dedicated funds that would allow access to credit line at lower cost. Policymakers could think of establishing such funds in support of export-oriented industries which are facing difficulties in view of the global crisis. Such funds could be used to ensure credit-flow to crisis-hit sectors at lower interest rates, and with expanded repayment period requiring higher number (with smaller size) of installments for repayment. The government could also consider pursuing the commercial banks to extend the repayment period of the existing loans for the sectors that are already affected.

### *Cash Incentive*

An amount worth Tk 1,050 crore has been kept in the budget for FY2008-09 as cash subsidy for 13 export-oriented activities including frozen food, products made of hogla, straw, coir and sugar cane, bi-cycle, processed agricultural products, RMG, jute products, leather products, potato, hatching eggs and one-day chicks, liquid glucose and light engineering products. In view of the need to strengthen competitive strength and lower the costs of doing business, this cash compensation scheme may be further strengthened. Immediate steps are required to release the arrear of about Tk. 2.43 billion cash subsidy which were not released to the 13 sectors which are eligible for this support.

As was detailed out in Section 3, Bangladesh's competitors are coming up with various initiatives to address the emerging challenges. Recently, India has announced setting up of cash incentives programmes for a number of items. For example, a Rs 325 crore export incentive programme has been established for apparels and leather products that are to be shipped to the US and the EU markets. Exporters will receive 2 per cent of the exported value as incentive from April, 2009.<sup>31</sup> India has also made an additional allocation of Rs 350 crore for export incentive schemes; however, the exact mechanism to implement the scheme is yet to be known – this could take the form of cash incentives, tax refund for import of inputs etc. At the same time, along with India, various other countries including China and Indonesia are creating multi-billion dollar funds that are mostly directed to infrastructure development, domestic demand stipulation, tax and duty refund, support to export-oriented sectors etc.

Table 18 provides an idea about the volatility being faced by the various export-oriented sectors. Although overall exports have picked up again in January, 2009 (12 per cent growth compared to January 2008), disaggregated figures of second quarter, FY2008-09 and January, 2009 testify to the fact that global crisis have started to have an adverse impact on Bangladesh's export-oriented sectors and has subjected it to higher volatility. The government has said that it is considering the idea of expanding the existing cash subsidy scheme to an additional seven export items. These will need to be carefully selected. Forward-looking analysis will need to be undertaken towards this end. For example, for the RMG sector's performance with regard to issuance of utilisation declaration (UD) certificates would be important to get a preview of future export performance<sup>32</sup>. For example, evidence suggests negative growths of UD's for the months of December, 2008 (-7.68 per cent), January, 2009 (-4.98 per cent) and February, 2009 (-17.5 per cent). This is likely to have adverse consequences for performance of export-oriented apparels sector in future months.

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<sup>29</sup> In FY2007-08 EEF allocation was also targeted to agro-based industries.

<sup>30</sup> The BB has agreed, in principle, to create this fund, to be worth about 500 crore taka, and to be disbursed through commercial banks.

<sup>31</sup> This facility, however, will be provided on temporary basis for six months.

<sup>32</sup> Utilisation Declaration (UD) are Certificates issued by the Bangladesh Garments Manufacturers and Exporters Association (BGMEA) and Bangladesh Knitwear Manufacturers and Exporters Association (BKMEA) to their member enterprises certifying the orders that they have received from apparels buyers through back to back L/Cs. The UD's (in volume terms) and its growth compared to earlier years provide an idea as regards trends in orders placed and hence gives an indication about growth in volume in near-term future (UD's generally are realised through exports in about 2-3 months).

As was pointed out in the text, Bangladesh has some fiscal space in FY2008-09 in view of the lower budgetary expenditure pressure, particularly on subsidy account. Using this cushion, the government could consider undertaking well-considered initiatives in view of the crisis. These could include economy-wide measures, such as monetary, fiscal policies (influencing interest rate, general fiscal rationalisation) as well as sector-specific measures (in the form of withdrawal of VAT, incentives for entry into new market, product specific tariff concessions etc.). Two issues are important here: firstly, many such initiatives should be strictly time-bound and secondly, these should be strictly monitored to ensure that these are targeted and used in an appropriate manner. Such initiatives could be in two forms: immediate measures of support and through the upcoming budget for 2009-10. The Task Force set up by the government with the Hon'ble Finance Minister as Convenor is mandated to monitor the impact of the crisis on various sectors of the economy. The work of the Task Force will be critical to addressing the attendant challenges. The government may like to consider the idea of a comprehensive stimulus package, if on the basis of performance of macroeconomic indicators relating to export, import, remittance, industrial growth and domestic labour market, the Task Force puts forward such a suggestion to the government.<sup>33</sup>

**Table 18: Growth in Major Export Items during the Last Quarter (Q2, FY09) and the Last Month (Jan 2009)**

Export Item	Growth (%)	
	Q2, FY09/Q2, FY08	Jan, FY09/Jan, FY08
Petroleum Products	-79.9	-86.4
Handicrafts	-32	-61.8
Raw Jute	7.4	-55.5
Tea	-28.7	-55.2
Textile Fabrics	125.3	-36.0
Jute Goods	-32	-32.5
Leather	-50.2	-31.4
Ceramic Goods	-22.7	-26.5
Agricultural Products	-20	-18.0
Frozen Foods	-24.3	-14.2
Vegetables	-52.8	9.1
Footwear	8.9	9.4
<b>Woven RMG</b>	<b>6.4</b>	<b>18.7</b>
<b>Knit RMG</b>	<b>4.7</b>	<b>21.2</b>
Tobacco	20.6	52.8
Home Textile	-3.8	205.7
<b>Total Primary</b>	<b>-21.1</b>	<b>-28.4</b>
<b>Total Mfd</b>	<b>0.5</b>	<b>14.7</b>
<b>Total Export</b>	<b>-1.2</b>	<b>11.9</b>

Source: Based on EPB monthly Statistics.

Support to backward linkage industries of apparels, in the spinning sector, could bolster Bangladesh's competitive strength. Better performance of trousers compared to shirt items in recent times testify to relative advantages that originates from domestic backward linkage (denim sector) as against imported fabrics. In view of the need to help entrepreneurs to go for upmarket products and raise productivity, the government could also consider providing incentives for R&D activities and import of capital machineries. A Technology Upgradation Fund could be set up to provide assistance for this. Any support should also take into account the emerging opportunities for Bangladesh's export sector.

<sup>33</sup> Some members of the Task Force that met in its first meeting on March 24, 2009 have put forward a number of suggestions: speedy release of money under CCS, withdrawal of renewal fee on diesel generators, relaxation of rules and regulations relating to loans and loan defaults, withdrawal of VAT on export income, expansion of safety-net programmes, support to modernise the BSTI to meet standardisation requirements. Emphasis was put by many on agriculture and rural development and infrastructure development particularly energy. A recurring issue mentioned was that of high interest rate on lending and ways to bring it down.

### *Domestic Demand Stimulation*

In these times of trouble, stimulating domestic demand must be seen as a critical policy instrument to address the adverse consequences of crisis. Unlike many other low income countries, Bangladesh does have a formidable and large domestic market. Private consumption accounts for 74.5 per cent of Bangladesh's GDP (in FY2007-08). Whilst export sector is important, export-value addition constitutes only about 9.0 per cent of GDP. Unlike many other neighbouring countries to the East, Bangladesh economy is thus critically dependant on domestic demand. Stimulating private consumption through direct government expenditure would thus be the most effective way of stimulating the economy. In view of low level of development of the financial market, direct fiscal-budgetary support to stimulate domestic economic activities, job creation and domestic demand should be seen as major policy interventions in view of addressing adverse affects of the crisis.

The upcoming budget provides an opportunity to take concrete steps in this regard. Effective implementation of programmes such as 100-day programme, proposed initiatives in support of one-job-one-family, higher allocation for VGD/VGF and other social protection programmes could absorb shocks arising from slowdown in export growth, slower pace of industrial growth and lower number of people going abroad. The government has already indicated plans to go for more expanded VGD programme and introduction of rationing system for selected groups of workers. The upcoming budget will need to reflect government's initiatives and contemplation in this regard. Government's initiatives to pursue large scale infrastructure projects could also play a positive role in stimulating domestic demand and creating jobs.

## **6. Concluding Remarks**

The third wave of adverse implications of the ongoing crisis appears to have started to hit the increasingly globally integrated economy of Bangladesh. The need to take policy initiatives in order to address the emerging challenges originates from three considerations:

- (a) negative impacts affecting the economy through various transmission mechanisms;
- (b) possible adverse impact of policies pursued by other countries;
- (c) the need to stimulate domestic demand in view of knock-on affects on production and employment situation; and
- (d) for taking advantage of emerging opportunities.

The upcoming budget offers an opportunity to undertake medium term economy-wide as well as targeted initiatives in view of the above challenges. However, concrete, sector-specific measures will need to be considered for immediate implementation. Three considerations could inform the policy choices in this regard – firstly, as was pointed out, the government will be able to take advantage of fiscal space in the 2008-09 budget; secondly, the targeted measures can be put in place for a limited period, i.e. would be of clear time-bound nature; thirdly, any opportunity arising from any global stimulus/initiative must be fully exploited. The analysis in this report has mentioned about various possible initiatives to stimulate both production related activities and domestic demand as instruments of possible counter-cyclical measures. These related to tariff rationalisation and tariff rebates, stimulus package for export-oriented sectors in the form of cash incentives, duty-free access for inputs, setting up a technology upgradation fund, establishing special credit lines for lending at reduced interest rates, income tax rebate, setting up of dedicated funds for returnee migrant workers, domestic demand stimulation through enhanced safety-net programmes and higher entitlements and higher investment in infrastructure programmes that create jobs and income-earning opportunities.

Along with the above, renewed effort to improve overall governance and business environment to raise the quality of implementation of various initiatives and programmes of the government, and greater effort to mobilise higher domestic resources, will be needed to address the emerging challenges.

The upcoming G-20 meeting provides an opportunity to highlight developing country interests with respect to aid and debt cancellation. There is likely to be a renewed call for raising aid

commitment to 0.7 per cent of the GNIs of developed countries;<sup>34</sup> a review of global financial architecture and the role of World Bank and IMF are also on the card. In the last meeting of G20 finance ministers and central bank governors held on March 14, 2009, there was an appeal to ensure higher capital availability to multilateral development banks; the need for a substantial capital increase for the Asian Development Bank to help the world's poorest was highlighted in this context. As a leading member of the LDC group, Bangladesh should play an active role in this debate. The attention of international community in recent times has been focused relatively more on Africa. However, the vulnerabilities of Asia-Pacific low income countries are also being quite manifestly exposed as a result of the ongoing crisis. It needs to be emphasised in this context that any package of support should not exclude low-income countries of the Asia-Pacific region. In this connection it may be recalled that Bangladesh has not been considered for support from the Millennium Challenge Account (MCA) put in place by the US government and this could be an opportunity to explore inclusion of Bangladesh in MCA.

It needs to be recalled in the context of the current discussion that over the recent past, Bangladesh had suffered a reversal of poverty reduction trend because of the high inflation, particularly on account of high prices of essentials. Possible negative consequences of the ongoing crisis could undermine Bangladesh's efforts to 'reverse this reversal of poverty reduction trends'. In view of this, every effort will need to be put in place so that policy initiatives are geared towards higher pace of poverty alleviation and that attainment of the MDGs by Bangladesh continue to stay on track. Global economic crisis is likely to make both these tasks much more challenging in 2009, and perhaps beyond.

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<sup>34</sup> It is also to be kept in mind that the devaluation of pound against dollar (by about 30 per cent) and Euro against dollar (by about 15 per cent) over the last one year are likely to cut the value of EU commitments.

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