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# State of the Bangladesh Economy in FY2007 and Outlook for FY2008

*Third Reading*

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**Paper prepared under the CPD programme  
*Independent Review of Bangladesh's Development (IRBD)***

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CENTRE FOR POLICY DIALOGUE (CPD)  
B A N G L A D E S H  
*a c i v i l s o c i e t y t h i n k - t a n k*



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**HOWEVER, THE IRBD TEAM 2007 ALONE REMAINS RESPONSIBLE FOR THE ANALYSIS AND OPINIONS EXPRESSED IN THIS PRESENTATION**



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## I. DISTINGUISHING FEATURES OF FY07

### Special features of FY2006-07 (FY07)

- **Extraordinary year spanning over three (and half) governments**
- **Year of political distress and emergency rule**
- **Year of initiation of major institutional reforms**
- **Year of high commodity prices in global markets**
- **Year of promising development in international relationship**
- **Year of Nobel Prize for Bangladesh**



## I. DISTINGUISHING FEATURES OF FY07

### Macroeconomic Conditions at the Beginning of FY2007

- **FY07 began its journey in the backdrop of a respectable growth rate of 6.71 per cent (provisional figure) in FY06**
- ***However, fiscal balance inherited fragility due to:***
  - **Inefficiency in implementation of public investment programme**
  - **Poor revenue mobilisation**
  - **High growth of revenue expenditure**
  - **Low foreign aid disbursement**
- ***Macroeconomic correlates were strained due to:***
  - **Monetary sector experiencing moderate credit expansion in manufacturing and agriculture sectors**
  - **Stretching of balance of payments as import outpaced exports**
  - **Rise in consumer price index**
  - **Frequent power outages**
  - **Uncertainty regarding large scale FDI projects**
- ***In the real economy:***
  - **Shortfall in foodgrain production**
  - **Respectable growth in manufacturing sector**
  - **Capital market failed to attract increased liquidity**



## I. DISTINGUISHING FEATURES OF FY07

### Major Developments in FY 2007

#### **Positive Economic Developments**

- (i) Improvements in Income Tax Collection***
- (ii) Sustained Manufacturing Growth***
- (iii) Impressive Disbursement of Term Loan***
- (iv) Robust Export Growth***
- (v) Rejuvenated Capital Market***
- (vi) Buoyant Remittance Flow***
- (vii) Improving Port Situation***
- (viii) More Competition in Telecom Sector***
- (ix) Reforms Gaining Momentum***



## I. DISTINGUISHING FEATURES OF FY07

### Major Developments in FY 2007

#### **Negative Economic Outcomes**

- i. Price Rise of Essential Commodities (particularly food)*
- ii. Weak Aggregate Revenue Collection*
- iii. Higher Revenue Expenditure*
- iv. Low Disbursement of Foreign Aid*
- v. High Government Borrowing*
- vi. All time Low Implementation of ADP*
- vii. Crisis of Fertiliser, Electricity and Diesel for Irrigation*
- viii. Fall in Gross Disbursement of Agriculture Credit*
- ix. Stagnant Foodgrain Production*
- x. Acute Shortage of Electricity*
- xi. Delinquent Enforcement of New Pay Scale in RMG Sector*

#### **Contentious Issues**

- (i) Uncertainty with TATA's Investment Proposal*
- (ii) What happens to Coal Mining by Asia Energy*



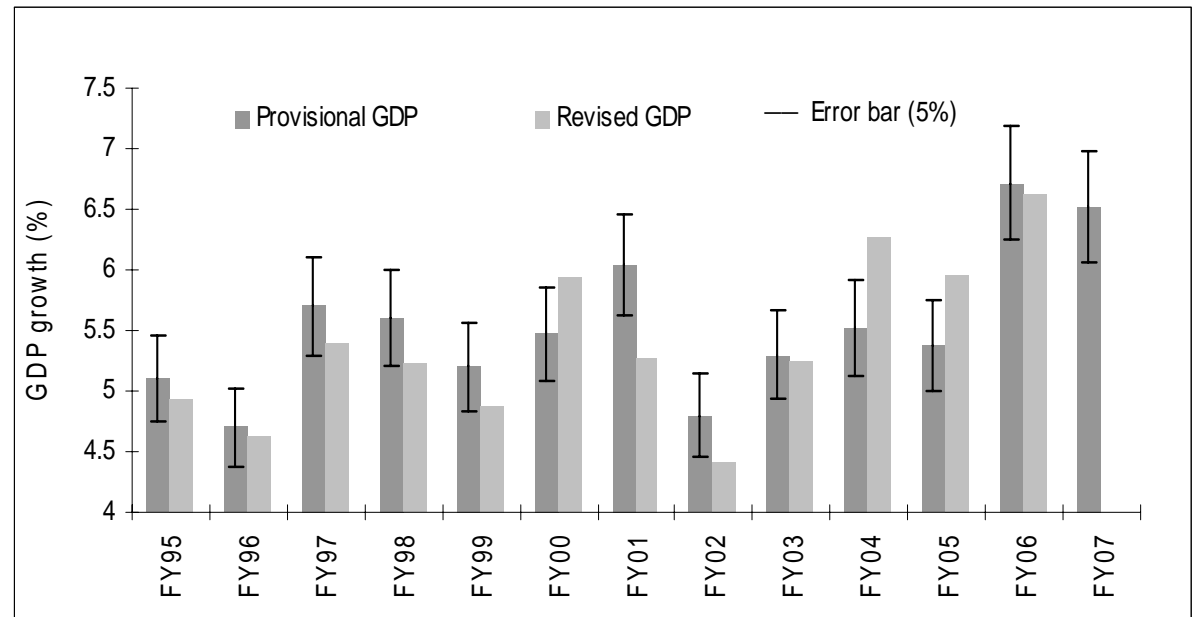


## II. GROWTH, SAVINGS AND INVESTMENT

### Growth Performance

- ❑ As expected, BBS has revised downward the GDP growth rate for FY06 from 6.71 per cent to 6.62 per cent
- ❑ This is the ninth time GDP has been revised downward in last twelve years
- ❑ According to preliminary estimates, Bangladesh economy in FY07 is set to post 6.51 per cent growth

#### Provisional and Revised GDP



This estimate was made on the basis of 6/7 months' data. Proxy indicators suggest that the economy has slowed down in FY07 compared to FY06

- ✓ **THE CREDIBILITY OF THIS ESTIMATE STILL REMAINS UNDER QUESTION!**
- ✓ **IN FACT COVERAGE, FREQUENCY AND QUALITY OF ECONOMIC DATA REMAIN MAJOR OBSTRACLES TO ENSURING QUALITY OF POLICY ORIENTED RESEARCH**
- ✓ **UNIFORMITY OF DATA ON SIMILAR INDICATORS & ISSUES, PROVIDED BY VARIOUS AGENCIES, MUST BE ENSURED TO AVOID CONFUSION**



## II. GROWTH, SAVINGS AND INVESTMENT

### Economic Growth Performance

- ❑ Factors affecting the economy in FY07 included the following:
  - *Agricultural* production was indifferent: Aus and Aman experienced negative growth, while a marginal growth is expected for Boro. Overall foodgrain production is not going to experience any significant growth in FY07 over last fiscal year.
  - *Avian flu* syndrome in *Poultry* sector.
  - Manufacturing growth (other than exports) had been modest due to political turmoil and energy crisis.
  - *Construction* and *Housing & Real Estate* growth affected by anti-graft drive.
  - *Banking* sector growth is found to be lower due to the above reasons.
  - Inflationary pressure including upward revision of energy price slowed down economic growth.
  
- ❑ Hence, it is anticipated that the initial growth estimate for FY07 may be revised downward once again (say by about 0.5% to settle at 6.0%).

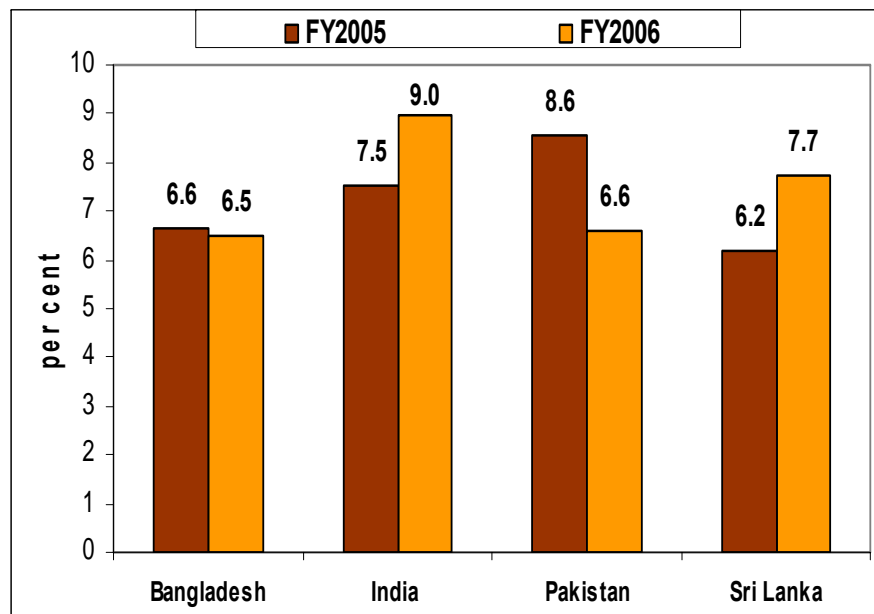


## II. GROWTH, SAVINGS AND INVESTMENT

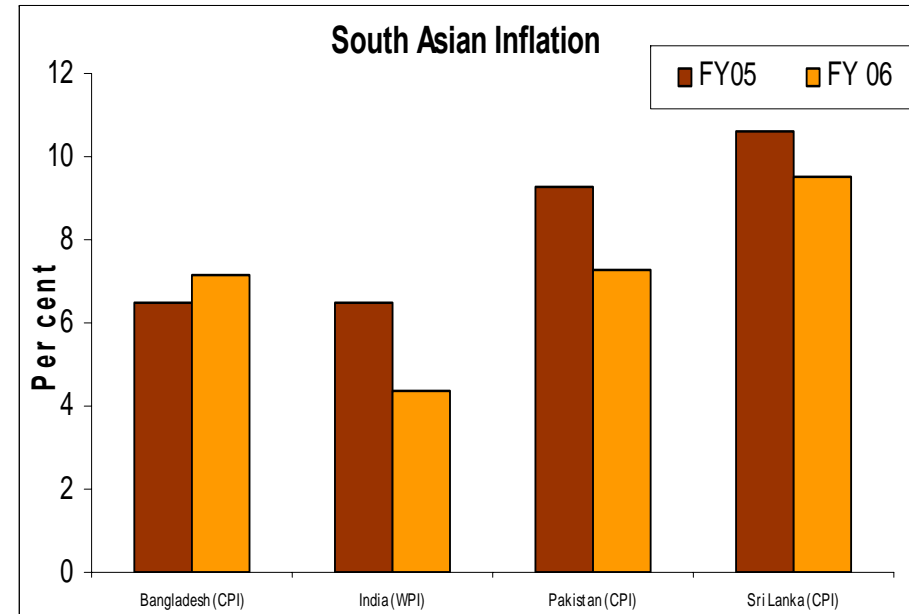
### Economic Growth in South Asia

Compared to the major South Asian countries, Bangladesh's GDP growth rates appear to be regular, not exceptional. South Asia as a whole is going through a moderately high growth trajectory. Inflation is also high regionally.

South Asia's GDP Growth during FY05 and FY06



South Asia's Inflation during FY05 and FY06



Source: Official Sources of Different Countries

## II. GROWTH, SAVINGS AND INVESTMENT

### Sources of Growth

(per cent)

Sector	Constant GDP (crore Tk.)		Growth FY06>FY07		Sectoral Share		Gain/Loss
	FY06	FY07	Sectoral	Incremental	FY06	FY07	
Real Sector	109851	117312	6.79	40.26	38.59	38.69	1.57
Others	174822	185895	6.33	59.74	61.41	61.31	-1.57

<b>Agricultural Sector</b>	59853	61756	3.18	10.27	21.03	20.37	-10.10
<b>Crops</b>	33644	34291	1.92	3.49	11.82	11.31	-7.82
<b>Industry</b>	79553	87118	9.51	40.82	27.95	28.73	12.08
<b>Manufacturing</b>	46820	52059	11.19	28.27	16.45	17.17	11.10
<b>Service Sector</b>	139375	148811	6.77	50.91	48.96	49.08	1.83
<b>Import Duty</b>	5892	5522	-6.28	-2.00	2.07	1.82	-3.82
<b>Total</b>	<b>284673</b>	<b>303207</b>	6.51	100.00	100.00	100.00	0.00

- ❑ One of the positive features of FY07 is the increased contribution of commodity production sector (posted a significant growth of 6.8 per cent)
  - Contribution of agriculture plus industry in incremental GDP was 51 per cent
- ❑ Manufacturing sector accounted for 24.64 per cent of the total incremental growth.
- ❑ While contribution from Crop sub-sector was as low as 3.49 per cent
- ❑ Share of services sector in GDP remained broadly static at 49%
- ❑ Import duty contribution was negative



## II. GROWTH, SAVINGS AND INVESTMENT

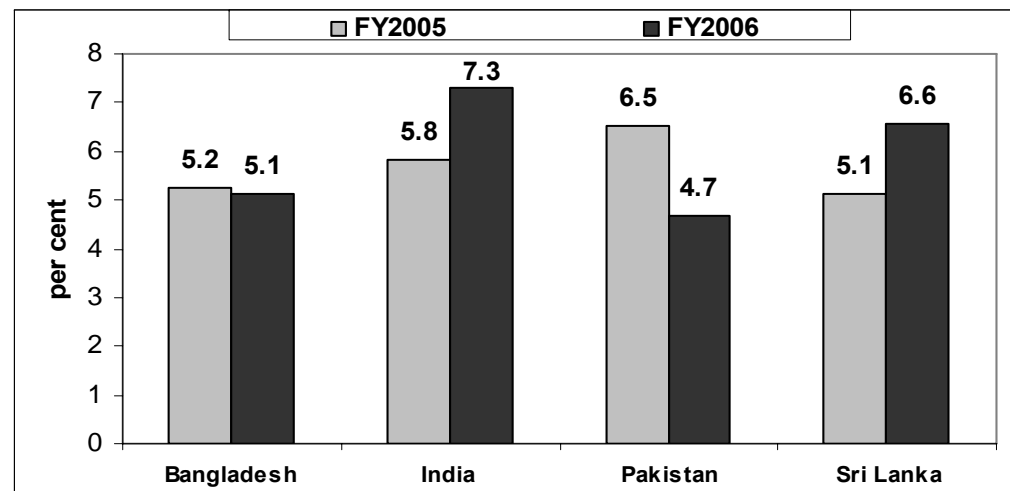
### Per Capita Income

- Per capita GDP and GNI stood at US\$482 and US\$520 in FY07 (7.8 % and 9.2 % growth respectively).
  - Stabilisation of exchange rate largely explains this achievement.
  - But with respect to the region and the rest of the world, Bangladesh is falling behind. NEED TO ACCELERATE GDP GROWTH RATE (and REDUCE POPULATION GROWTH RATE).

Per Capita GDP Differential with Bangladesh

Country Name	1990	2004
China	1.43	3.29
Malaysia	9.30	10.67
Indonesia	2.24	2.25
Vietnam	0.83	1.25

Growth of per capita GDP in South Asia FY05 and FY06

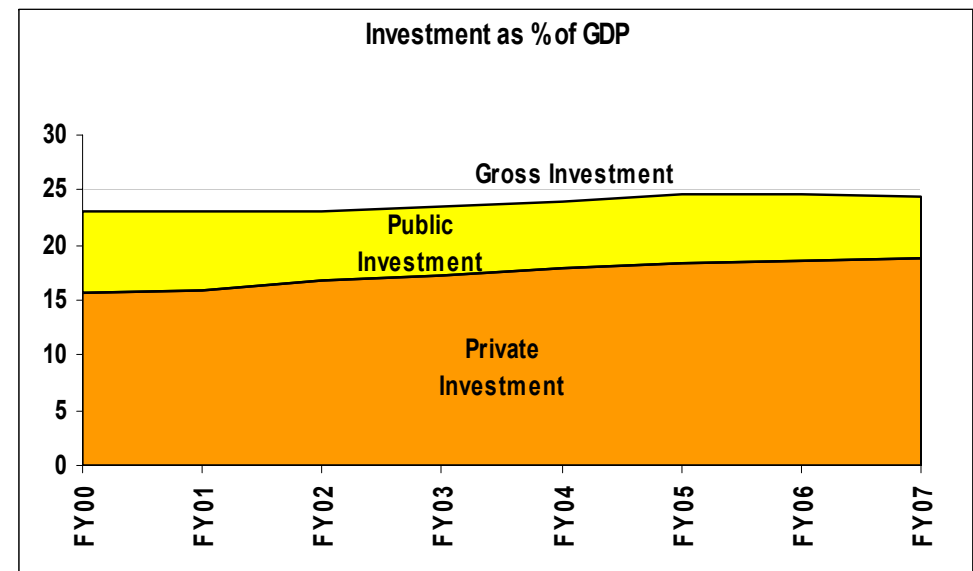


## II. GROWTH, SAVINGS AND INVESTMENT

### Investment

#### INVESTMENT SITUATION HAS BEEN DISMAL

- ❑ Gross capital formation slowed down in recent years and in FY07 growth rate has been lowest in last five years (7.22 per cent).
- ❑ Gross investment as percentage of the GDP is lower at 24.33 per cent in FY07 compared to 24.65 per cent in FY06
- Public investment stands all time low at 5.60 per cent of GDP in FY07 (6.0% in FY06)
- Private investment as a share of GDP stagnated at 18.73 in FY07 (marginally increased from 18.65 in FY06)



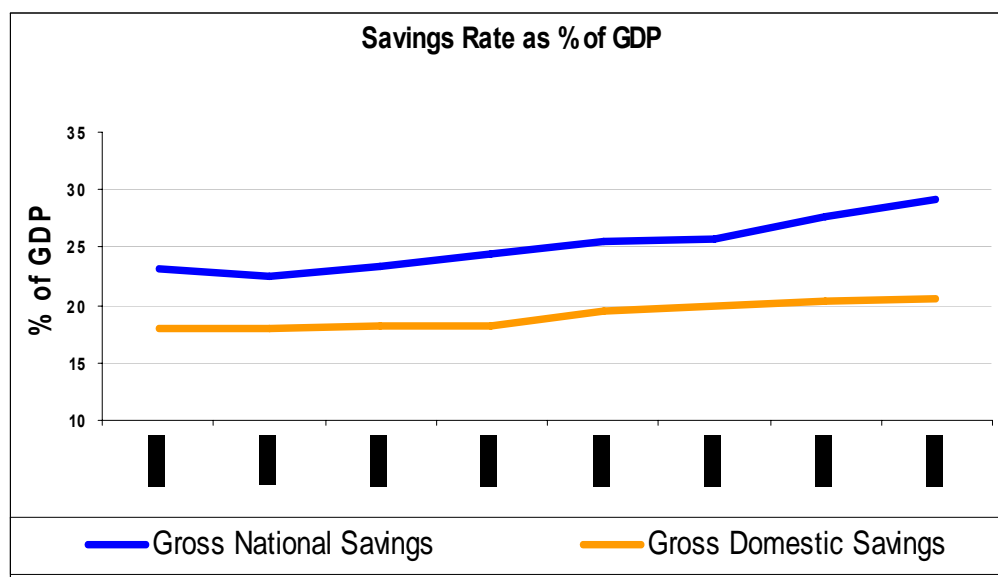
## II. GROWTH, SAVINGS AND INVESTMENT

### Savings

#### STAGNATION OF DOMESTIC SAVINGS

- ❑ The share of national savings in GDP increased significantly in FY07 (29.15% as against 27.67% in FY06).
- ❑ But national savings growth also slowed down in this fiscal (13 per cent) compared to FY06 (17 per cent).
- ❑ Stagnation in domestic savings continues
  - Only marginal increase from 20.25 per cent in FY06 to 20.46 per cent of the GDP in FY07
- ❑ Indeed, domestic savings growth slowed down considerably in FY07 – recording lowest growth performance in recent years. It implies people have to allocate incremental share of their income for consumption, possibly due to price hike.
- ❑ The gap between national and domestic savings is increasing consistently.

*Trend in domestic savings behaviour suggests deterioration in income distribution.*

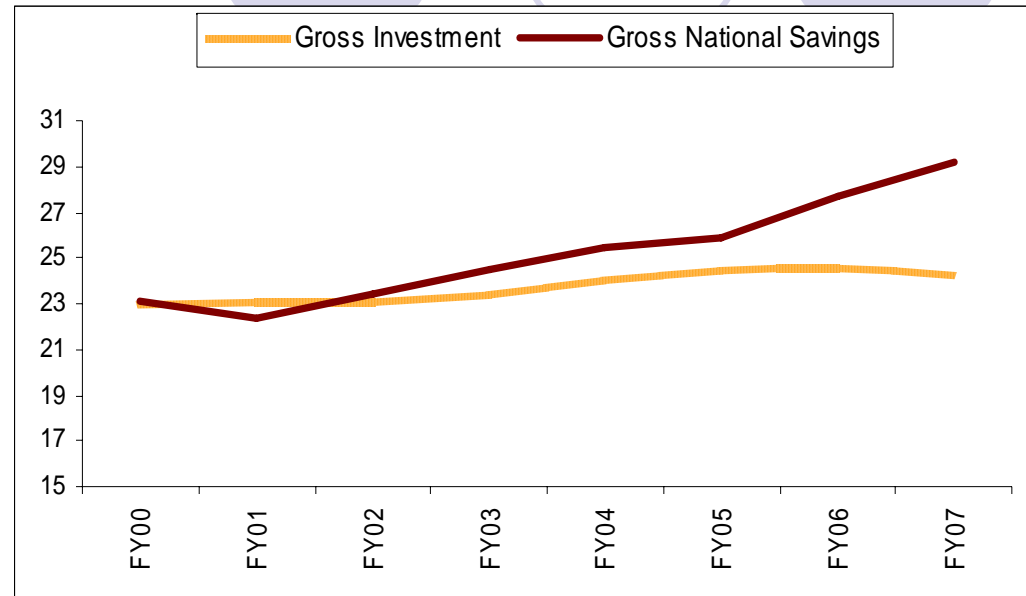




## II. GROWTH, SAVINGS AND INVESTMENT

### Investment and Savings

- ❑ While Bangladesh continues to remain an under-invested country, National savings rate (29.15 per cent) remains higher than the gross investment rate (24.65 per cent)
- ❑ The gap keeps increasing in recent times



Widening Savings-Investment Gap

### WHERE IS THE SURPLUS (TK. 22530 CRORES) GOING?

- ❑ A portion of the surplus is reflected in the increase of foreign exchange reserve. **Transforming this savings into investment still remains a major challenge.**





## II. GROWTH, SAVINGS AND INVESTMENT

### Growth - Investment

- ❑ Incremental Capital-Output Ratio (ICOR) is the ratio of new investment Required to Produce an additional unit of output. A high ICOR is often taken as a measure of poor “quality of investment”, the variations in the ICOR usually represent the change in capital productivity.
- ❑ The latest figures suggest that the ICOR improved during FY06 by 0.37 per cent (from 4.09 in FY05 to 3.72 in FY06). But in FY07 ICOR registered marginal increase implying a fall in capital productivity.

**Recent ICOR Trend in Bangladesh**

	<b>FY2005</b>	<b>FY2006</b>	<b>FY2007</b>
<b>Growth rate of GDP at constant price (%)</b>	6.00	6.62	6.51
<b>Investment as % of GDP</b>	24.53	24.65	24.33
<b>ICOR</b>	4.09	3.72	3.74

**HOW CONSISTENT ARE GROWTH, INVESTMENT & ICOR ESTIMATES?**

**Again the Issue of Poor Quality of Data!**

## II. GROWTH, SAVINGS AND INVESTMENT

### Growth Outlook for FY2008

- ❑ The growth target for FY2008 has been set at 7 per cent. To achieve the target, it would require either a considerable increase in investment rate or a much improved ICOR, or a combination of both.
- ❑ Under a BAU scenario (unchanged ICOR), the required investment rate will be 29% of GDP (i.e. higher by 4.7% of GDP). Alternatively, under an optimistic scenario (improved ICOR to trend rate of 4.21), the required investment rate will be 26% of GDP (i.e. higher by 1.7% of GDP). Incidentally, Bangladesh economy experienced investment growth of around 0.5% of GDP only twice in last 7 years.
- ❑ From investment perspective, a target of 6.0 to 6.5 per cent growth rate for FY08 looks rather more realistic.
- ❑ Thus consistency check once again indicates that GDP estimate for FY07 may not only face yet another downward revision, but target for FY08 may need to be trimmed as well.

Scenarios	ICOR	Investment
FY07 ICOR	3.74	26.2
FY 00 - FY06 average ICOR	4.22	29.5
ICOR Trend	4.17	29.2



## II. GROWTH, SAVINGS AND INVESTMENT

### Poverty Situation

- According to the *Preliminary Report on Household Income & Expenditure Survey (HIES 2005)* between 2000 and 2005, Bangladesh achieved remarkable progress in poverty alleviation.

Head Count Rate of Incidence of Poverty (CBN)

Residence	2005	2000	Change
National	40.0	48.9	-8.9
Rural	43.8	52.3	-8.5
Urban	28.4	35.2	-6.8

- Between 2000 and 2005 HC poverty level declined by 8.9 per cent at the national level (i.e. 1.8% per annum). Acceleration over 1990s (1.0% per annum on average).
- Poverty reduction in the rural areas has been faster than in the urban areas. But rural-urban gap still remains high.



## II. GROWTH, SAVINGS AND INVESTMENT

### Poverty Situation - HCR

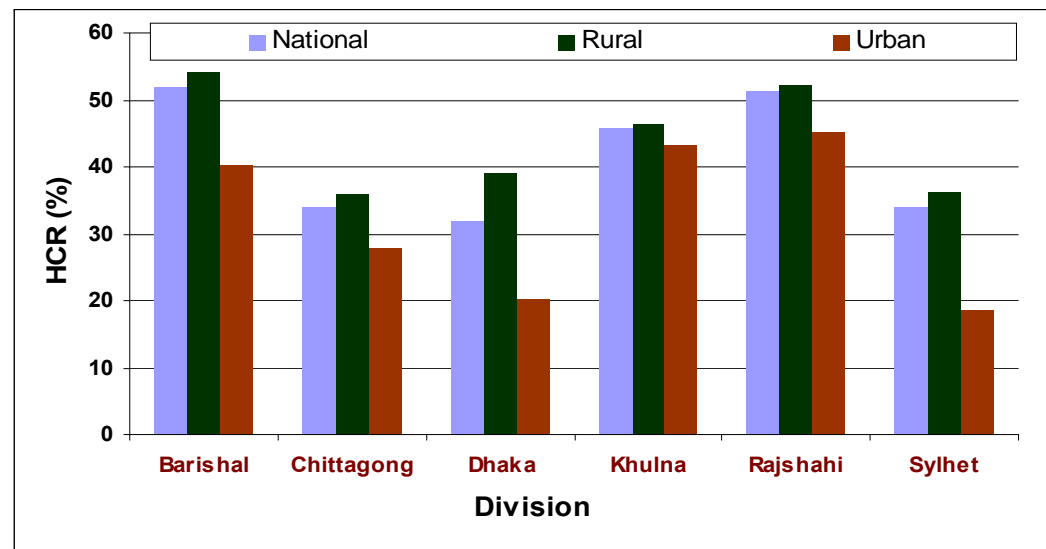
#### NUMBER OF HARDCORE POOR INCREASES

- ❑ Total number of poor in the country remained unchanged between 2000 and 2005 according to the DCI estimates.
- ❑ Number of hardcore poor increased from 2.5 crores in 2000 to 2.7 crores in 2005.

#### REGIONAL DISPARITY DEEPENS

- ❑ Despite an inspiring show in national poverty reduction, regional disparity is glaringly apparent.
- ❑ Barisal (stagnant), Rajshahi (marginal improvement) and Khulna (deterioration) turned out to be the most poverty-prone areas in the country.

Head Count Rate of Incidence of Poverty (CBN) 2005





## II. GROWTH, SAVINGS AND INVESTMENT

### Poverty Situation – Gini Coefficient

#### **INEQUALITY INCREASES**

- ❑ Between 2000 and 2005 the income gini coefficient increased from 0.45 to 0.47 at the national level.
  - The income ratio of highest and lowest 5 per cent at national level increased from 30.5 times (2000) to 35.0 times (2005).
  - The rural income gini coefficient significantly increased from 0.39 (2000) to 0.43 (2005).
- ❑ Surprisingly urban gini remained unchanged at 0.50 during the intervening period.
  - The income ratio of highest and lowest 5 per cent increased from 22.0 to 26.2 times at rural level, while at urban level it increased from 39.6 to 45.3 times.
- ❑ However, the consumption inequality remained fairly unchanged, as a matter of fact, it improved in urban area.



## II. GROWTH, SAVINGS AND INVESTMENT

### Poverty Situation: SOURCES OF INEQUALITY

- ❑ Based on HIES 2005 unit level data, Bhattacharya and Khan (2007) explain the underlying sources of inequality in rural and urban Bangladesh
- Both in rural and urban areas income from **Non-farm Enterprises** and *Remittances* from abroad are major sources of inequality.
- Property income from **Land and Rental Value of Housing** are the other sources of rising inequality. In fact their contribution is much higher for urban areas compared to the rural areas.
- Unlike urban areas, **Salaried Wage** in rural areas is another important source of inequality.

**Policies to raise the share of wage income, income from farm income, inland remittance and formal transfers can help to mitigate the rising inequality.**



## II. GROWTH, SAVINGS AND INVESTMENT

### Wage Rate Discrepancy

- ❑ During the January-March, 2007 real wage rate has declined; female workers are more affected compared to their male counterparts.
- ❑ Particularly in cotton textile mills and construction sector male workers enjoyed better monthly earnings, which increased in the third quarter while the earnings of females has declined.
- ❑ Gender discrimination also increased in the RMG sector.
- ❑ Wage rate discrimination is also found to be acute across regions. Wage rate is significantly low in Barisal, Rajshahi and Khulna – the most poverty prone areas.
- ❑ Regional discrepancy is prominent for both male and female workers. For example, maximum daily wages in agriculture are Tk135 (male) and Tk 90 (female) prevalent in Chittagong while in Rangpur these are Tk 70 for male and Tk 58 for female workers.
- ❑ These figures are fairly consistent with earlier findings on poverty dimension.



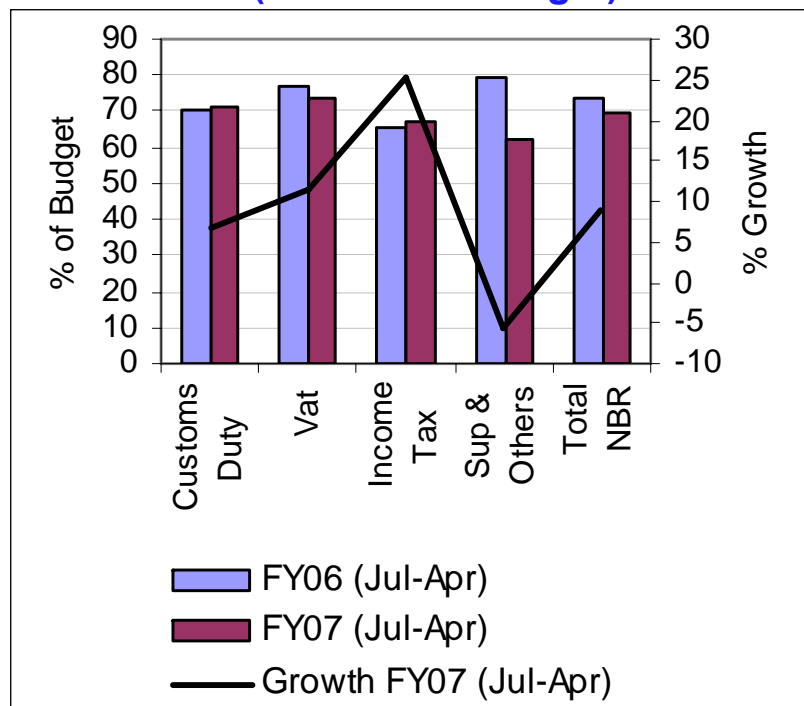
### III. FISCAL SECTOR

#### Revenue Collection: Poor Show

- ❑ Total Revenue collection grew by 11.3% during Jul-Feb of FY07 (18.6% in FY06). *The targeted annual growth for FY07 is 15.0% over budget and 23.4 % over actual collection of last year.*
- ❑ During Jul-Feb 54% of the fiscal target was realised, which was 56% in FY06.

#### NBR Tax Revenue: Varying Performance

Figure: NBR Revenue Collection (% of Fiscal Target)



- ❑ NBR registered a growth of 9.1% in Jul-April FY07, against target annual growth of 26.6% over actual collection of FY06.
- ❑ **Income tax grew by 25.1%, increasing its share in total NBR from 17.4% in FY06 to 19.9% in FY07 (Jul-Apr).**
- **VAT sustained robust growth (11.6%).**
- **Growth of import duty marginally went down to 6.5% (6.6% in FY06).**
- **Supplementary and others posted negative growth (-5.8%)**

**THE GROWTH TARGET WAS UNREALISTIC! WHY GROWTH OF CD AND SD IS SO LOW?**

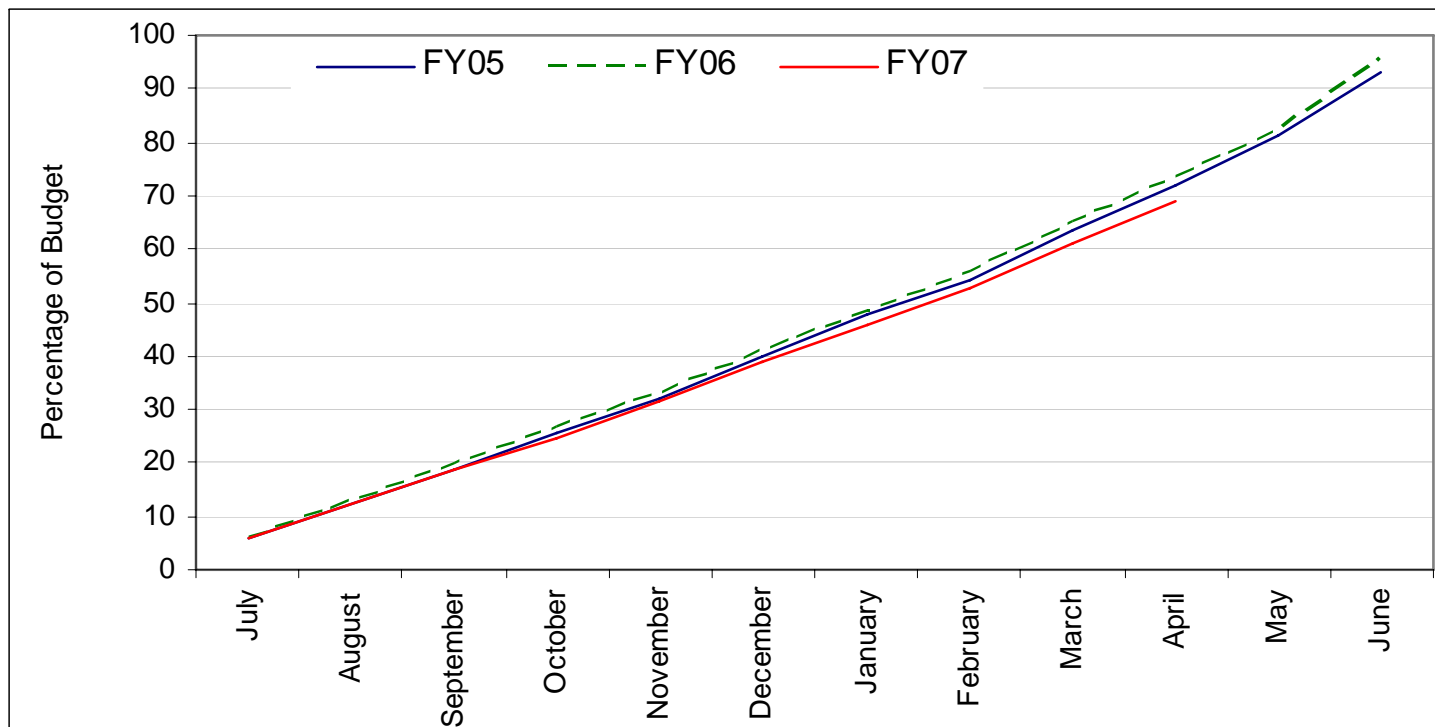




### III. FISCAL SECTOR

#### NBR Tax Revenue

- ❑ **Total number of tax returns submitted during Jul-Feb of FY07 is 13,98,166 (5% company, rest are individuals) which was 13,64,647 during the full fiscal of FY06.**
  - Tax return submission is increasing at a faster rate during the last few years
- ❑ **NBR achieved 69.4% of its annual target during Jul-Apr of FY07, which was 73.4% during the comparable period of FY06.**



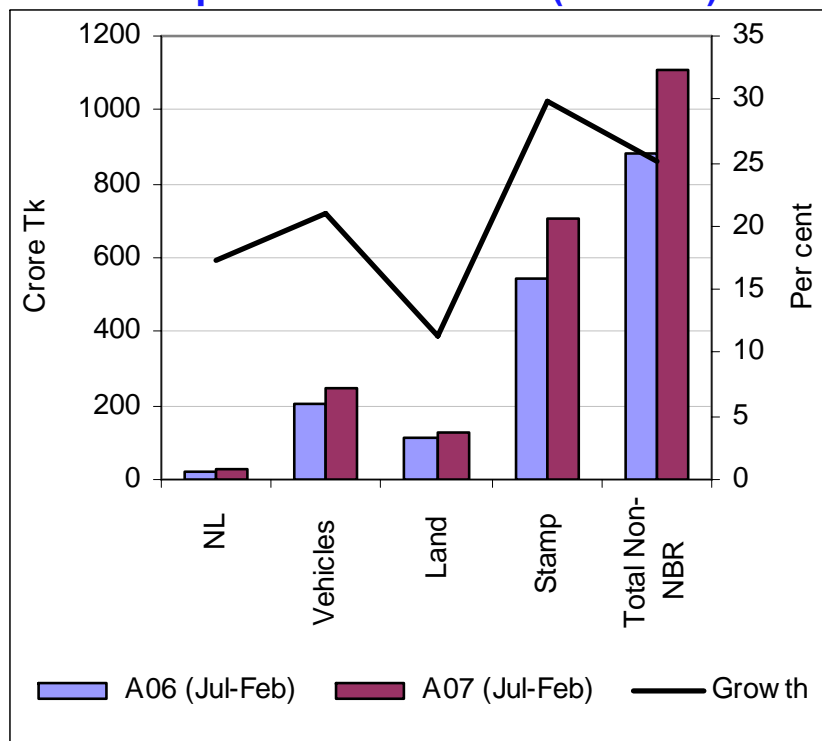


### III. FISCAL SECTOR

## Revenue Collection

### Non-NBR Tax Revenue: Significant Growth

Collection of Tax: Non-NBR Component in FY06-07 (Jul-Feb)



□ **Against an annual target of Tk 1860 crore, the realization stood at Tk 1107 crore till February 2007.**

➤ Targeted annual growth is 12.0% over budget and 21.9% over actual collection of FY06.

▪ **59.5% of annual target achieved till February (53.3% in FY06)**

□ **Registered significant growth of 25.1% against 13.3% of FY06 (Jul-Feb)**

✓ Tax on vehicles	: 21.0% ↑
✓ Land	: 11.3% ↑
✓ Narcotics and Liquor	: 17.4% ↑
✓ Taxes on stamps	: 29.9% ↑

***Better performance than last year, also outpaced target***

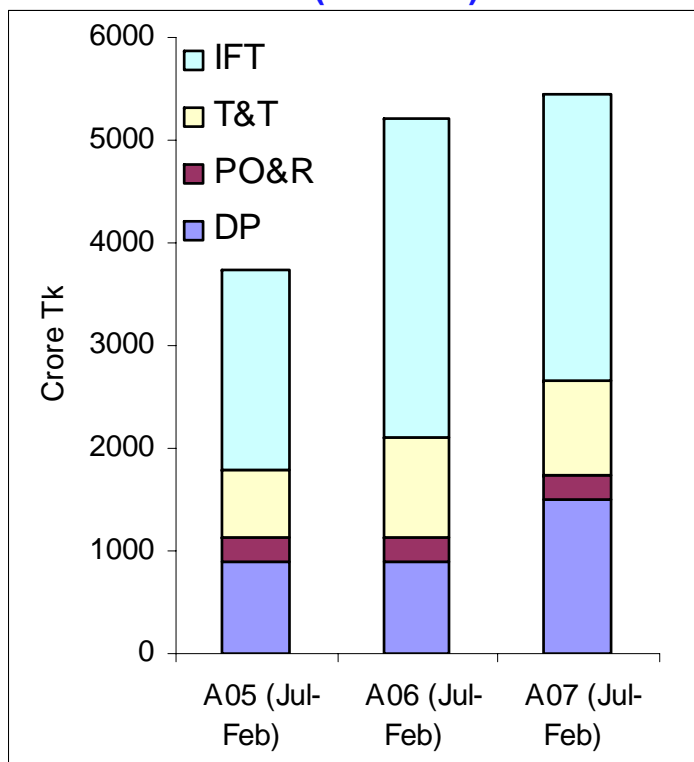


### III. FISCAL SECTOR

## Revenue Collection

### Non-Tax Revenue – Way Below Target

Collection of Non-Tax Revenue in FY05-07 (Jul-Feb)



□ Non-tax revenue collection stood at Tk 5435 crore in FY07 (Jul-Feb) as against Tk 5206 crore in FY06. The annual targeted growth over budgeted collection is 14.6% and 11.8% over the actual collection in FY06.

▪ **Subdued growth of 4.4% in FY07 (Jul-Feb) (Target growth: 11.8%), last year for this period: 39.1%.**

▪ **56.8% of the annual target realised (62.4% in FY05)**

✓ Interest, Fees & Toll (IFT) : (-)10.3% ↓

✓ Telephone & Telegraph (T&T) : (-) 6.6% ↓

✓ Dividend and profit : 66.6% ↑

✓ Post office and Railways : 7.1% ↑

▪ **Negative growth of IFT and T&T contributed to slower intake**

▪ **NEW SOURCES OF NON-TAX REVENUE: RECOVERY OF MONEY FROM HOME AND ABROAD: TK. 431 CRORE ++++++ ????**

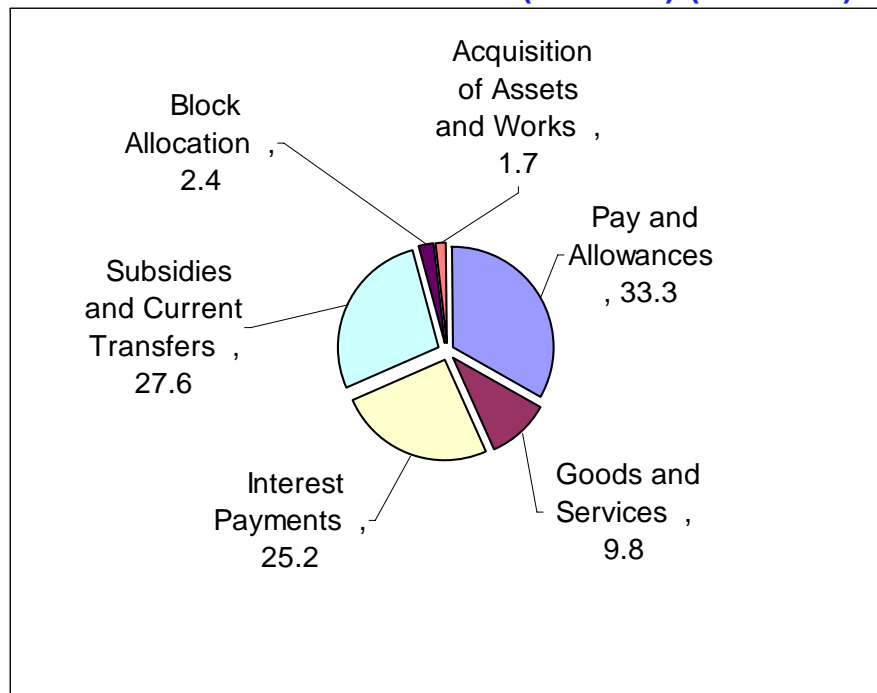


### III. FISCAL SECTOR

## Public Expenditure

### Revenue Expenditure: INCREASE BEYOND REVENUE GROWTH

Revenue Expenditure by Economic Classification FY2006-07 (Jul-Feb) (% share)



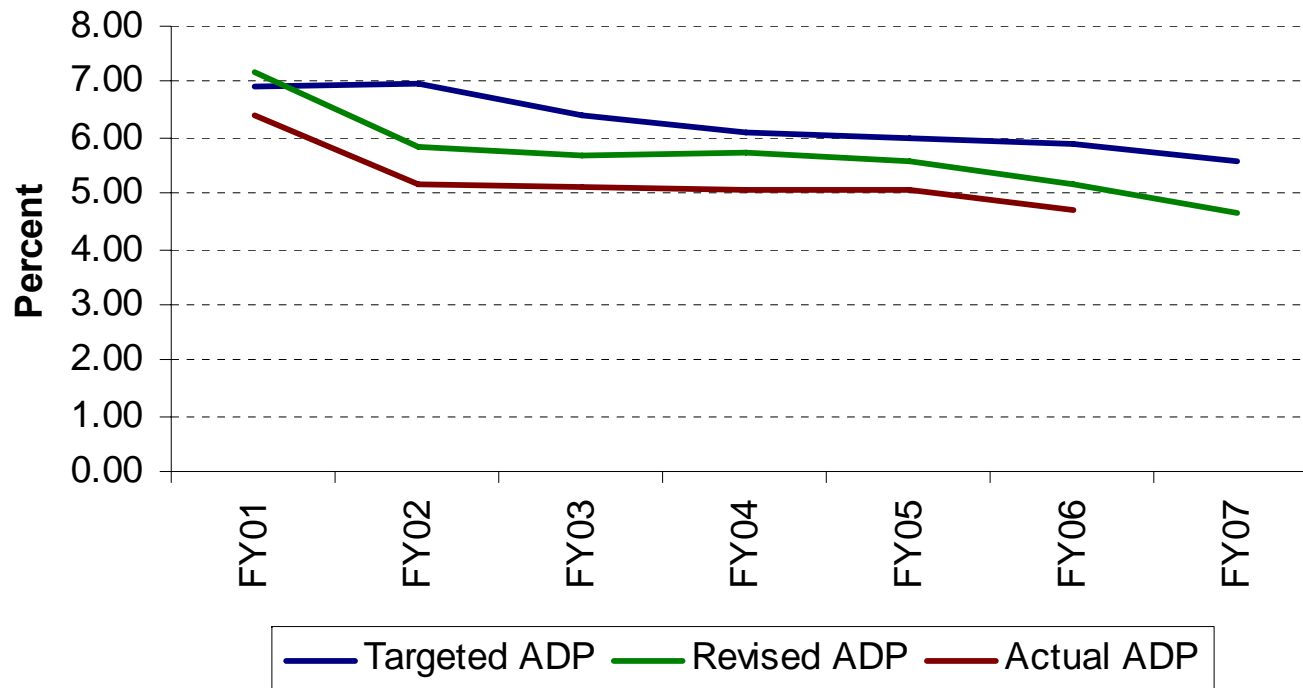
- Share of Pay and Allowance becoming dominant
- Growing burden of DSL (Domestic): 21.7% (20.7% in FY06)
- Fall in share of subsidies and transfers: 27.6%
- Expenditure on block allocation rose significantly: by 86.2%

- ❑ Revenue expenditure (Jul-Feb) of FY07 was 19.5% higher than that of FY06. The targeted annual growth is 16.9% over actual expenditure of FY06.
- ❑ Actual spending stood at 57.3% of the annual target (53.6% in FY06) .
- ❑ “Pay and allowances”, “Subsidies and transfers” and “Interest payments” accounted for 86.0% of the total (85.4% in FY06)
- ❑ Growth trends:
  - ✓ Pay and allowances: 27.5% (21.1% in FY06).
  - ✓ (Subsidies and transfers: 11.2% (22.9% in FY06).
  - ✓ Interest payments: 22.7% (29.2% in FY06).

### III. FISCAL SECTOR

#### Annual Development Programme

- ADP size as percentage of GDP has been declining since FY02. ADP size accounted for 6.90% of GDP in FY01 whereas the corresponding figure for FY07 was 5.56%. Similarly, RADP accounted for 7.2% of GDP in FY01 which came down to 4.6% in FY07 while the actual (realised) ADP was 6.4% of GDP in FY01 which declined to 4.7% in FY06.



Proposed size of ADP for FY08 is Tk26500 crore, which is 1.8% and 18% higher than the original ADP and RADP of FY07 respectively.

***What should be the appropriate size of the ADP for FY2008?***



### III. FISCAL SECTOR

#### Annual Development Programme

- **Size of ADP for FY07 was Tk26000 crore (Tk21,600 crore in RADP). RADP allocation was 16.9% and 13.4% lower than the ADP of FY07 and the RADP of FY06 respectively. Shares of domestic resources and project aid in ADP (RADP) of FY07 were 66% (63.2%) and 34% (36.8%) respectively.**
- **In original ADP of FY 2007, Block Allocation was 1108.3 crore taka (4.3% percent of total allocation) which was surprisingly increased in the RADP to reach 1304.6 crore taka (6% of total allocation). This block allocation was 50.1% higher than the block allocation of RADP in FY 2005-06.**
- **18.6% (242.6 crore) of this Block Allocation was placed under the head Special Block Allocation; details of which was not available. This poses a question mark about the transparency of this allocation (may be for to Election financing). On the other hand, block allocation for CHT was 12% lower than the previous fiscal year.**



### III. FISCAL SECTOR

#### Annual Development Programme

- **Performance of ADP implementation during the first three quarters of FY07 was notably poorer than that of FY06. Quarterly data reveals that 37% of ADP allocation has been spent during the first three quarters of FY07 whereas 45% allocation was spent during the corresponding period of FY06.**
- **Taka release during the first three quarters has decreased in the recent past. 45% of the allocation (Tk7805 crore) of taka was released during the first three quarters of FY07 which is significantly less than the corresponding figures of FY06 and FY05 which were 52% and 57% respectively.**
- **Ministry-wise analysis of ADP for FY07 reveals that the implementation rate of only 4 out of 43 Ministries/ Division was satisfactory (i.e. more than 60%) whereas the implementation rate was less than 10% for 5 Ministries. Incidentally, the nature of expenditures sustained by the relatively “better” performers remain suspect.**



### III. FISCAL SECTOR

#### Annual Development Programme

Ministry/Division	ADP Allocation (taka in lac)	Taka Release as % of allocation	Expenditure as % of Allocation
<b>Better Performer</b>			
Ministry of Rural Development	11340	55%	90%
M/O Religious Affairs	7327	67%	62%
M/O Primary and Mass Education	199278	72%	54%
Local Govt. Division	506874	55%	52%
<b>Poor Performer</b>			
M/O Shipping	33893	16%	9%
Energy and Mineral Resources Division	37935	16%	8%
M/O information	7598	21%	4%
M/ O Liberation War Affairs	2220	25%	4%
Internal Resources Division	2565	0%	3%

- M/O Rural Development was the best performer with 90% implementation rate followed by Religious Affairs (62%) in FY07, while Internal Resource Division was the worst performer with only 3% implementation rate followed by M/O Planning, M/O Information and M/O Liberation War Affairs with 4% of implementation rate.
- Surprisingly, the implementation rate of M/O Energy and Mineral Resources was only 8%!!





### III. FISCAL SECTOR

#### Annual Development Programme

##### *Housing for the Homeless*

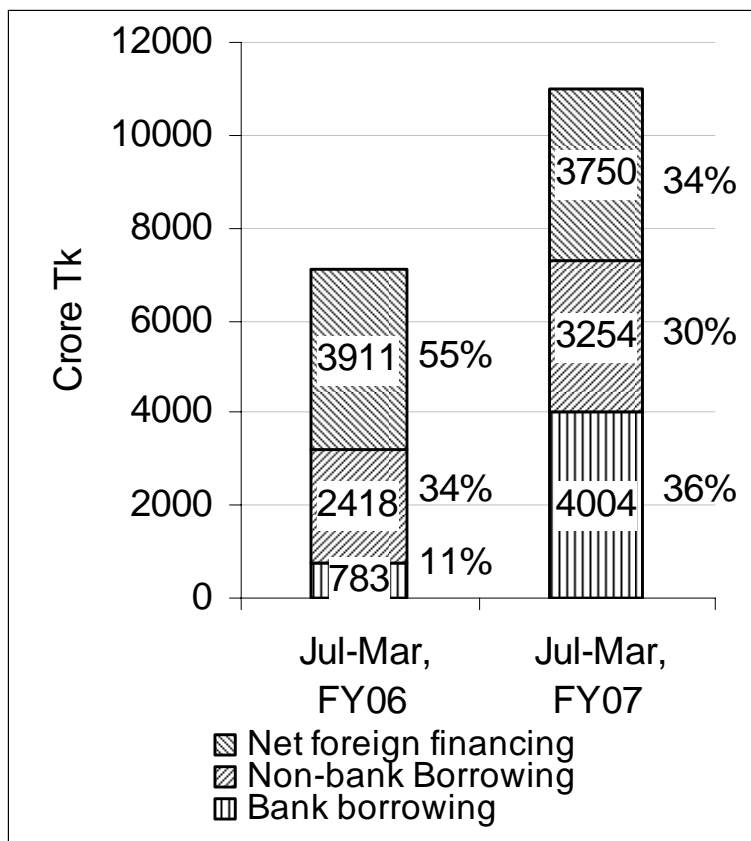
- ❑ In FY 2006-07, government allocated Tk.50 crore to the “Fund for Housing the Homeless” to address the housing problems of the homeless, the poor and the low income group, particularly the rural families. Implementation progress is not known.
- ❑ In FY07, ADP allocation for *Abashan project* for housing for the poor was Tk 140 crore and 25000 metric tons of rice. Until April 2007, total expenditure was Tk 93.32 crore (67% of allocation) and distributed 17 thousand metric tons (68% of allocated foodgrains).
- ❑ ADP allocation for *Adarsha Gram* project was Tk 14.17 crore in FY07. Up to 10 May 2007, total expenditure was Tk 11.16 crore (69% of allocation).



### III. FISCAL SECTOR

#### Budget Deficit and Financing: Deficit Increases

Sources of Financing: FY06-FY07 (Jul-Mar)



- ❑ Overall deficit was 54.8% higher at the end of March 2007 than in FY06. The overall budgeted deficit for FY07 is Tk 17261.2 crore (B06: Tk 18067.1 crore A06: Tk 12658.8 crore).
- ❑ Net foreign financing showed a negative growth of (-) 4.1% (Jul-Mar). Its share declined to 34.1% in FY07 from about 55.0% in FY06 (July-Mar).
- ❑ Share of domestic financing in total increased from 45.0% (Mar FY06) to 65.9% (Mar FY07).
- ❑ Bank borrowing has emerged as the major source.
  - Borrowing from bank on March FY07 increased to Tk. 4003.6 crore (411.1% growth) from previous year's matching figure of Tk. 783.4 crore
- ❑ Contribution of non-banking sources in total financing declined from 34.0% (Mar FY06) to 29.6% (Mar FY07)

**As net foreign financing declined, the government has to heavily lean on the domestic source for financing deficit, particularly on borrowings from banking system**



## IV. MONETARY SECTOR

### Liquidity

- ❑ Money supply (M2) posted a growth of 19.8% at the end of March, FY07.
- ❑ Reserve money posted a rise of 16.0%
  - ✓ Excess liquidity of the scheduled banks stood higher at Tk. 10520 crores

### **Domestic Credit – NEED TO MODERATE ITS GROWTH?**

- ❑ FY2007 continued with moderately high rate of overall domestic credit growth (19.6%-1st quarter, and 20.7%-2nd quarter). The growth figure at the end of the third quarter (March 07) was comparatively lower at 17.8% on a point-to-point basis.
  - Credit to “Other Public Sector” rose by 3.0%.
  - Credit to the private sector posted a moderately high 16.6% growth
- ✓ Total outstanding domestic credit to the public sector at the end of March increased by 21.4%

### **Government Borrowing**

- ❑ Total government borrowing (bank + non-bank) registered 18.4% rise
  - Share of non-bank borrowing declined to 54.9% at the end of March FY07 from 59.6% at the end of March FY06.
- ❑ Sale of NSD certificates grew by 8.5%
  - Net sale posted high growth of 24.8% due to low repayment growth of 3.5%



## IV. MONETARY SECTOR

### Industrial Loans: MISMATCH BETWEEN TERM AND WORKING?

- ❑ Term loan disbursement recorded 26.37 % growth during the first three quarters of FY07. But disbursement of working capital increased by only 9.21 %.
- ✓ **The improving political scenario may increase investment demand (already corroborated by the upward movement in the capital market).**
- ✓ **In the context of inflationary trend and high rate of interest, the banks will need to follow a cautious approach in industrial loan disbursement, without penalising good projects.**

### Loan Default Scenario: PCBs SLIPPING

- ❑ Total classified loan for July 06 - March 07 registered a 2.44% growth.
- ✓ Total classified loan of PCBs increased significantly by 27.14 per cent.
- ✓ Financial crisis of Oriental Bank and the restrictive business practices due to the current anti corruption drive are probably the explanations for the increase in PCB's total classified loan.

### Agricultural Credit: FALL IN GROSS FLOW

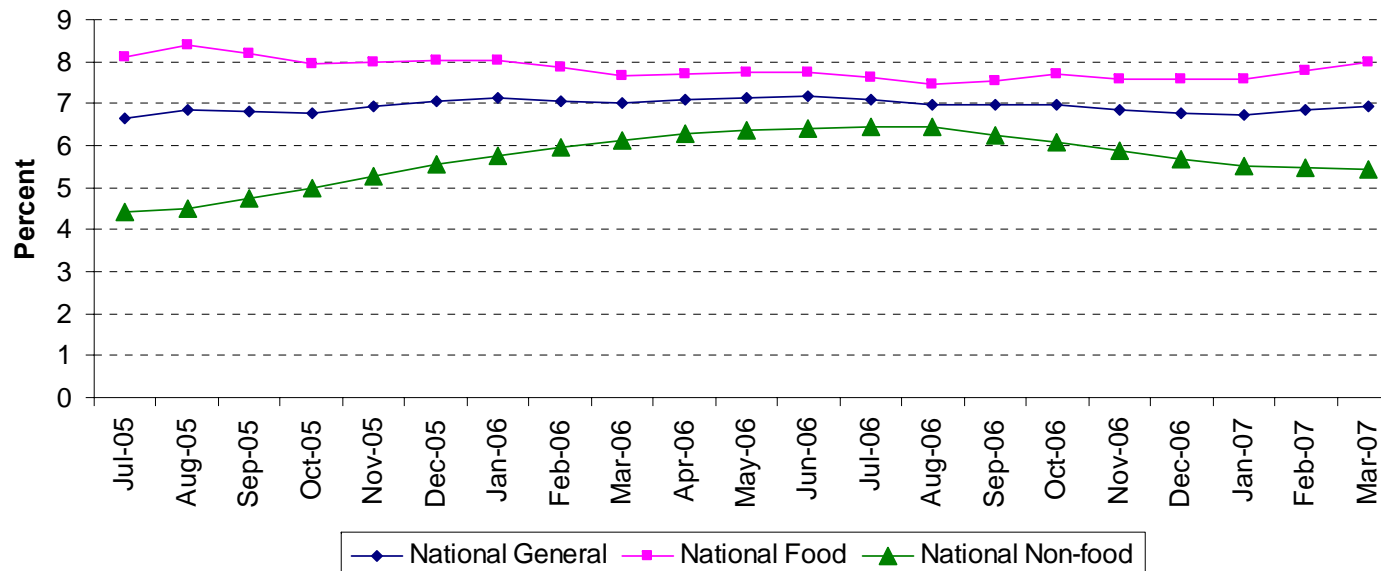
- ❑ After many years, gross disbursement recorded a fall by 7.8% during the July-April period. Particularly affected areas were storage and marketing, poverty alleviation, crop and live stock. Significant growth was observed for the component 'others' (149.56%), details of which are unavailable.
- ✓ Recovery is 14.7% higher, and net disbursement is 62.6% lower.
- ✓ In view of the rising production cost, the negative growth of Agri credit may have adverse impact on future agri products.



## IV. MONETARY SECTOR

### Consumer Price Inflation

- On the basis of moving average, consumer price inflation decreased from 7.02 percent in March 2006 to 6.94 percent in March 2007.
- Food inflation had been higher than the non-food inflation during the first three quarters of FY07

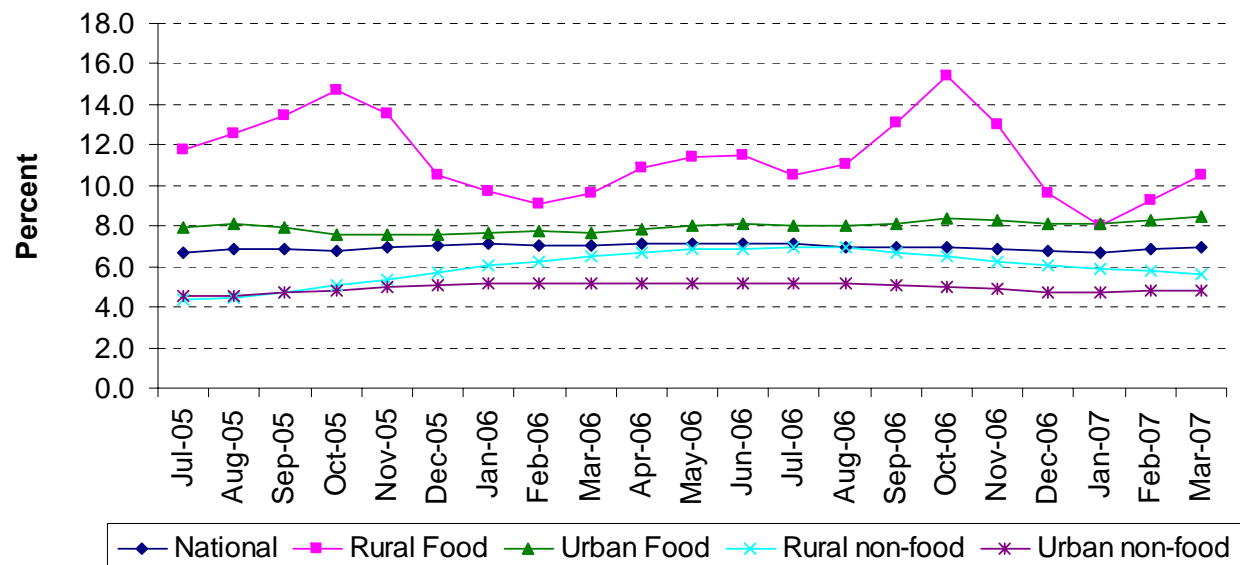




## IV. MONETARY SECTOR

## Consumer Price Inflation

- Rural food inflation is notably higher than all other classification of inflation most of the times, if not always. Similar trends were observed during the first three quarters of FY07 except for the month of January 2007. The urban food inflation (8.6%, moving average) was marginally higher than the rural food inflation (8.0%, moving average) in January, 2007.
- ✓ Rural non-food inflation declined at a steady rate through out the first three quarters of FY07 whereas both urban food and non-food inflations were stable except for few insignificant deviations.





## IV. MONETARY SECTOR

### Price Hike- Reasons, Outlook and Nature

#### Reasons

CPD study made an attempt to identify the reasons behind the creeping inflation, particularly food inflation.

#### **Domestic**

- Lack of institutional monitoring mechanism
- Information gap between different stakeholders
- Market concentration/collusion of market agents (both at importers and bepari level)
- Increased production cost of domestic commodities
- Too many market intermediaries
- Dislocation in market structure due to anti-corruption drive
- Increased transportation cost
- Relatively high interest rate and bank charges
- An inflationary expectation originating from the current inflation trend

#### **International**

- Global supply shocks due to adverse climatic conditions in major exporting areas.
- Global price hike of petroleum products.

#### **Outlook for FY2008**

The national inflation is unlikely to come down below 7 percent in near future (till Aman).

#### **Nature and Possible Strategy to cope with Inflation**

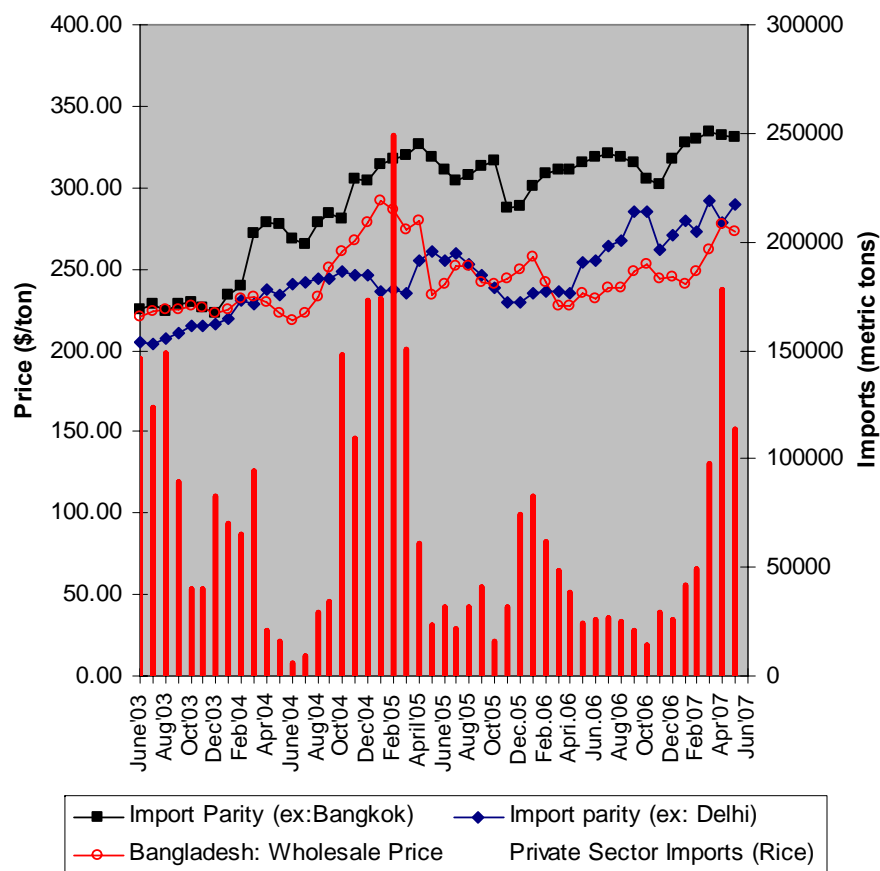
- Pursue price-stabilisation approach to decrease price volatility.
- Originates from the change in relative prices indicating that it's a cost-push inflation. More of a supply side issue. It's not a macroeconomic problem rather it's a product specific issue. Increase supply of essential commodities (e.g. rice and lentil) with no or least tariff and efficient intermediation.



## IV. MONETARY SECTOR

### Agriculture: RICE PRICE AND PRIVATE SECTOR IMPORTS

Rice Prices and Quantity of Private Rice Imports 2003-2007



- ❑ In FY07, wholesale price of coarse rice in Dhaka was lower in Dhaka than import parity price of rice in Delhi and Bangkok
- ❑ On 8 March 2007, government withdrew existing duties (5%) on rice and wheat import
- ❑ In April 2007, average wholesale price of coarse rice (Tk. 19,120/MT) was 18.98% higher than that of April 2006. From July 2006 to April 2007 rice price increased by 22.49%
- ❑ In general price of coarse rice in Bangladesh was higher than the import parity price of India and Thailand; but in FY07 rice price in Bangladesh was lower than in Thailand and India
- ❑ This possibly explains why import level in FY07 by Bangladesh's private sector is less than previous year
- ❑ Wheat price both in domestic and international market was high in FY07.
- Wheat price in US Gulf in July'06 was \$204/MT has increased 4.9% to reach \$214/MT in May' 07.
- During the same period, average wholesale price of wheat in Bangladesh has increased 31.7% from Tk 13,670/MT to Tk 18, 000.

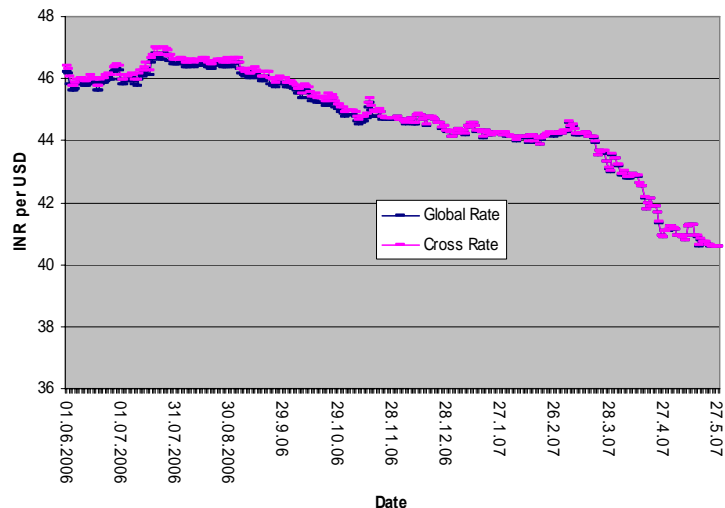




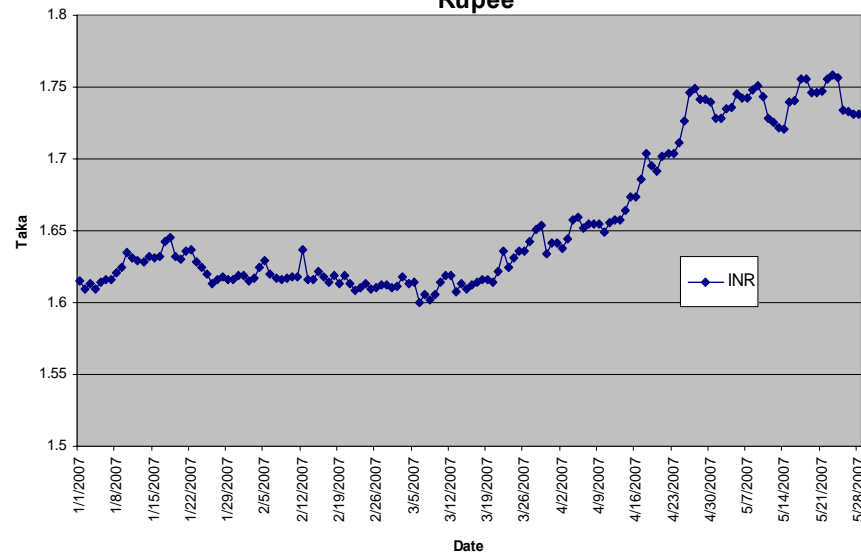
## IV. MONETARY SECTOR

### Exchange Rate: Corrections for INR

USD-INR Global Rate and Cross Rate 2006-07



Movements in Nominal Exchange rate of Taka and Indian Rupee



- ❑ From July 1, 2006 to May 28, 2007 Taka appreciated 2.25% against US\$ while during the same period Taka depreciated moderately against Euro (3.32%) and significantly against the Indian Rupee (6.99%).
- ❑ However, inter-bank cross rate analysis does not reveal any significant misalignment of taka with major foreign currencies.



## IV. MONETARY SECTOR

### Exchange Rate

- Due to the product/sector specific nature of inflation, and in view of sound forex reserve and healthy BoP situation appreciation of Taka (particularly due to devaluation vis-à-vis INR – India being a major source of import) will not be an effective exchange rate policy to stabilize inflation.
- In Bangladesh, the USD-BDT exchange rate buy-sell difference for importers and exporters is currently 2.23 per cent, which is 1.30 per cent in India, 0.61 per cent in Pakistan and 1.47 per cent in Sri Lanka. This difference should be close to 1.00 per cent. Bangladesh Bank should take necessary measures to correct this anti-import bias in business practices of the commercial banks.



## IV. MONETARY SECTOR

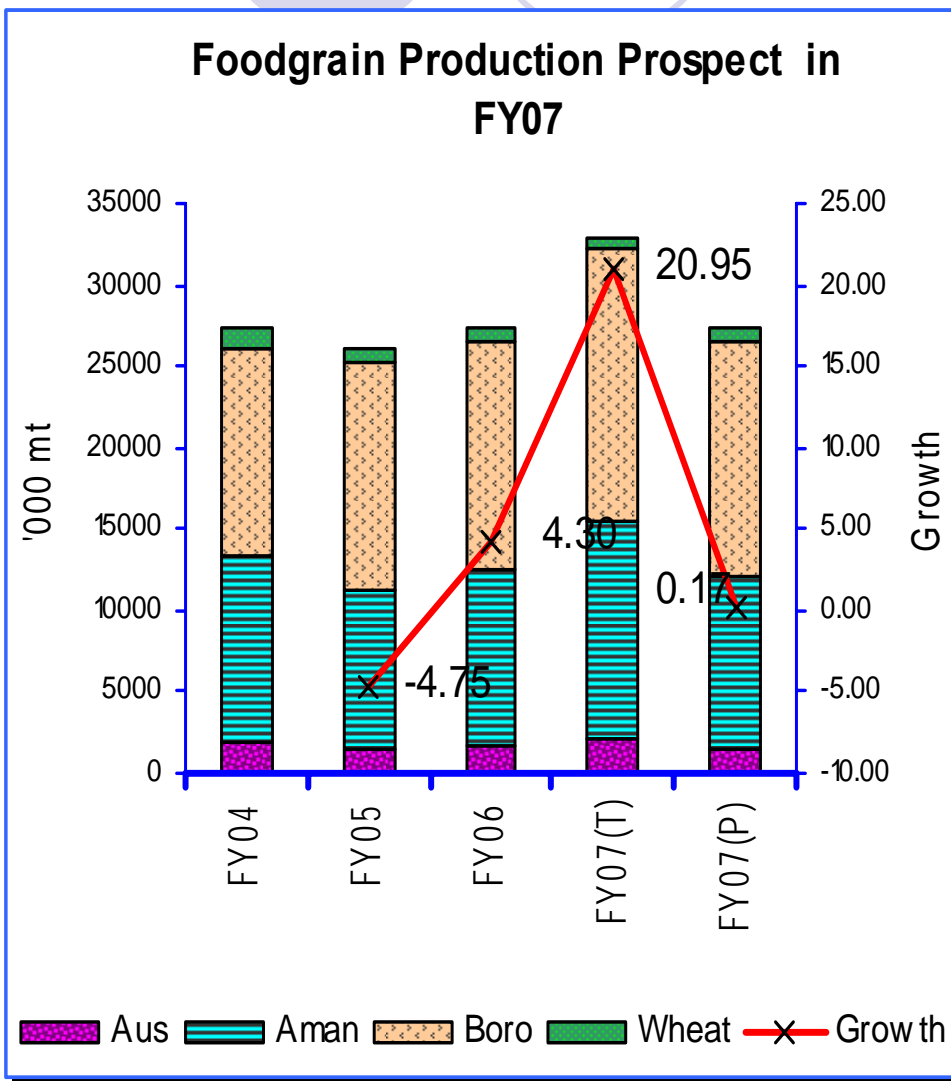
### Interest Rate: INCREASING TREND

- ❑ Commercial lending rate stood at 12.68% in March 2007, compared to 11.85% in July 2006 registering a growth of 7.00%.
- ❑ Deposit rate (3 to 6 months) recorded a significant growth of 21.14% during the first three quarters of FY07 to reach 6.99% in March 2007 from 5.77% in July 2006.
- ❑ Real commercial lending rate stood at 5.25% in March 2007, compared to 3.21% at the end of FY06.
- ❑ Deposit rate (3 to 6 months) could not protect real value for the depositors and has remained negative in real terms since February 2006 except for the months of December 2006 (0.06%) and January 2007 (0.41%).
- ❑ Real deposit rate continued to show corrections recovering from (-) 2.03% in July 2005 to (-) 0.44% in March 2007.
- Increasing interest rate to tame inflation has become a routine monetary tool in government's monetary policy arsenal. CPD finds it to be an inadequate policy proposition since it facilitates rise of lending interest rate but not the deposit interest rate.
- **Bangladesh Bank needs to monitor the widening gap between commercial lending and deposit rate. Bangladesh Bank may also consider making T-Bills more attractive to influence credit flow to private sector and making government borrowing expensive.**



V. REAL SECTOR

Agricultural Production: LOWER THAN TARGET



- ❑ **Target for foodgrains production in FY07: 32.97 million MT (20.95% higher than production in FY06)**
- ❑ **Production in FY07—Less than target!**
  - **Aus 1.51 million MT (Act): 13.4 % ↓**
  - **Aman 10.6 million MT (Plm.): 1.9% ↓**
  - **Boro 14.0 mil-14.5 mil (Proj): 0.18%↑ or 3.8% ↑**
  - **Wheat 0.7 million MT (Proj): 4.8% ↓**
- ❑ **CPD estimates, foodgrain production in FY07 is likely to be either marginally higher (0.17%) or slightly lower (1.7%) than actual production in of FY06. NOT AN EXCITING PROSPECT FOR PRICE SITUATION**
- ❑ **Bird flu was a major problem for poultry production which costed Tk 300 million economic loss (until May 07)**



## V. REAL SECTOR

### Agricultural Production: REASONS FOR AGRI STAGNATION

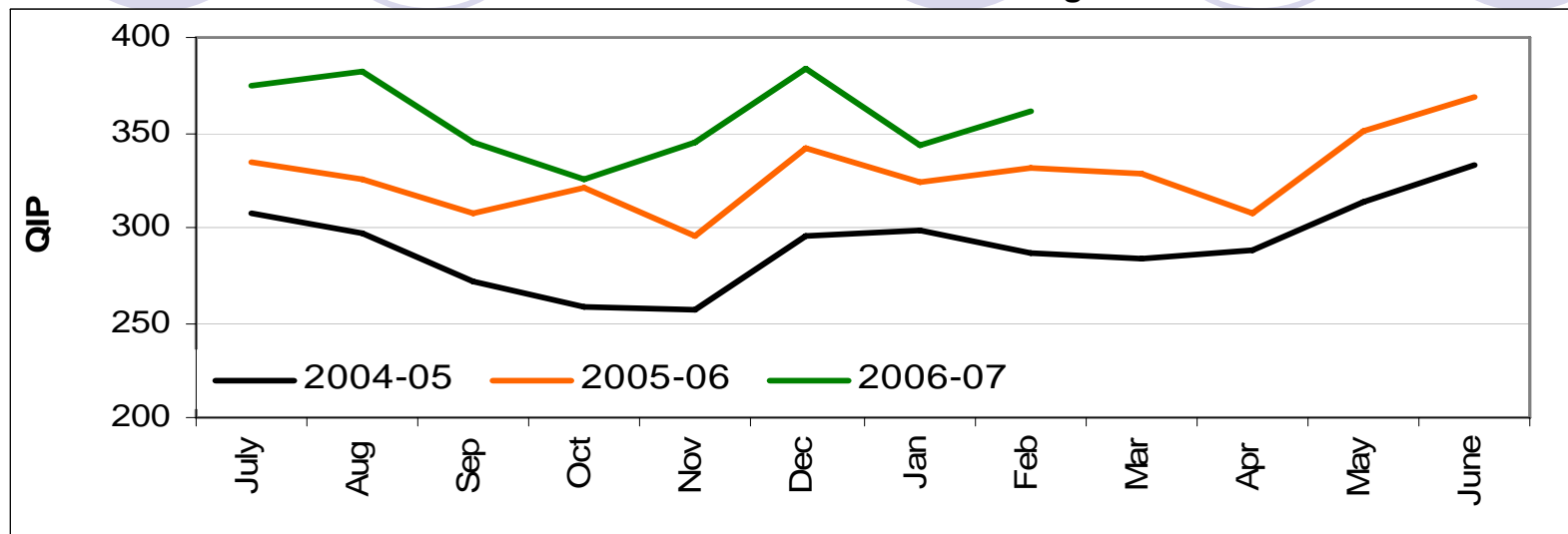
- ❑ **Crisis of Fertiliser, Electricity and Diesel for Irrigation, and *Chita***
- ❑ **Bangladesh faced a fertilizer distribution crisis in FY07. Fertiliser crisis was most acute in northern districts of Rangpur, Dinajpur, Narail, Natore, Sirajganj, Joypurhat, Bogra, Kishoreganj, Sylhet and Gaibandha. Farmers of some of these districts have protested publicly.**
- ❑ **Electricity for irrigation was also a major problem. Electricity used for irrigation was 39.66 MKWh in FY07 (July-Feb), compared to 78.80 MKWh in FY04 (July-Feb). That is, only 50 percent of the electricity used two years earlier.**
- ❑ **Rise in diesel price has increased irrigation cost for Boro rice. Price of diesel was increased by 21 percent (from Tk 33 to Tk 40 per litre) on April 2, 2007.**
- ❑ **1.2% of the Boro cultivated area (53,758 ha) of 19 districts has been affected by Chita (unfilled grain) problem; about 90% of the chita affected area is in three districts: Kishoregonj, Netrokona and Mymensingh.**



## V. REAL SECTOR

### Industrial Production: GOOD PERFORMANCE UNDER THE CIRCUMSTANCES

Quantum Index of Industrial Production during FY03-06



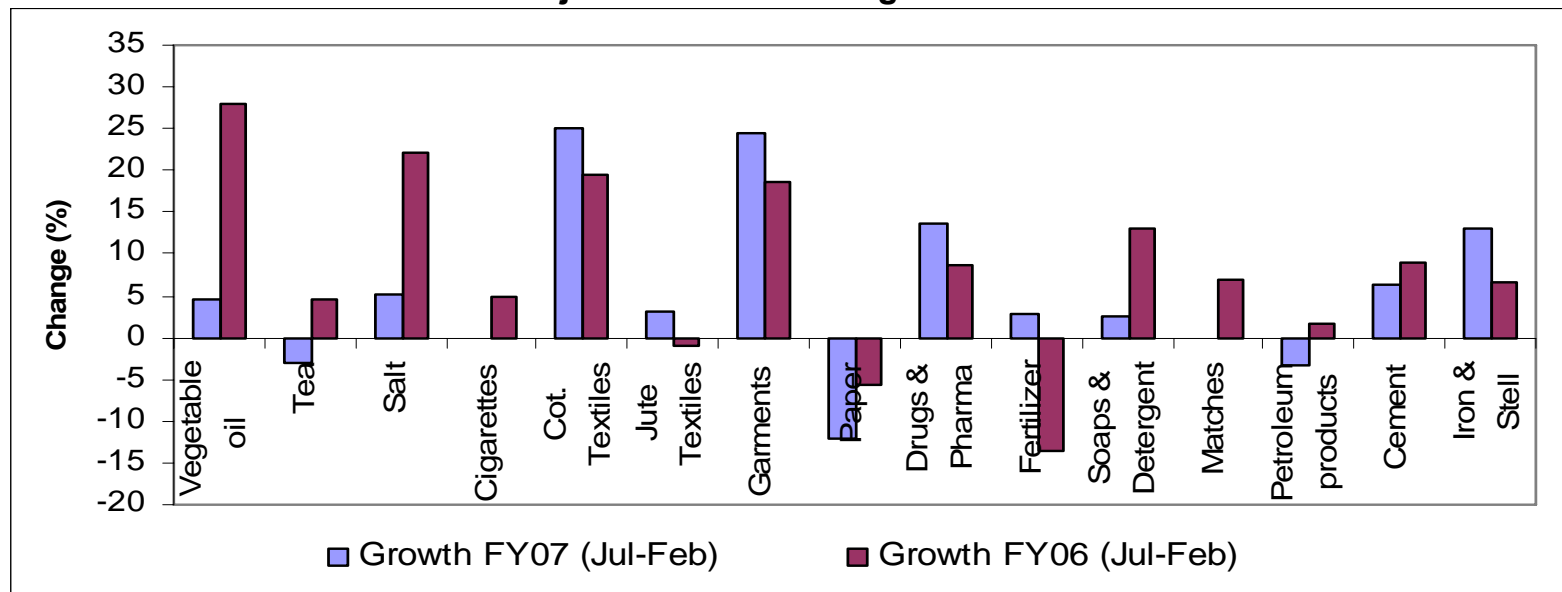
- ❑ QIP of large and medium scale manufacturing firms has increased by 11.4% between July-Feb, FY07 compared to the preceding year. **GIVEN THE CIRCUMSTANCES IT WAS A GOOD PERFORMANCE.**
- ❑ QIP index of all major industries have shown considerable improvement in FY2007.
- ❑ BBS estimates 11.2% growth of the manufacturing sector in FY07 (10.8% in FY06).
  - ✓ Large and medium scale enterprises 11.6%
  - ✓ Small scale enterprises 10.3%
- ❑ Provisional estimate shows manufacturing sector's contribution in GDP to be 17.8% in FY07 (17.08% in FY06).



V. REAL SECTOR

Industrial Production: GOOD PERFORMANCE UNDER THE CIRCUMSTANCES

Growth in Major Industries during Jul-Feb of FY06 & FY07



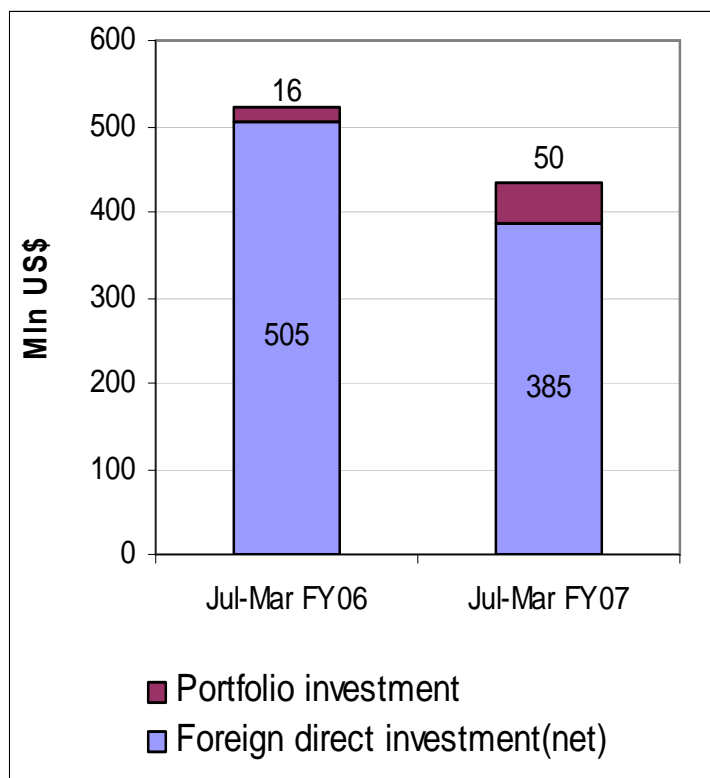
- ❑ During FY07 (Jul-Feb) industries like cotton textiles (25.0%), garments (24.6%), drugs & pharma (13.5%), and iron & steel (MS prod.) (12.9%) achieved high positive growths.
- ❑ Moderate to low growth was observed for edible oil (4.5%), salt (5.1%), jute textile (3.2%), fertilizer (2.9%), soap and detergent (2.5%) and cement (6.3%).
- ❑ Production declined for tea (-3.0%), cigarettes (-0.1%), paper (-12.1%), matches (-0.3%) and petroleum prod. (-3.3%)



V. REAL SECTOR

Foreign Investment: Declines !

**BOI had set FDI targets at US\$1.2 billion for 2007  
(71.4% growth over FDI inflow of 2006!)**



- During Jul-Mar of FY07, foreign investment declined by 16.5%. Total flow \$435 million
  - \$385 mln as net FDI (-23.8% growth)
  - \$50 mln as portfolio investment (212.5% growth)
  - Investment in EPZ was \$81.6 mln
- Financial account showed net inflow of \$414 million
  - The amount was \$-29 million during the corresponding period of last year
- Major outflows included the following-
  - MLT amortization payment (-) \$ 366 mln
  - Other capital (-) \$ 160 mln
  - Trade credit (-) \$ 490 mln

**● Government needs to react quickly as regards the pending proposals of large FDIs to encourage and attract potential foreign investors.**

**Decision on KEPZ is welcome.**

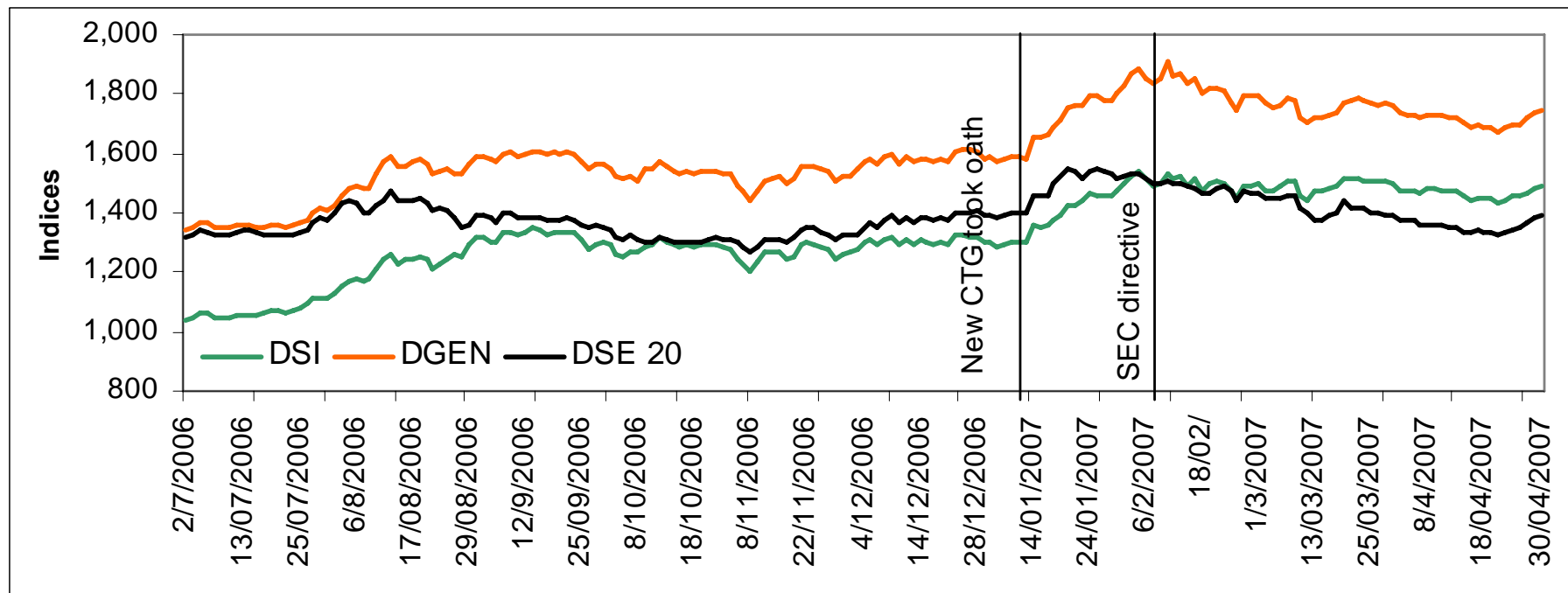




## V. REAL SECTOR

### Capital Market: ROBUST RALLY

- ❑ Assumption of the current CTG coincided with restoration of confidence, and infused momentum to the market
- Following the mid-February directive of the SEC to bring five of the top trading companies under spot market, all indices started to fall again.
- This trend persisted till end of April following which indices have started to rise again.





## V. REAL SECTOR

### Capital Market: ROBUST RALLY

- Between 1 July 2006 to 27 May 2007:
  - DSE all share price index rose by 590.1 points (56.7%).
  - DSE General Index rose by 608.2 points (45.3%).
  - DSE20 posted slower growth, grew by 382.2 points (29.1%).
- DSE Market capitalisation grew by 73.6%.
- DSE Turnover a day hits all time high at TK 178.98 crore on May 27, primarily due to debut trading of the Premier Bank Ltd on that day.
- During the same period CSE all share price index and CSE30 grew by 65.3% and 52.9% respectively.
- Apart from the two direct listing, 9 new IPO's came to the market so far in FY07, oversubscription amounting to Tk. 1857.9 crore (14 IPO's came during FY06, oversubscription stood at Tk. 1541.7 crore)
  - **Cautious monitoring is required, but not to jeopardize the current stimulus. How to bring more companies remain a question. Widening the tax gap between listed and non-listed companies could be a solution. Higher tax on mobile companies may induce them to enlist.**



## V. REAL SECTOR

### Power Sector: THE MAIN CONSTRAINT

#### Electricity

- The projected shortage during the peak hour has reached almost 2500 MW (1500 MW according to official data).  
**About 900 MW of capacity remains unutilized due to lack of maintenance, poor condition of the plants and overhauling of the projects.**
- **During the last five years only one project has been undertaken with only a capacity of 80 MW.**

#### Efforts Underway

- Power tariffs have been increased by 10% for bulk and 5% for retail in March 2007 to reduce fiscal burden.
- The government has approved five power projects (3 to add 620 MW to the grid and 2 for maintenance works of 3 plants).
- Short term measures include shut down of markets by 7 pm, different weekly holiday in industrial areas, promotional campaign etc. (saving at least 700 MW of electricity).
- Very recently the government has decided to import power from Myanmar.
- CTG is considering plans to generate around 6,000 megawatt (MW) of additional electricity by 2012. 26 new power plant will be installed according to the plan (17 public with 3,375 MW and 8 private with 2500 MW).
- However, there has not been any effective improvement in the power sector yet.



## V. REAL SECTOR

### Power Sector

#### Way Forward:

- Closed generation units should be put to operation.
  - The government should continue pursuing the issue of South Asian Regional Power Grid.
  - Decision to purchase electricity from different private companies needs to be reviewed and implemented urgently.
  - Government may also consider short-term power generation projects such as barge-mounted power plants, combined cycle power plants etc.
  - Providing around 300 megawatts (MW) electricity to the national grid within a short time through captive power producers (CPPs) is possible.
- 
- ❑ **Importance should be given in electricity production. CTG should act immediately to ease the current power crisis in addition to load management and system loss.**
  - ❑ **One may now expect that the CTG will immediately take the medium term action plan to recoup the lost opportunities and to build capacity considering future demands.**



## V. REAL SECTOR

### Privatisation of SOEs

- ✓ *The government has decided to privatise 17 stateowned enterprises, 12 of them operating in the textiles and jute industries, aiming to complete the process in four months.*

#### *Biman*

- The CTG has decided to turn Biman into a public limited company and halve its manpower by June as the national flag carrier continued to sustain colossal losses.
- The annual losses for FY07 have been budgeted at Tk. 691.4 crore, reinforcing the need for immediate steps.
- Government will, however, hold 100% share, private shares will be offloaded only when it becomes profitable.

#### *NCBs*

- Janata and Agrani Bank received licenses from the Bangladesh Bank on May 30 to become public limited companies.
- Agrani Bank has already received license from the Registrar of Joint Stock Companies and Firms (RJSCF) to operate as a public limited company.
- The Saudi buyer is expected to take over a total of 93.3% government-held shares of the Rupali bank for over US\$ 330 million with the rest remaining as public issues.

#### *Major Concerns*

- Whether making Biman a PLC with 100% government share will at all reduce their loss remains a question.
- Handing over of the Rupali bank has to be accelerated.
- Disclosure on the contingent (quasi-fiscal) liabilities on account of SOEs a must.



## VI. EXTERNAL SECTOR

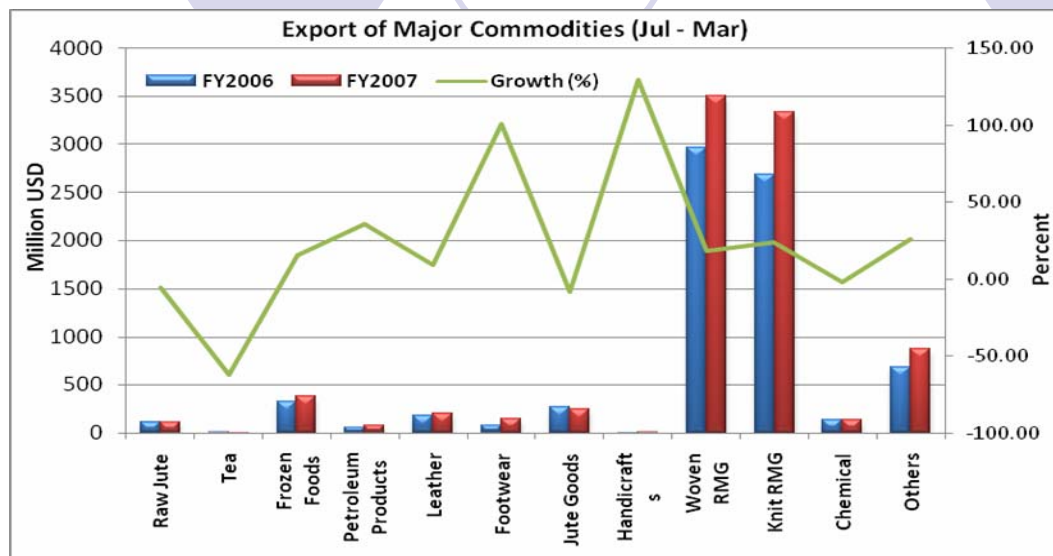
### Poised to Attain Newer Heights

- **High export growth (20.2%) and record high remittance flow (26.2%) contributed to robust export growth of 20.2% in July-March, 2007.**
- **Higher rate of foreign exchange inflow and relatively lower rates of outflow led to record forex reserves of \$4.53 billion (in April '07).**
- **For the third consecutive year, Bangladesh has been able to successfully cope with the post-MFA challenges.**
- **However, as imports pick up and the sanctions on Chinese apparels come to an end by the end of 2007, Bangladesh's export sector could come under some pressure.**



## VI. EXTERNAL SECTOR

### External Sector Performance in FY2007 (July-March)



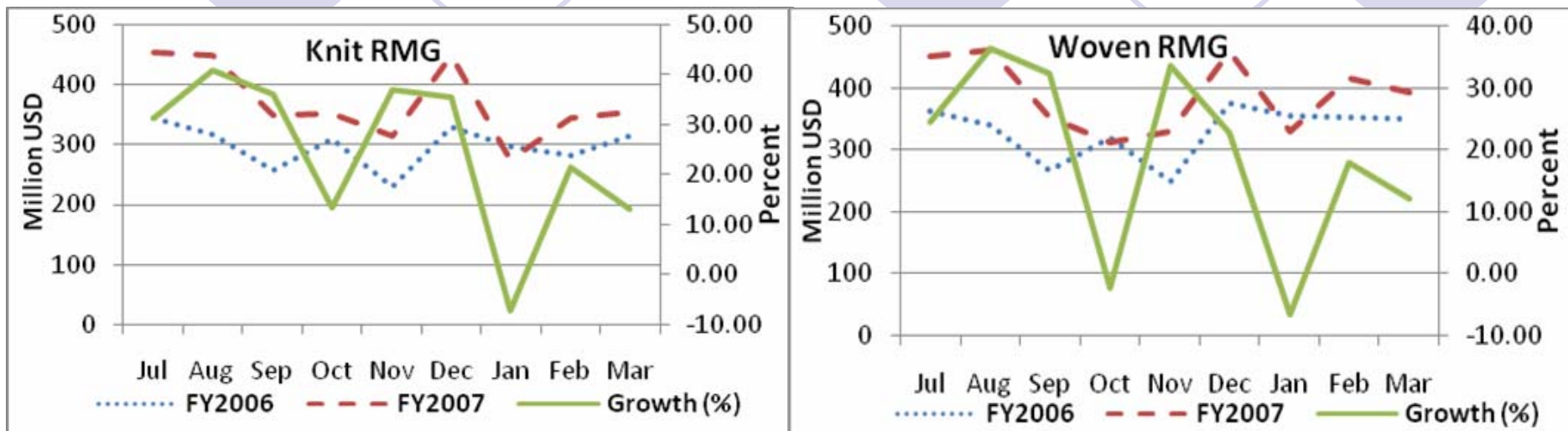
- Export earnings of \$9065.8 million in July-March FY2007 was one and half billion dollar more than matched period of FY2006.

- All major exports posted high growth rates in the first nine months of FY2007**
  - ➔ **RMG Growth : 21.1%**
    - of which*
    - knitwear : 24.3%
    - woven-wear : 18.2%
  - ➔ **Frozen food : 15.9%**
  - ➔ **Leather : 9.1%**
  - ➔ **However, traditional exports such as raw jute(-5.3%) and jute goods (-8.4%) continued to experience negative growth**



## VI. EXTERNAL SECTOR

### Monthly Trends in RMG Export (FY2006 vs. FY2007)



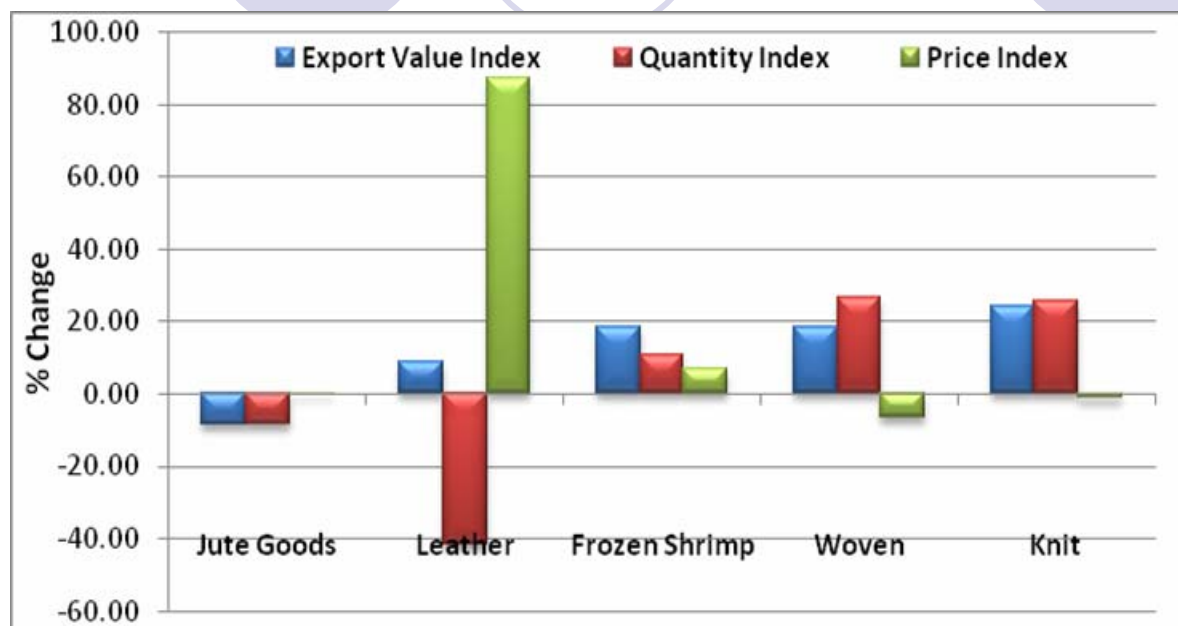
- Monthly export performance indicates month for month rise.
- However, in January 2007 export posted negative growth (-4.6%) due largely to the lagged response to production and marketing disruptions in the second quarter of FY2007. However, exports recovered subsequently.
- The January experience reinforces the importance of a stable environment for continuity and sustainability of the present high export growth.





## VI. EXTERNAL SECTOR

### Commodity-wise Decomposition of Export growth in FY2007



#### *Disquieting Feature*

- Growth of export earning driven by volume growth, rather than price-growth.

- Of the 20.2% growth in export earnings, 19.6% was contributed through rise in volume index and a meagre 0.6% by rise in price index. This underpins the need for export diversification and product and process upgradation.
- Some positive changes in prices for leather and frozen shrimp, but average prices of both woven and knitwear almost unchanged.



## VI. EXTERNAL SECTOR

## Bangladesh's Terms of Trade: FY2000-FY2006

(Base: FY2000 = 100)

	Export Price Index	Import Price Index	Commodity Terms of Trade
FY2000	100.00	100.00	100.00
FY2001	102.40	107.52	95.24
FY2002	104.82	115.61	90.67
FY2003	107.44	124.57	86.25
FY2004	111.80	133.41	83.80
FY2005	115.75	137.77	84.02
FY2006	120.46	143.17	84.14

- ***Declining terms of trade:*** The ToT has come down from 100 in FY2000 to 84.1 in FY2006. Export indeed has lost about 15% of its purchasing power between FY2000 and FY2006.
- Further fall in ToT in FY2007 expected in the face of stagnating export price in FY2007 (only 0.6% rise) and high global inflation.



## VI. EXTERNAL SECTOR: NEW HEIGHTS

### CAREFUL MONITORING REQUIRED

- **Phase out of quota imposed on Chinese apparels in EU and US and its implications for Bangladesh's export of apparels.**
- **Revised EU Rules of Origin requiring change from stages of production to value addition criteria. GSP utilisation rate must increase.**
- **The US is currently designing her offer list for the WTO DF-QF initiative for the LDCs (the so-called 97% : 3%). The TRADE Act 2007 (Tariff Relief Assistance for Developing Economies) is also being discussed. Bangladesh should lobby and prepare in view of these.**
- **WTO discussions in relation to GATS, particularly GATS Mode-4, are expected to have important implications for Bangladesh. Bangladesh should protect her own interests in domestic market (defensive interest) and enhance market access in foreign markets (offensive interest).**



## VI. EXTERNAL SECTOR

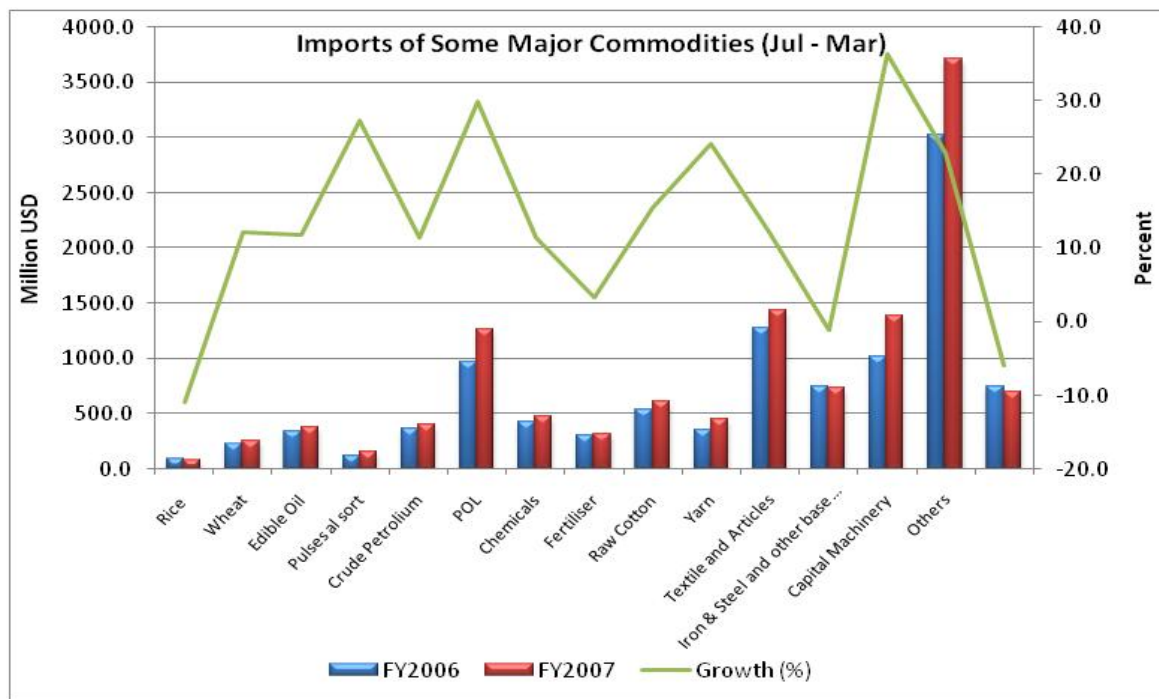
- **Comprehensive policy required in view of potential market openings under the DF-QF initiative, SAFTA, APTA and BIMSTEC-FTA to make these commercially meaningful.**
- **The CPD RMG Study has identified a number of key areas for enhancing the competitiveness of Bangladesh's RMG sector: (a) technology requisition and upgradation, (b) development of clusters, (c) promotion of horizontal integration, (d) compliance assurance, (e) skill upgradation, (f) market promotion and (g) development of logistics and support services.**
- **Focused policy interventions required in each of the aforesaid areas.**



## VI. EXTERNAL SECTOR

### Import Sector Performance

Import of Some Selected Commodities (FY2006 vs. FY2007) in Value Terms



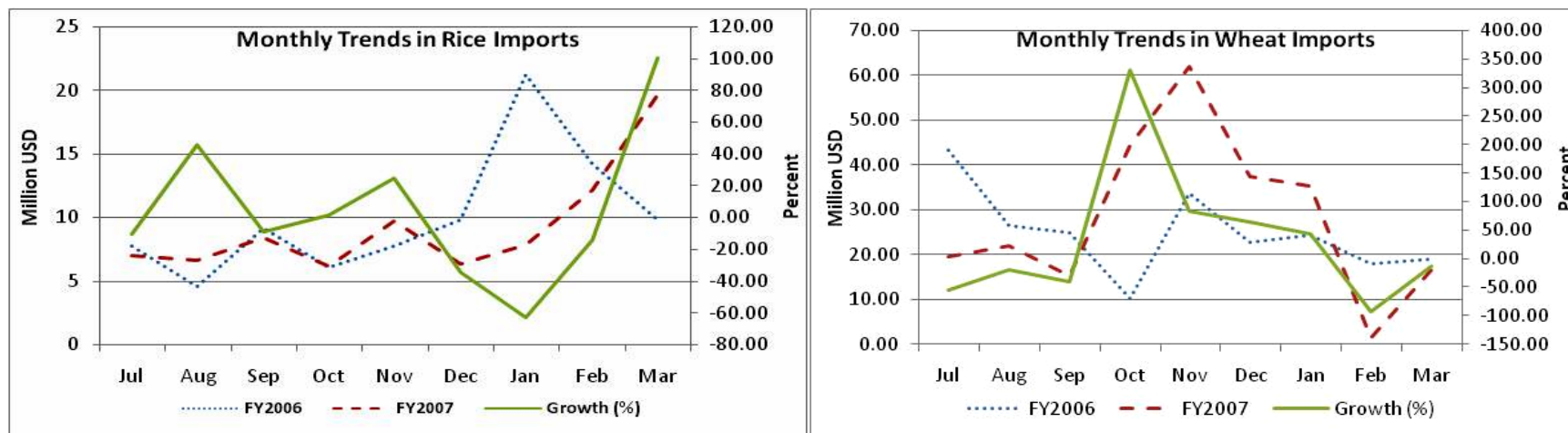
- Total import during July-March of FY07 amounted to \$12393.5 million, a 17.2% growth over the corresponding period.
- Highest import was registered for textiles (11.6% of total) and capital machineries (11.2%), which are closely related to exports and investments.



## VI. EXTERNAL SECTOR

### Import Trends of Rice and Wheat

Monthly Trends in Import of Rice and Wheat (July-March) in Value Terms

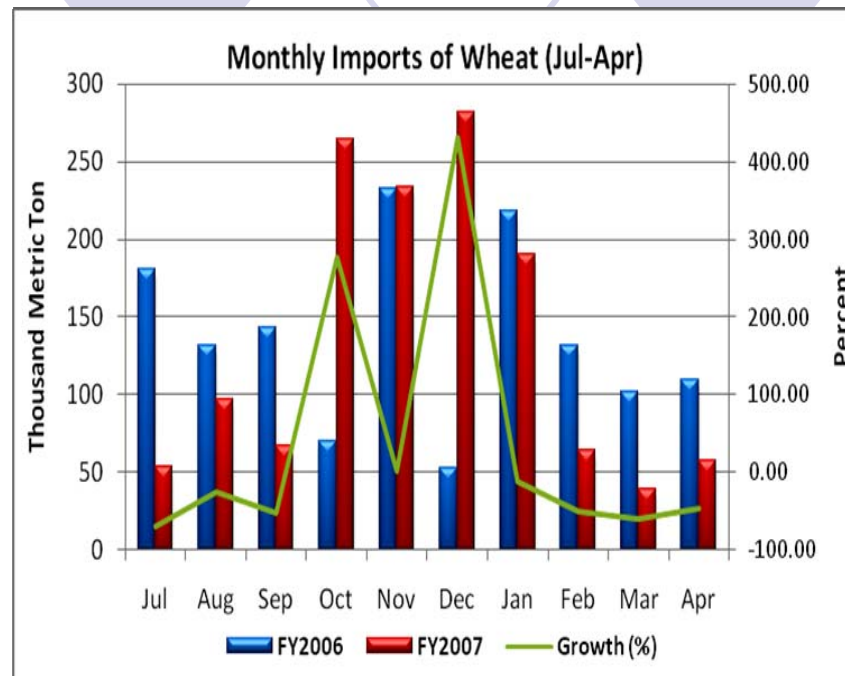
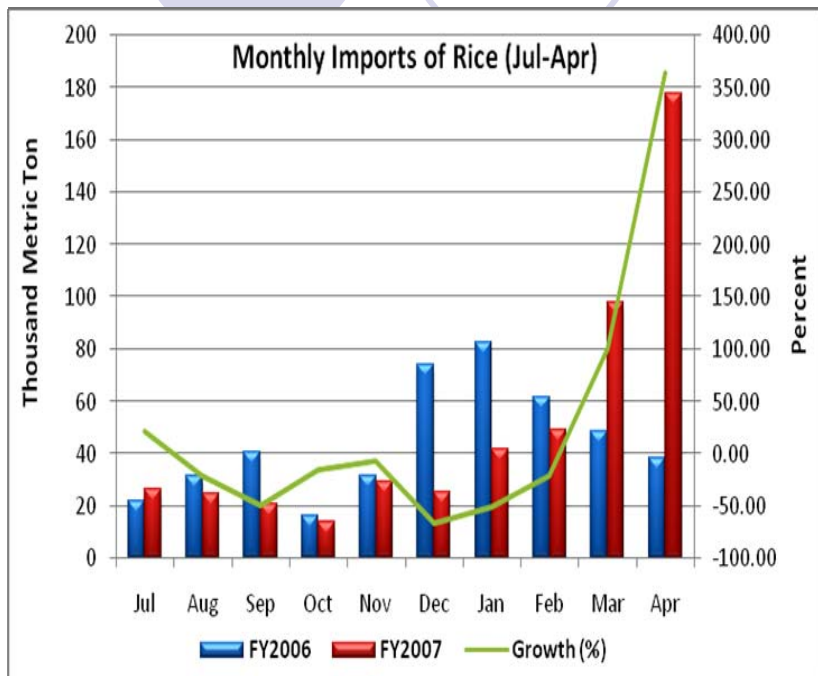


- Import of POL products posted sharp rise of 29.9% (July-March) in FY07, incurring an extra cost of \$291.7 million (from \$975.3 million in July-March of FY06 to \$1267.0 million during the same period of FY07), driven by the rise in fuel prices in the international market. Fuel bill is expected to rise in the coming months.
- Import of rice has come down from \$94.3 million in July-March, FY06 to \$84.0 million during July-March FY07 (-10.8% growth), although import of wheat rose from \$225.9 million to \$253.5 million (12.2% growth).



## VI. EXTERNAL SECTOR

### Monthly Imports of Rice (FY2006 vs. FY2007) in Volume Terms (Thousand Metric Tons)



- Imports of rice by private sector during July-April, FY07 was 507.81 thousand Metric ton, against 447.98 thousand Metric ton of FY06 (13.4% higher).
- Import between August and February was lower in FY07; imports were relatively higher in March and April 2007 when imports picked up quite remarkably.

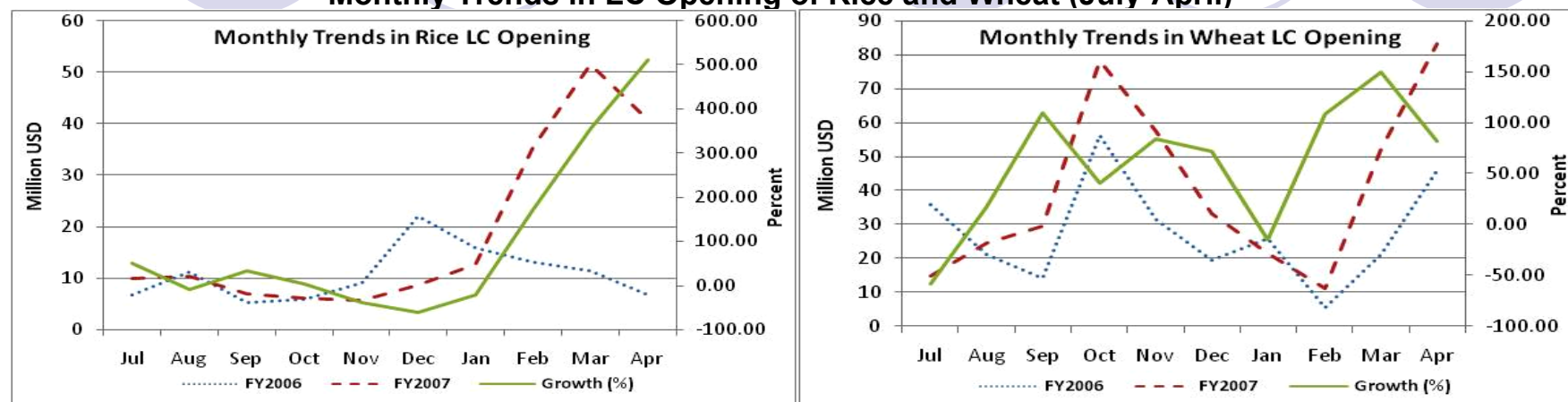
- Imports of wheat during July-April, FY07 was 1348.76 thousand Metric ton, against 1373.16 thousand Metric ton of FY06 (- 1.8% growth).
- Imports of wheat in FY07 were lower between July-September, then higher between October-December; but came down sharply between January-April.



## VI. EXTERNAL SECTOR

### L/C Opening & Settlement

Monthly Trends in LC Opening of Rice and Wheat (July-April)



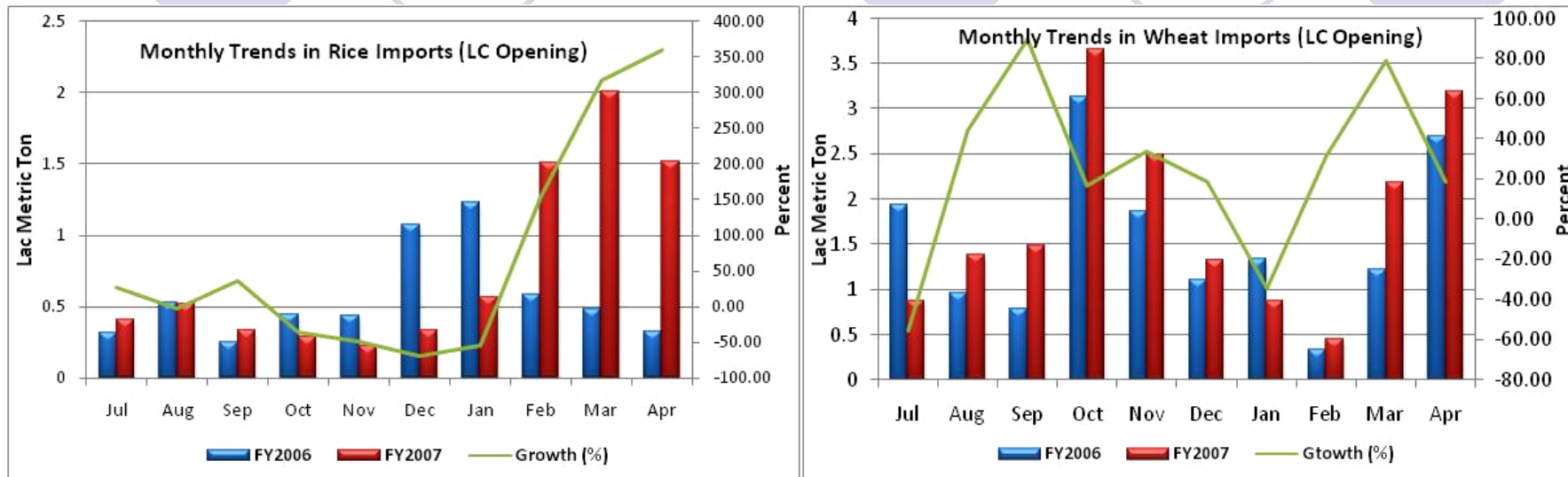
- L/Cs opened during July-April of FY2007 was worth 14.40 billion or 13.9% higher than corresponding imports in FY '06. To compare, growth of L/C settlements were higher, at 17.24%.
- L/Cs opened for consumer goods including foodgrains posted high growth rate of 52.09%.
- Month for month, L/Cs opened for rice during November-January was lower in FY07 compared to the matched period of FY06. However, L/Cs opened for rice rose sharply in February '07 and this trend has continued till April 2007.
- In case of wheat, month for month, L/Cs opened in FY07 was higher in FY07 compared to FY06 barring the months of July and January.
- L/C opening data indicate higher availability of food grains over the coming months. L/Cs opened for rice and wheat in July-April, FY07 (\$595.2 million) was 55.5% higher compared to that of FY06.





VI. EXTERNAL SECTOR

Monthly Trends in LC Opening to Import Rice and Wheat (July-April) in Volume



- L/Cs opened for rice during July-April of FY2007 was 7.74 lac metric tons (35.8% higher) and that of wheat was 17.94 lac metric tons (16.64% higher).
- L/Cs opened for both rice and wheat have picked up quite notably in February-April, 07 period, indicating higher supply in the market over subsequent months.



## VI. EXTERNAL SECTOR

### *Some Observations*

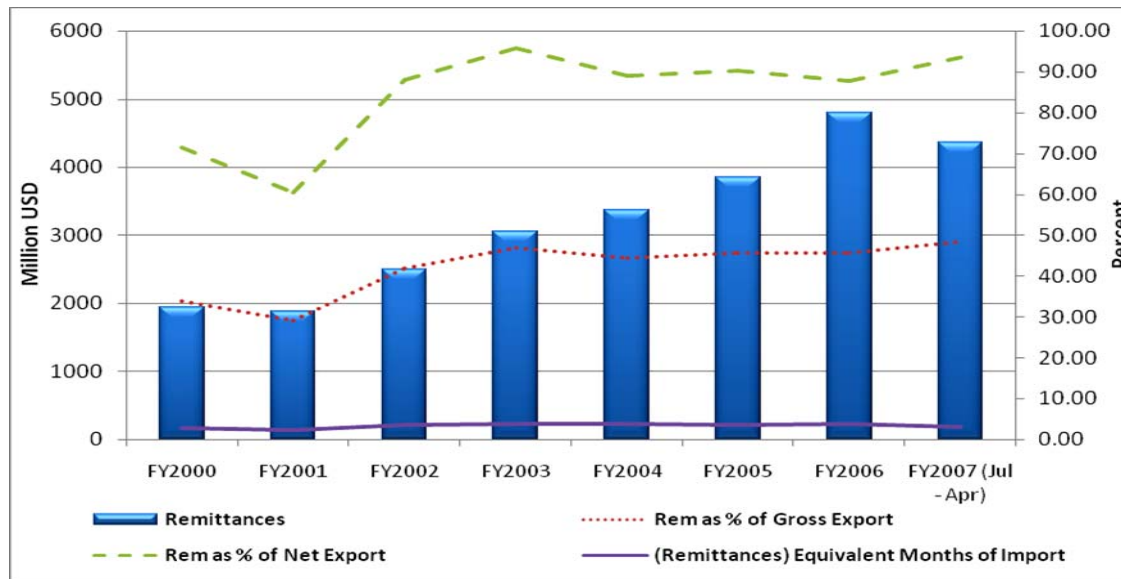
- L/C opening indicate higher availability of foodgrains in the market in coming months.
- *A disquieting feature:* stagnation in L/Cs opened for textile fabrics, fabrics under b/b L/Cs and accessories: \$2171.9 mln in FY07 (Jul-Apr) against \$2164.82 mln in FY06 (Jul-Apr).
- Growth of import L/Cs opened for capital machineries, high in recent years, has slowed down (6.7% growth).
- Overall, growth of L/Cs opened during the first three quarters of FY2007 (14.5%) was lower than export growth (20.2%). This was likely to have positive impact on balance of trade and forex reserves.
- Trends in both imports and L/C openings indicate higher import growth in coming months.



## VI. EXTERNAL SECTOR

### Flow of Remittance

Figure: Percentage Share of Remittances in Net and Gross Export and Month Equivalent of Imports



- Flow of remittance has been phenomenal, registering a growth of 26.2% in the first 10 months of FY07 (July-April) compared to the matched period of FY06.
- On May 21, 2007 remittance stood at all time high of \$5234.5 million.

- Remittance flow in July-March, FY2007 was equivalent to almost half of gross export (48.4%) and approximated that of net export (93.4%).
- Growth of remittance was high for traditional sources such as Kuwait (43.1%) and UK (66.9%), but low for Saudi Arabia (5.3%), the largest source of remittance.



## VI. EXTERNAL SECTOR

### Workers Abroad: HIGH ON NUMBER, LOW ON SKILL

- **During December-April period a record 250 thousand workers have gone abroad. April '07 has seen the highest number leaving (66196) in a single month. Number leaving for Malaysia, UAE and South Korea is expected to go up further.**
- **Share of skilled and semi-skilled in the total number of workers has been falling in recent years.**
- **Comprehensive approach and support required: training, recruitment, travel, placement, employment permit and assured salary.**



## VI. EXTERNAL SECTOR

### Foreign Aid

**According to the budgetary targets, about \$1.8 billion of foreign assistance is needed to underwrite the programmed fiscal deficit.**

- During July-April of FY07 foreign aid disbursement stood at \$ 976 mln, 4.3% less than the corresponding period of FY06.
  - \$ 970.1 mln project aid
  - \$ 5.9 mln food aid
- **During Jul-Mar of FY07, payment of principle amounted to \$366.3 mln, resulting in \$543.1 mln net aid flow in that period.**
- Till April about 54% of the target could be met.
  - World Bank approved disbursement of \$ 200 mln under the DSC-IV on 29 May.
  - Education Sector Support Credit of \$104 mln by the World Bank is expected to be disbursed by end of May.
  - Another \$ 40 mln is also expected as Railway Budget Support.
- Total disbursement, according to recent projection of ERD, is to be \$1552 mln for FY07 – very unlikely to cross \$ 1.2 bln.
- With approximate repayment of \$500 mln, net flow of foreign aid in FY07 may hover around \$700mln - \$800mln (\$752.4mln in FY06)



## VI. EXTERNAL SECTOR

### Balance of Payment and Reserves

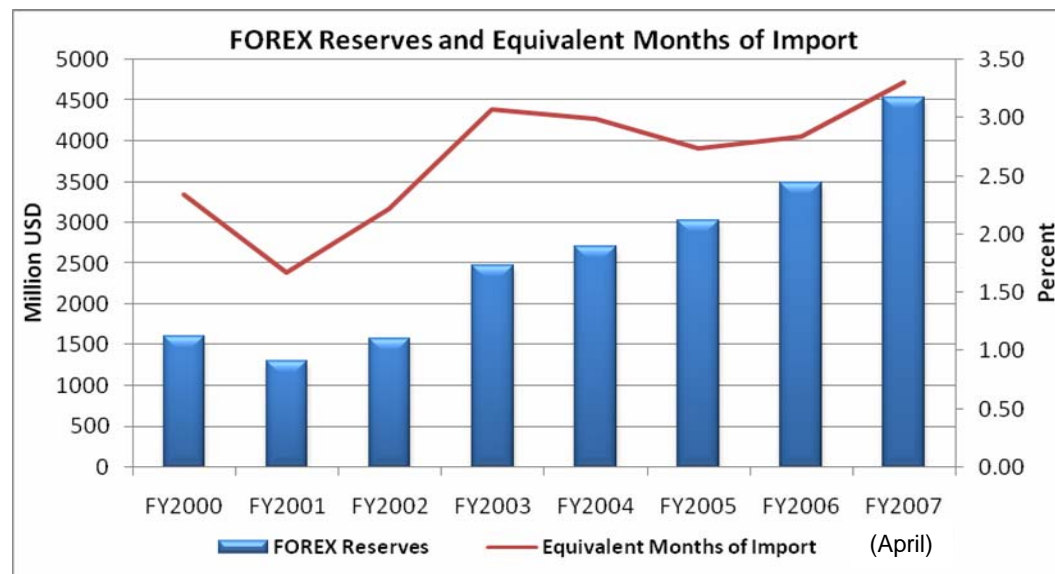
- **Negative trade balance somewhat increased in million in July-April '07 (-)\$2551 against of the last year (-) \$2093 million.**
- **Services also posted a higher negative balance: (-) \$1139 million in FY07 against (-) \$765 million in FY06.**
- **Similar trend prevailed in income balance: (-) \$652 million against (-) \$515 million.**
- **Current transfer rose to a positive \$4660 million from \$3896 million underwritten by high remittance flow, somewhat compensating for the above negative trends in other balances.**
- **Overall, the current account balance for July-March period came down from \$523 million in FY07 to \$318 million in FY06.**



## VI. EXTERNAL SECTOR

## Balance of Payment and Reserves

Figure: FOREX Reserves and Equivalent Month of Import



- Capital account balance increased from \$236 million in FY06 to \$361 million in FY07.
- Financial account also posted a healthy improvement from (-)\$29 million to \$414.0 million.
- Although FDI flow has decreased (from \$505.0 million to \$385.0 million) as also the multilateral loans (from \$648.0 million to \$519.0 million), there was tangible improvements in terms of 'other short-term loans, from (-) \$292.0 million to + \$503.0 million, and a reduction in trade credit from (-) \$583 million to (-) \$490 million.

- In the backdrop of high export and remittance growth and improvement in the financial accounts and short term loan position, forex reserves at the end of April 2007 stood at \$4538.0 million as against \$3483.0 million in June 2006.
- The forex reserves were equivalent to more than three months' of imports, compared to two and half months' equivalent in 2006.
- What effect the healthy reserves position is likely to have on the exchange rate will need to be closely monitored over the next months.



## VII. CHALLENGES AND OUTLOOK FOR FY2008

- Stabilising Market Price, particularly Food Prices**
- Realistic Growth Projection**
- Addressing Inequality**
- Investment Augmentation**
- Improved Domestic Savings**
- Expanding Domestic Tax Base**
- Greater Foreign Aid Flow**
- Improving Quality of ADP Implementation**
- Improving Investment in Agriculture**
- Proper Utilisation of Allocation in Power, Education and Health**
- Sustaining Export Growth**
- Improving FDI Flow**
- Greater Mobilisation of Equity Capital**
- Sustaining Remittance Flow**
- Whither PRS!**
- Pushing Forward Structural Reforms**





*Thank You*