State of the Bangladesh Economy in FY2008-09

(IRBD 2008-09: Third Reading)

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B A N G L A D E S H
a civil society think–tank

CPD IRBD 2008-09 Team

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The team acknowledges the valuable contribution of colleagues at CPD's Dialogue and Communication Division and the Administration Division in preparing this report. Support of *Mr A H M Ashrafuzzaman*, Senior System Analyst and *Mr Hamidul Hoque Mondal*, Senior Administrative Associate is particularly appreciated.

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

Expert Group Meeting
on
CPD-IRBD 2009 (Third Reading)

As part of the CPD-IRBD tradition, CPD organised an Expert Group Consultation Meetings on 3 June 2009 at the CPD Dialogue Room. The discussion was moderated by Professor Rehman Sobhan, Chairman, CPD. The working document of the Third Reading of *State of the Bangladesh Economy FY2008-09* prepared by the CPD was shared at this in-house meeting with a distinguished group of policymakers and professionals. CPD-IRBD Research Team is grateful to all of them for sharing their views, insights and comments on the draft report. However, the IRBD Team 2009 alone remains responsible for the consents of this report.

A list of the participants of the meeting is provided below (in alphabetical order):

Dr Quazi Mesbahuddin Ahmed	Managing Director PKSF
Dr M Asaduzzaman	Research Director Bangladesh Institute of Development Studies
Mr Siddiqur Rahman Choudhury	Chairman, Agrani Bank and Former Secretary, Finance Division
Dr Mohammed Farashuddin	Former Governor, Bangladesh Bank and Director, Board of Trustees, East West University
Professor Ismail Hussain	Department of Economics Jahangirnagar University
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Mr A F M Shariful Islam	Chief Executive Officer Dhaka Stock Exchange Ltd.
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Content

1. INTRODUCTION

The Budget for FY2009-10, expected to be presented at the session of the Bangladesh Jatyo Sangshad on 11 June 2009, comes in the backdrop of manifold challenges that the Bangladesh economy had to face in FY2008-09. From the perspective of macroeconomic governance the current fiscal year has been unusual on a number of counts. While the Caretaker Government (CTG) was in charge of macroeconomic management during the first two quarters of FY2008-09, the last two quarters were managed under the stewardship of the newly elected government. This transition in power within one single fiscal year injected uncertainties both in terms of policy making and policy continuity as well as with regard to private sector investment decisions. On a different level, macroeconomic management in FY2008-09 also became more challenging as a consequence of the high inflationary pressure on the economy during the first few months of the year. The need to address the adverse impact of the ongoing global economic crisis over the subsequent period of the fiscal year emerged as a new challenge confronting both the policymakers and the private sector.

In view of the abovementioned developments, this study presents an analysis of the major macroeconomic performance indicators of Bangladesh in FY2008-09, identifies positive achievements and examines some of the emerging disquieting features. In this sense, the report is more of a diagnostic nature. However, with regard to some of the more urgent challenges and the attendant tasks to be addressed, the study has also ventured to put forward a number of policy recommendations for consideration by the policymakers.

As was mentioned, the FY2009-10 budget will inherit an economy that has witnessed considerable volatility over the preceding year. How has the economy fared in the context of the manifold challenges that it has faced? How have the major macroeconomic indicators performed? What were the demonstrated strengths, and which are the emerging problems that need to be tackled in the next year? These are the questions that are pertinent to understanding the context in which the budget FY2009-10 is being designed and will subsequently be implemented. No doubt that answers to these questions will help identify the areas where focus will need to be placed if high growth, robust investment and fair distribution are to be achieved in the course of the next subsequent years. Various chapters of the present report attempt to address these questions by examining performance record with regard to growth, investment and savings scenario, public finance, monetary sector, real economic sectors, external economy and social sectors of the economy.

2. GROWTH, SAVINGS AND INVESTMENT

2.1 GDP Growth

Preliminary estimates prepared by Bangladesh Bureau of Statistics (BBS) reports that, GDP is expected to post a growth of 5.88 per cent during FY2008-09. If this be actually the case, it would be the lowest GDP growth over the last five years and will be considerably less (0.62 per cent) than the targeted growth of 6.5 per cent for FY2008-09. However, in view of the ongoing global recession and in the context of uncertainties in domestic economy in the backdrop of high inflation during the early months of FY2008-09, low investors' confidence and change of government in January 2009, this growth rate ought to be considered as respectable. As a matter of fact, adverse factors that which informed macroeconomic performance in FY2008-09 led to considerably lower GDP growth projections of around five per cent or even lower by many quarters, including the World Bank (WB), the International Monetary Fund (IMF) and the Asian Development Bank (ADB). However, a bumper crop harvest, resilience of the service sector, ability to contain deceleration of export growth and sustained high levels of remittance flow helped the economy to attain a near-six per cent growth rate which is projected for FY2008-09.

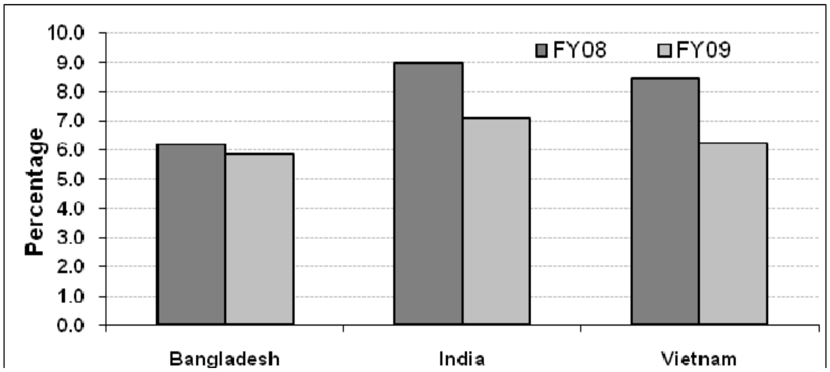
Per capita GDP of Bangladesh was likely to be about USD 621 in FY2008-09, while per capita GNI was USD 690 in FY2008-09. In taka terms (1995-96 constant prices) the projected growth would indicate a per capita GDP growth of about 4.5 per cent in FY2008-09 over the preceding year; per capita GNI growth was expected to be higher at 6.7 per cent (mainly thanks to remittance flow). However, it should be noted here that these averages conceal the fact of worsening income distribution situation in Bangladesh. An increase in incremental share of farm sector in GDP may have helped contain the rise in income inequality seen in the past years. However, rising inequality continue to remain a serious problem with regional dimension of the inequality situation exacerbating the problem.

Admittedly, any slowdown of the Bangladesh economy is likely to have a knock-on impact on resource mobilisation, poverty alleviation and employment creation. The downward revision in the projected GDP growth for FY2008-09 (from 6.5 to 5.9 per cent) would imply that this would have adverse implications for the number of people coming out of poverty, other things remaining the same. However, using growth elasticity of poverty mentioned in the PRSP II, a GDP growth of 5.88 per cent should result in 1.76 million people coming out of poverty in FY2008-09. However, this estimation is based on PRSP II, which does not take into cognisance increase in poverty incidence owing to high inflation of the recent past. Indeed, a number of studies have indicated either deceleration in the pace of poverty reduction (WB) on reversal of poverty reduction trends and rise in poverty levels (CPD). Following the International Labour Organization (ILO) methodology, with 5.88 per cent growth in GDP, the projected level of employment generation during FY2008-09 should be around 2.0 million. The PRSP II projected that, during 2009-2011, every year on average 1.8 million people would be added to the labour force. Relatively high growth of agriculture sector perhaps had a positive impact from labour absorption perspective; on the other hand, lower than projected GDP growth was likely to have adverse impact on labour absorption capacity of the economy than would have been otherwise. These conjectures will need to be tested through more in depth investigation.

It may be recalled here that, the provisional GDP was also revised downward, albeit by small margin in FY2007-08, from 6.21 per cent to 6.19 per cent. Interestingly, growth rates of agriculture, manufacturing as well as service sectors were revised downward in FY2007-08. Upward revision was also made for import duty component of the GDP which restrained the fall in GDP growth estimates. In absence of this, the GDP growth rate would have been revised downward by another 0.2 per cent. This is important to note in the sense that import duty was the only component of GDP that does not have a direct employment effect. This would mean that even though the GDP growth rate estimates did not change in any significant way in FY2007-08, employment generation was projected to be 0.1 million less than would otherwise be as a consequence of this compositional change.

As is known, global slowdown has affected all emerging Asian economies. However, compared to her Asian counterparts, Bangladesh's growth rates declined at a slower pace (by 0.3 percentage point) compared to target rates. In case of, for example, India and Vietnam projected growth rates were lower by higher margins than their targets (by 1.9 and 2.3 percentage points respectively) (Figure 1).

FIGURE 1: GDP GROWTH IN ASIAN COUNTRIES

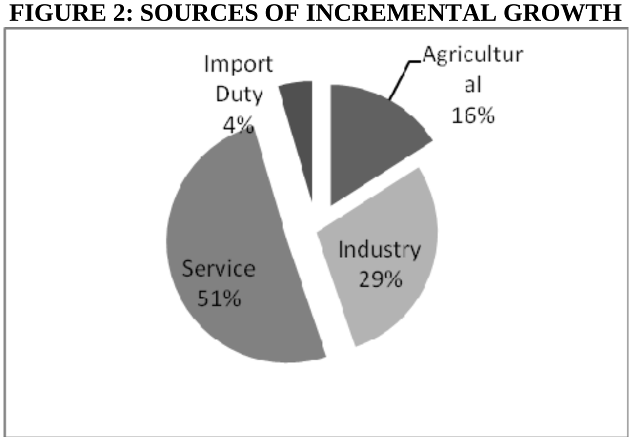


Source: BBS; Ministry of Finance, India & Ministry of Finance, Vietnam.

2.2 Sources of Growth

Despite the notably robust performance of country's agriculture sector, overall, tangible sectors of the economy[1] posted a moderate growth of 5.38 per cent while intangible sectors recorded a growth of 6.20 per cent. Global recession adversely impacted the manufacturing sector of Bangladesh which failed to achieve the projected targets. In the incremental GDP of FY2008-09, industrial sector contributed only 28.8 per cent whereas service sectors remained the front runner with a share of 50.7 per cent. Agriculture sector responded to positive policy initiatives and its contribution to incremental GDP was to the tune of 15.96 per cent (Figure 2). Overall, agriculture sector posted an impressive 4.68 per cent growth; more than 1 per cent higher than the PRSP target. Within the agriculture sector, crop sector had posted an impressive 5.93 per cent growth, contributing to ensuring country's food security in the backdrop of the inflationary pressure on prices of food items experienced in the recent past.

FIGURE 2: SOURCES OF INCREMENTAL GROWTH



Source: CPD-IRBD estimate.

It is to be noted that the targeted industrial growth of 11.70 per cent in FY2008-09 was significantly higher than the actual growth of 6.78 per cent in FY2007-08. The sector's

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[1] Tangible sectors of the economy include Agricultural Sector (both Agriculture & Forestry and Fisheries), Mining & Quarrying and Manufacturing. The rest of the sub-sectors are noted as Intangible.

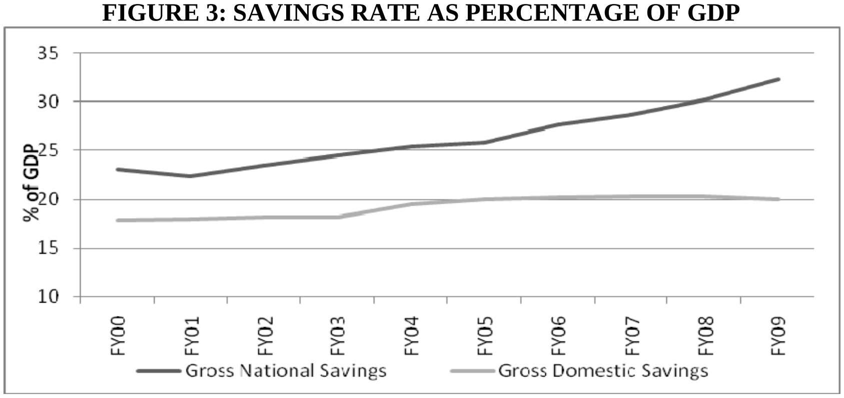
performance was particularly afflicted by domestic uncertainties and the ongoing economic crisis. Industrial sector as a whole could actually manage a growth rate of 5.93 per cent in FY2008-09. Within the industrial sector, growth rate of the manufacturing sub-sectors (contributing 17.24 per cent in the incremental GDP) experienced significant slowdown, posting a growth of 5.92 per cent in FY2008-09 against 6.78 per cent in FY2007-08.

Historically, service sector has consistently experienced a moderately high performance, contributing to its increasing share in GDP. In FY2008-09, service sector recorded a 6.25 per cent growth, which was lower than the PRSP target of 6.87 per cent. Among the nine sub-sectors of the service sector, three experienced lower growth performance (wholesale & retail trade; transport & communication and financial intermediaries), while for others growth rates were higher in FY2008-09 compared to FY2007-08.

2.3 Savings

Stagnating share of domestic savings in the GDP continued to remain unchanged in FY2008-09; rather domestic savings as a percentage of GDP in Bangladesh somewhat declined from 20.31 per cent in FY2007-08 to 20.02 per cent in FY2008-09 (Figure 3). Rising prices of essential items in the first half of FY2008-09, particularly for food items, was perhaps also a contributing factor.

FIGURE 3: SAVINGS RATE AS PERCENTAGE OF GDP



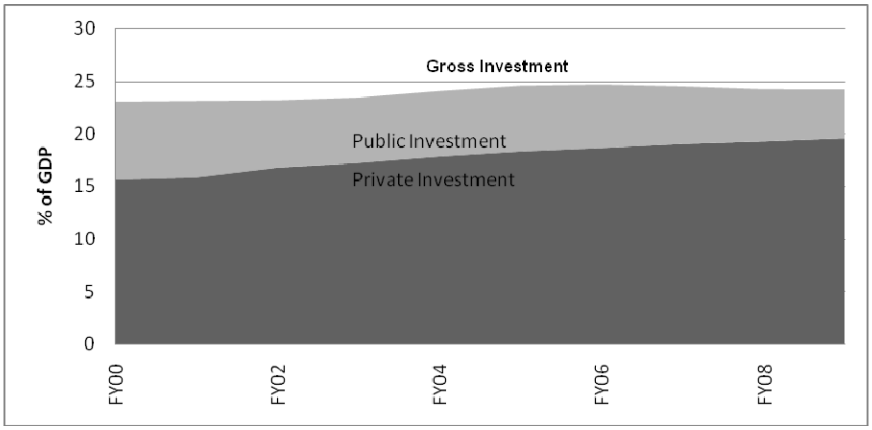
Source: BBS.

In contrast, inspired by successive high growth in remittance inflow, national savings rates have registered higher growth in recent times. Share of national savings as percentage of GDP increased further in FY2008-09, to reach 32.36 per cent of GDP, as against 30.21 per cent in FY2007-08, registering a remarkable rise to the tune of 2.15 per cent of GDP. It is to be noted that, the gap between national and domestic savings in Bangladesh has been rising in a consistent manner over the recent past. This gap primarily originates from lack of investment demand and limited scope to channel remittances towards investment. A continuation of this trend may result in further deterioration in income distribution, since remittance, whilst poverty alleviating, has also been found to be inequalising.

2.4 Investment

In absolute terms, Gross capital formation in FY2008-09 would be Tk. 148,840 crore in nominal terms (Tk. 92,002 crore at constant prices). Growth of gross capital formation made some progress, posting 5.72 per cent in FY2008-09 compared to only 1.80 per cent in FY2007-08. However, this is lower than the general trend which hovers between eight to nine per cent. Investment has suffered from both lack of infrastructure and continuing uncertainty in recent times. Ongoing recession also has had an adverse impact on investors' confidence. In spite of growth in absolute terms, mentioned above, gross investment as percentage of the GDP has declined for the third consecutive year, recording 24.18 per cent of GDP in FY2008-09 compared to 24.21 per cent of GDP in FY2007-08 (Figure 4). This was somewhat lower than the MTMF target of PRSP which was set at 24.40 per cent of GDP.

FIGURE 4: INVESTMENT AS PERCENTAGE OF GDP



Source: BBS.

Low implementation pace of the ADP is underwritten by low realisation of public investment. Public investment continued to plunge to record a historic low rate of 4.63 per cent of GDP in FY2008-09, lower even compared to the earlier low levels of 4.95 per cent in FY2007-08. Share of private investment in GDP which covers four-fifths of total investment of the country increased marginally to 19.55 per cent in FY2008-09 from 19.25 per cent in FY2007-08.

National savings rate (32.36 per cent) remains higher than the gross investment rate (24.18 per cent), indicating availability of investible surplus. This was estimated to be about Tk. 500 billion (more than 8 per cent of GDP). Compared to India and Vietnam, investment scenario in Bangladesh looks rather bleak; these countries invest around 40 per cent of their national income. Furthermore, the incremental capital-output ratio (ICOR) increased from 3.91 to 4.11 between FY2007-08 and FY2008-09, implying a fall in capital productivity for the third consecutive year. A continuation of this trend would result in two possible outcomes: a higher investment requirement in future to attain same growth rates, or lower growth rates if investment levels remained the same. This once again reemphasises the need to ensure higher investment to attain higher GDP growth rate along with measures to raise capital productivity. This would also reemphasise the need for the government to go for higher allocation of resources in large scale infrastructure development projects which could crowd-in private sector investment. Recent move to influence downward revision of lending rate aimed at supporting private investment is a welcome initiative; however, this could also lead to lower interest rate on savings, which could have a dampening effect on domestic savings and national savings. From policy perspectives, maintaining a realistic spread between lending and deposit rate was an issue of critical importance in this context.

Thus, a near six per cent growth, in many ways a respectable achievement, had been characterised, by falling domestic savings, failure to translate surplus savings into investment, decelerating aggregate investment that was predicated by fall in both public and private investment and deteriorating capital productivity.

3. PUBLIC FINANCE

3.1 Revenue Mobilisation

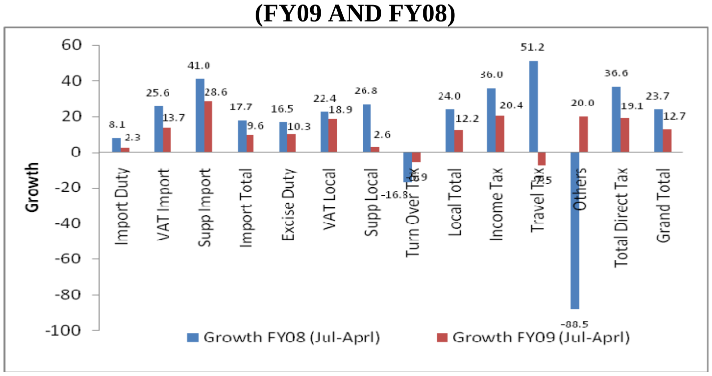
Attaining 19.2 per cent revenue growth in FY2009 was always going to be difficult in the backdrop of the high benchmark growth of 20.0 per cent in FY2008. This task was made even more challenging by the need to reduce duties on many (food) items when prices were on the rise and as a consequence of the ongoing global economic crisis which resulted in decline of duties on imports owing to the fall in global commodity prices.

NBR Collection

The total revenue target for FY2009 was set at Tk 69,338 crore. Over 78 per cent of this amount (Tk 54,500 crore) was expected to come from the National Board of Revenue (NBR) sources. During the first ten months of the fiscal year (July-April), Tk 39,959.4 crore was generated by the NBR, i.e. till now 73.3 per cent of the annual target has been achieved. This also implies a 12.7 per cent growth achieved over the NBR revenue collection during the matching period of FY2008, which was lower than the annual growth target of 14.9 per cent (Figure 5).

Lower than projected growth rates posted for NBR revenue collection was primarily due to significantly lower growth of collection of import duty (2.3 per cent growth achieved against the annual growth target of 13.1 per cent) and supplementary duty at local stage (2.6 per cent growth during July-April against the annual growth target of 23.6 per cent).

FIGURE 5: GROWTH IN NBR REVENUE COLLECTION DURING JULY-APRIL (FY09 AND FY08)



Source: National Board of Revenue (NBR).

Revenue losses on these accounts mentioned above has been compensated, to some extent, by high growth of income tax collection of 20.4 per cent, which was significantly higher than the targeted growth of 11.1 per cent.

Non-NBR Tax and Non-Tax Revenue

Available data on non-NBR tax and non-tax revenue for the first eight months of the current fiscal year indicate encouraging growth performance. Despite a negative growth target (-1.0 per cent) set in the original budget, non-NBR tax collection posted 19.0 per cent growth during July-February period over the corresponding period of the previous fiscal year. Non-tax revenue collection also recorded an impressive growth of 15.3 per cent during this period which, however, was lower than the targeted growth of 24.5 per cent.

Aggregate Revenue Outcome
It is estimated that, given the current growth rates, NBR may fall short of its target by about Tk 910 crore, non-NBR tax revenue collection in FY2009 may surpass target by Tk 470 crore, while non-tax revenue collection may experience a shortfall of Tk 930 crore. At the aggregate level, *total revenue collection in FY2009 may fall short of its target by about Tk 1370 crore, which would be equivalent to about 2 per cent of the total revenue target.*

Overall, revenue growth performance during FY2009 reveals some positive developments in terms of compositional change in the revenue structure of Bangladesh. Estimated revenue structure of FY2009 may result in 21.4 per cent share of direct tax[2] in total revenue, backed by high growth in income tax collection. In the previous fiscal year, share of direct tax was 21.0 per cent. As is known, direct tax is generally recognised to be progressive (since it is mean-tested), while indirect tax has the propensity to be regressive. Raising the share of direct taxes in the total revenue must be seen as a major goal by the concerned authorities.

It is to be noted that revenue earnings from “undisclosed legal income”, allowed for the past several years, have been on the decline in recent years. Total revenue earnings from this provision amounted to Tk 105 crore in FY2009 which was Tk 803 crore in the previous year. Number of people availing this facility has also come down in FY2009 to 14,216 from 42,000 in the previous year. This would indicate that the nature of this type of provision is such that its continuation over successive years tends to reduce incremental income. While compulsions of resource mobilisation to combat negative impacts of global economic crisis may justify the continuation of the facility in FY2010 (with penalty rates), the government may consider revisiting the policy subsequently. It needs to be recognised and appreciated that this type of provisions create disincentive for honest tax payers.

4.2 Revenue Expenditure

Revenue expenditure data for the first eight months of FY2009 indicates a deceleration in expenditure growth. A 15.0 per cent rise was recorded in this respect over the corresponding period of FY2008 (July-February) as against the target of 19.5 per cent annual growth of the same in FY2008-09 budget. Three major heads of revenue expenditure - “pay and allowances”, “interest payments” and “subsidies and transfers” – constituted 78 per cent of the total revenue expenditure budget of FY2009. Interest payments posted a moderately high growth of 12.5 per cent during the July-February period. This high growth was recorded on top of the significantly high growth of 36.2 per cent that was recorded during the comparable period of FY2008 (over FY2007). Additionally, this growth was significantly higher than the target growth of less than one per cent set for FY2009. Subsidies and transfers, on the other hand, recorded high growth of 23.7 per cent in FY2009 (July-February). It is to be noted that, subsidies in the revenue expenditure classification do not cover subsidies for BPC, fertiliser and other major subsidy categories, majority of which is expected to fall considerably compared to the respective budgetary allocations owing to the falling global commodity prices. With moderate to high growth rates on account of interest payments and subsidies and transfers, lower than targeted revenue expenditure growth was mostly due to lower growth in pay and allowances, recording only 7.7 per cent rise against the target of 24.2 per cent. This may have happened because government employees (e.g. doctors and nurses, school and college teachers) were not recruited as planned.

[2] Direct tax includes income tax, travel tax, land tax and some other taxes.

Among other heads of revenue expenditure, goods and services and acquisition of assets and works recorded high growth rates (17.9 per cent and 77.4 per cent respectively) during the July-February period of FY2009. Expenditure on account of block allocations, however, declined significantly by (-) 45.8 per cent.

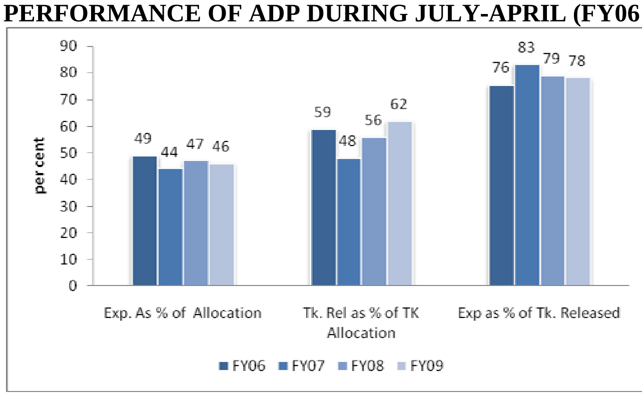
Since the budget for FY2009 estimated subsidy demands based on June 2008 prices, which were at significantly high levels, significant amount of savings is likely to result on account of lower subsidy payments. BPC subsidy demand for FY2009 may end up to be around Tk 1,000 crore, for which an allocation of Tk 6,106 crore was kept in the original budget. While significant savings on fertiliser subsidy is also a possibility, full benefits of lower fertiliser prices in the international market could not be harnessed as most of the imports were made during the initial two quarters of FY2009 when prices were much higher compared to the current levels.

3.3 Annual Development Programme (ADP)

Historical trend of low ADP implementation further deteriorated in FY2008; actual spending as a percentage of the original allocation stood at 69.8 per cent in FY2008 compared to the 86.1 per cent average implementation record of the preceding 10 years. In FY2008 actual ADP expenditure stood at 3.39 per cent of GDP which was lowest in history of ADP implementation in Bangladesh.

Project fund utilisation rate for the first ten months of FY2009 was only around 46.3 per cent of the original ADP (compared to 46.7 per cent in FY2008) (Figure 6). ADP expenditure record shows that, against original allocation of Tk. 25,600 crore, only about Tk. 11,856 crore could be spent by the involved agencies till April 2009.

FIGURE 6: PERFORMANCE OF ADP DURING JULY-APRIL (FY06 TO FY2009)



Source: Implementation, Monitoring and Evaluation Division (IMED).

The top five ministries/divisions (in descending order of allocations) received 64.2 per cent of the total ADP allocation. *Among these, Ministry of Communication and Power Division utilized the least amount of allocation, 25 per cent and 44 per cent respectively, in the first ten months of the fiscal year*. It must be noted that Power Division was given high priority in the ADP in consideration of the deteriorating electricity supply situation in the country.

The 16 ministries which were stipulated to develop their own budgets under the Medium Term Budgetary Framework (MTBF) initiative had an average expenditure of 48.44 per cent. This was almost identical to the average utilization rate of 48.13 per cent by all ministries. This should be considered a cause for concern. Thus, the idea that giving more power with regard to investment decisions to ministries would result in higher and better rate of fund utilization has not actually proved to be the case. Ironically, IMED, which has been charged with monitoring and evaluation of the ADP, has utilized only 29 per cent of its allocation in the first ten months.

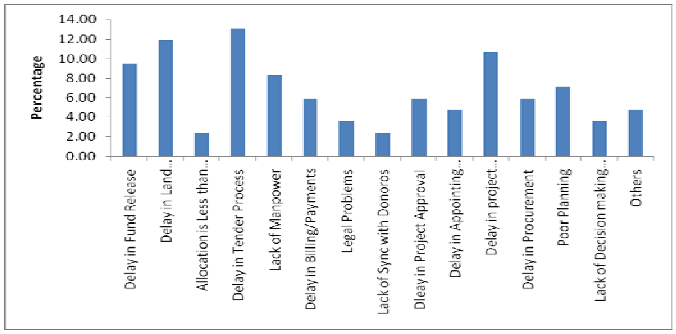
In view of low progress in project implementation by various ministries, the National Economic Council (NEC) recently has revised the Annual Development Programme (ADP) downward to Tk. 23000 crore for FY2009, a reduction of around 10 percent. The RADP targets stipulate that, of the total expenditure 55.7 per cent is to be financed from domestic resources, while the rest (44.4 per cent) would be financed by foreign resources. In the original ADP, foreign resources were set to fund 47 per cent of the total requirement. Low disbursement of project aid owing to sluggish pace of implementation so far might have forced the ADP to be revised, with lower share of foreign funding. Utilization of project aid stood rather low at 43.47 per cent during July-April period, which was even lower than the rate of project aid utilization of 50.71 per cent during the corresponding period of FY2008.

It appears that the quality of implementation will continue to suffer as agencies and ministries, following the usual trend, rush to spend respective allocations in the last two months of the fiscal year, which often results in poor project outcomes. It is reckoned that in the end, ADP spending may turn out to be around Tk 19,500 crore (about Tk 6,000 crore less than the original ADP), which would bring the ADP-GDP ratio down to a new historical low level of 3.19 per cent.

As it appears, the government has decided on an ADP of Tk. 30,500 crore for FY2009-10. The new ADP, which will be 19.2 per cent bigger than the original ADP of FY2009 and 32.6 per cent higher than the revised one, allocates the highest amount to agriculture (19 percent) followed by transport, energy and power and education (15 percent, 14 percent and 13 percent respectively). The proposed ADP will perhaps be about 50 per cent higher than what will be actually implemented in FY2009. Such a significant scaling up planned expenditure will require quite considerable enhancement of government capacities, in absence of which the pace of implementation will come down further.

According to the IMED Implementation Progress Report (FY2008-09), major difficulties faced in implementation of the ADP as reported by the ministries relate to delay in tender processing, delay in land procurement, delays caused by project amendment and delay in fund release. 25 ministries whose implementation rate was less than the national average rate of 41 per cent were assessed by the IMED to identify major causes of slow implementation. Figure 7 provides information on frequency distribution of major causes of delay in project implementation. It has been mentioned by several quarters that the current procurement law may need to be amended to address the delay in procurement which has been seen as a major constrain in ensuring speedy utilisation of ADP fund. Whilst some changes in some aspects of the law may be called for, this is no way should made at the cost of transparency and accountability in utilisation of public resources.

FIGURE 7: FREQUENCY DISTRIBUTION OF REPORTED PROBLEMS BY VARIOUS MINISTRIES



Source: EMED IMED Implementation Progress Report (FY2008-09).

The government will need to put an all out effort to remove these obstacles to attain the ambitious targets in FY2009-10, since historically ADP implementation had never crossed the Tk 20,000 crore mark (highest ever implementation was of Tk 19,472 crore in FY2005-06).

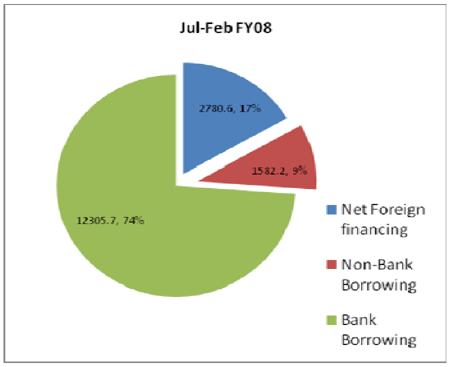
3.4 Budget Deficit and Financing

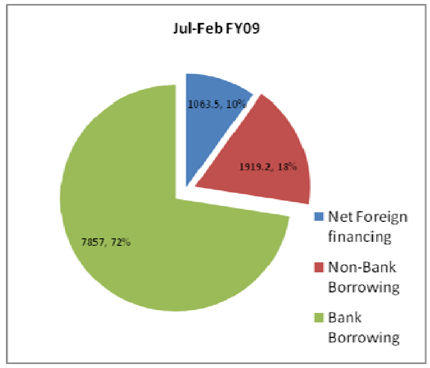
It has been the general experience in Bangladesh over the past years that deficit situation at the end of fiscal year tended to benefit from lower implementation of the ADP. While this has been true for FY2009 as well, this time around lower revenue expenditure and much lower subsidy expenditure helped to attain a measure of comfort. Although shortages in revenue collection and stimulus package of Tk 3,424 crore announced recently may reduce the gains, to some extent, significant savings on the above mentioned accounts is likely to result in lower deficit-GDP ratio (about 3.51 per cent) compared to what was estimated in the original budget (at 5 per cent).

Available information on current status of budget deficit matches the aforesaid projections. During July-February of FY2009 total deficit stood at Tk 10,959.1 crore, which indicates a decline of (-) 34.3 per cent compared to the deficit of the same period in the previous year. In view of the 15 per cent positive growth target of the budget in terms of deficits for FY2009, such lower actual levels of deficit would allow the government to accommodate the stimulus package without much difficulty from the perspective of fiscal management.

However, budget for FY2009 estimated 44.4 per cent of the projected deficit to be financed from net foreign support. The attendant record has not been encouraging so far. *Only 9.7 per cent of the current level of deficit has been met by foreign financing component.* Net foreign financing amounted to Tk 1,063 crore during July-February period, indicating a significant fall of (-) 61.8 per cent compared to July-February figure of FY2008 (Figure 8). This also indicates that only 7.8 per cent of the net foreign financing target has been materialised during the first eight months of the current fiscal year.

FIGURE 8: COMPONENTS OF DEFICIT FINANCING IN FY08 AND FY09





Source: Ministry of Finance (MoF).

Domestic financing during July-February period of FY2009 also declined by (-) 28.8 per cent: total bank and non-bank borrowing amounted to Tk 9,895.6 crore. It is to be noted that the government has increasingly gone for non-bank borrowing as against bank borrowing. In the background of significant overall decline in deficit, non-bank borrowing during July-February period has posted a positive growth of 21.3 per cent, while bank borrowing declined by (-) 36.2 per cent.

Table 3.5 provides information with regard to projections of what could be the final fiscal structure for FY2008-09 and possible targets for FY2009-10. It is to be noted that along with significant enhancement in the size of ADP, revenue expenditure growth target for FY2009-10 (could be about 29 per cent over the projected expenditure of FY2008-09) may stand well above the average growth recorded during the last five fiscal years of about 16 per cent. Even if subsidy demand comes down significantly for FY2009-10, by about 50 per cent from the subsidy budget of FY2008-09, added expenditure burdens from block allocations for PPP budget and implementation of the recommendations by the pay commission (at least a part of it) could result in a total budget of about Tk 116,639 crore for FY2009-10; this would be 30.3 per cent higher than the projected public expenditure in FY2008-09. Such estimated expenditures would force the government to accommodate a deficit target of 5.7 per cent of GDP as is indicated by the projections presented in Table 1. However, if significant improvements in ADP implementation capacity cannot be ensured, actual deficit at the end of the next fiscal year would again be lower than the targets set in FY2009-10 budget.

TABLE 1: PROJECTED FISCAL STRUCTURE FOR FY2009 AND FY2010

(Crore Tk)

	FY2008-09 (Budget)	FY2008-09 (Projected)	Difference	FY2009-10 (Projected)	% Change in FY2009-10
GDP at current price	613111	614943	(+) 1832 (+0.3%)	677733	10.2
Revenue Earnings	69338	67,964	(-) 1374 (-2%)	78,200	15.1
as % of GDP	**11.31**	**11.05**	**(-) 0.26**	**11.5**	**0.5**
Revenue Expenditure	61469	59171	(-) 2298 (-3.7%)	79139	29.0
as % of GDP	**10.03**	**9.62**	**(-) 0.40**	**11.7**	**2.1**
ADP	25600	19600	(-) 6000 (-23.4%)	30500	55.6
as % of GDP	**4.18**	**3.19**	**(-) 0.99**	**4.5**	**1.3**
Total Budget	99962	89544	(-) 10418 (-10.4%)	116639	30.3
as % of GDP	**16.30**	**15.2**	**(-) 1.11**	**17.2**	**2.0**
Deficit	30580	21580	(-) 9000 (-29.4%)	38439	78.1
as % of GDP	**4.99**	**3.51**	**(-) 1.48**	**5.7**	**2.2**

* Figures in parenthesis indicate differences between original budget and projections for FY2009 as percentage of the original budget.

While the government should be ready to go for higher deficits in view of the need to address the adverse impact of global economic crisis, which has been the case in other countries, it should be borne in mind that higher deficits would also lead to higher interest payments in the long run. Accordingly, along with the size of the deficit, mode of financing the deficit should be carefully considered when decision is taken in this regard.

4. MONETARY SECTOR

Though the rate of inflation has been showing a benign trend in recent times, underwritten largely by falling commodity prices in the global market, keeping the growth momentum on track in view of the global economic meltdown continues to remain a daunting task for the policymakers. In order to tackle this, monetary policy will need to focus mainly on three major areas. *First*, ensuring higher credit to the productive sectors; *second*, managing the interest rate in a manner that is able to maintain real interests rates stable for both lenders and depositors; *third*, balance the apparently conflicting interests of exporters and importers through prudent management of the exchange rate regime. In addition to these, efforts have to be made to keep the inflation rate contained. Monetary policy tools such as Repo, Reverse Repo, Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) have to be used in a prudent manner to facilitate growth.

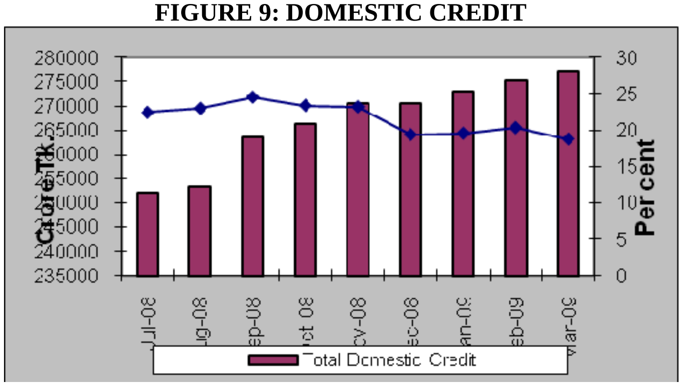
Some of the emerging trends in the monetary sector relating to the period under discussion are highlighted below.

4.1 Low Credit Expansion May Dampen Investment Scenario

In the backdrop of the global financial crisis and the resulting international economic downturn, private sector credit has taken a significant hit since August 2008. Total private sector credit at the end of March 2009 was only 13.67 per cent higher compared to private sector credit in March of FY2007-08. This was well below the 26.86 per cent growth in August of FY2008-09. Though total domestic credit increased by 18.74 per cent at the end of March 2009 on a point-to-point basis over the corresponding high benchmark figure in FY2007-08 and domestic credit to the government increased by 29.71 per cent, domestic credit to other public sectors decreased by 5.72 per cent over the same period (Figure 9).

In terms of sectoral credit disbursement, agriculture sector posted a positive but lower growth (14.82 per cent for July-April in FY2008-09 against 16.50 per cent in FY 2007-08). Industry sector, however, had experienced a major downturn as disbursement of term loan declined by 9.6 per cent during July-March 2008-09 compared to July-March 2007-08 though disbursement of working capital increased by 15.5 per cent over the same period.

FIGURE 9: DOMESTIC CREDIT



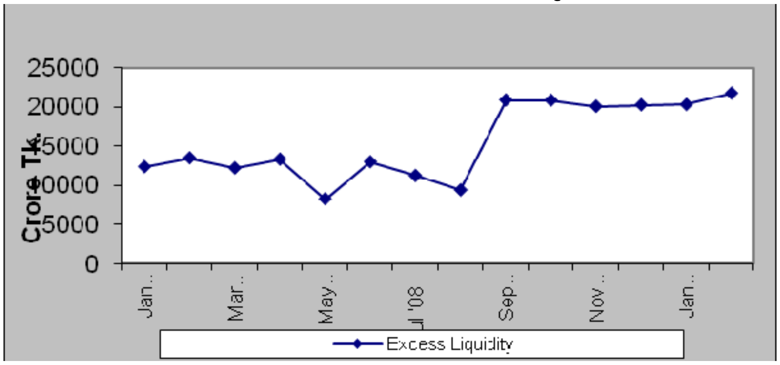
Source: Bangladesh Bank.

There has been an increase in government sector borrowing by 17.40 per cent at the end of March FY2008-09 compared to the corresponding figure of the last fiscal year. During the same period of FY2007-08 the comparable figure was 12.18 per cent. Out of total government borrowing, 52.49 per cent was contributed by the banking sector.

Lower demand for credit has resulted in excess liquidity in scheduled banks which amounted to Tk. 21,752.50 crore as of end February 2009 (Figure 10). This amount is Tk. 8,763.92 crore higher (by 67 per cent) compared to the excess liquidity at the end of June 2008. The excess liquidity situation has been compounded by several factors in the face of the ongoing global financial crisis.

Firstly, a large share of the bank credit in Bangladesh goes towards L/C opening. Prices of majority of commodities have gone down in the global market since September 2008, which would imply that less money would be required to import the same amount. This has reduced the requirement for import credit. *Secondly*, because of the financial crisis the business community has been prone to taking conservative steps with regard to business decisions. This is evident through the decline of L/C opening for capital machineries. *Thirdly*, government expenditure during FY2008-09 has also been low.

FIGURE 10: TRENDS IN EXCESS LIQUIDITY



Source: Bangladesh Bank.

4.2 Capping of interest rate to improve export and investment and whether it will work

In line with its objective of providing adequate credit for production-oriented activities, the Bangladesh Bank (BB) has reduced the Repo and Reverse Repo in March 2009 by 25 basis points to 8.5 per cent and 6.5 per cent respectively. As is known, the BB has asked the commercial banks to limit the lending rate to within 13 per cent from an average rate of 15.5 per cent for all sectors, except for consumer and credit card loans. However, the policy's desired effect on spread may not be realised as several banks (by some account this group included 20 banks) moved to reduce interest rates for fixed deposits by 1.5 percentage points, on the next day, following the BB move. Table 2 depicts the large spread which has tended to remain the same as a consequence.

The reasons for high lending rates include inefficiencies in the system, market segmentation, and lack of competition. Apart from these supply side problems, high interest rate can also be linked to high demand for corporate loans. If equity finance could be encouraged through policies that stimulate and encourage capital markets, demand for loanable funds would be reduced with favourable effect on lending rates. Other factors responsible for high lending rates include inflationary pressure and loan default risks, particularly in a country such as Bangladesh where non-economic factors also play a role in loan classification. The percentage of classified loan to total outstanding loan is still 11.12 per cent as of March FY2008-09.

As is well known, interest rate is only one of many tools in the arsenal of the monetary policy to boost investment. This policy tool cannot be successful without supportive fiscal and institutional policies. Effective tax measures are important and so is a business-supportive environment, which includes, among others, supportive infrastructure and a stable political environment for attracting foreign and domestic investment. An earlier IRBD report (2005-06) of the CPD noted that the correlation between interest rate and investment was not significant. Along with capping of lending rates, emphasis should also be put on reducing the interest rate spread (IRS), which is still above 5 per cent, one of the highest in the world. The idea of fixing a floor on deposit rates needs to be carefully examined in view of the emergent situation.

TABLE 2: INTEREST RATE SPREAD

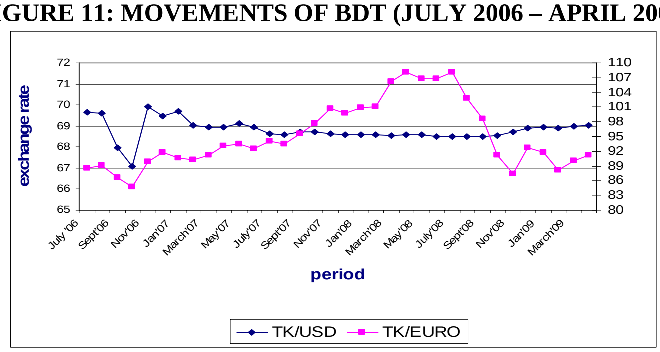
Period	Commercial Lending Rate (%)	Deposit Rate (%) (3 months to less than 6)	Spread	Inflation Rate	RRI on Lending Rate	RRI on Deposit	Growth of M2
Jun 2007	12.7	7.04	5.66	7.20	5.50	-0.16	17.07
Jun 2008	11.82	7.46	4.36	9.94	1.88	-2.48	17.63
Dec 2008	13.51	7.9	5.61	8.90	4.61	-1.00	17.88
Mar 2009	13.62	7.91	5.71	7.69	5.93	0.22	19.82
Apr 2009	13.53	8.17	5.36	5.36	8.17	2.81	

Source: Bangladesh Bank.

4.3 Exchange Rate Manipulation is Not a Feasible Option

Stability of the exchange rate of Bangladesh Taka (BDT) with the US Dollar (USD) since June 2006 has given rise to concern among a segment of the business community, particularly exporters (Figure 11). Exporters argue that competitiveness of Bangladeshi products in the global market is being undermined at a time when most other currencies have seen significant depreciation of their exchange rate vis-à-vis USD. The BDT has indeed in the recent past, appreciated (via a lower percentage fall against the USD) in relation to a number of currencies including Vietnamese Dong (VND), Cambodian Riel (KHR), Sri Lankan Rupee (LKR) and Indian Rupee (INR). However, the REER of BDT appears to have been stable over the same period (Figure 12). The call for depreciation needs to be considered carefully since export and import elasticities are important considerations that need to be taken into account in deciding on whether a depreciation of BDT will actually have positive overall impact on trade and current account balance. Research has also shown that Bangladesh's imports exhibit higher price elasticity than exports[3]. Hence, as a result of depreciation of the BDT, ceteris paribus, imports would fall but exports may not register comparable rise.[4] It would appear that, instead of pursuing policies that would lead to depreciation of the BDT, other policies including fiscal and monetary measures that stimulate export-oriented activities and enhance their competitiveness, should be given more emphasis by the policy makers.

FIGURE 11: MOVEMENTS OF BDT (JULY 2006 – APRIL 2009)

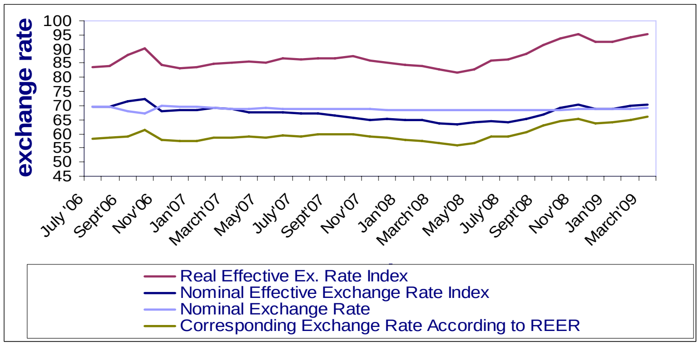


Source: Bangladesh Bank.

[3] Razzaque, Abdur, The Small Country Assumption, Econometric Estimates and Policy Making: A Reassessment with Bangladesh's RMG Exports to the European Union, The Bangladesh Development Studies, Volume XXX, March-June 2004, Number 1&2, Dhaka.

[4] Panagariya, A., Shah, S. and Mishra, D, Demand Elasticities in International Trade: Are they Really Low? World Bank 1996, Washington DC.

FIGURE 12: REAL AND NOMINAL EFFECTIVE EXCHANGE RATES (BDT WITH RESPECT TO USD) (JULY 2006 – MARCH 2009)



Source: Bangladesh Bank.

In view of the dull investment scenario as indicated by low credit flow to the productive sector and high excess liquidity, policy makers may pursue a moderate expansionary monetary policy, as inflation rate is at a tolerable level at the moment.

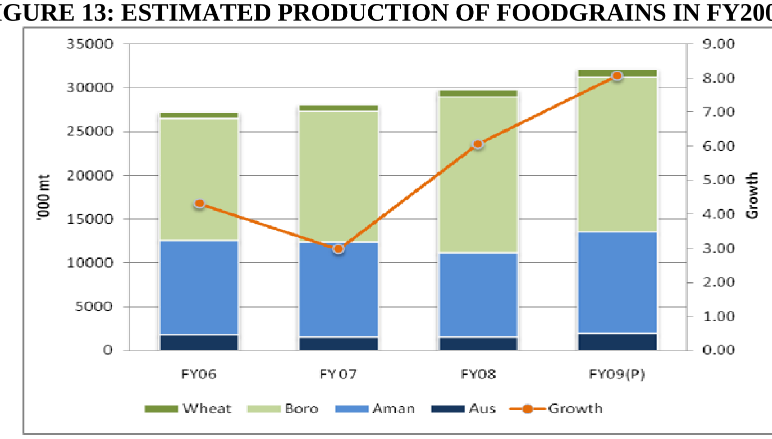
5. REAL SECTOR

5.1 AGRICULTURE

Production of Foodgrains

Bangladesh Bureau of Statistics (BBS) has recently released estimates on Aus and Aman rice production in FY2008-09. As regards production of Boro rice and wheat, BBS and the Department of Agriculture Extension (DAE) are yet to do so. In view of this, the CPD has attempted to estimate the likely production of these two crops in FY2008-09. *Total production of foodgrains in FY2008-09 is likely to be about 32.17 million metric tons (comprising 1.90 mmt of Aus rice, 11.61 mmt of Aman rice, 17.77 mmt of Boro rice and 0.90 mmt of wheat), which would be the highest in Bangladesh's history* (Figure 13). In other words, total production of foodgrains in FY2008-09 is likely to be 8.0 per cent higher than that of last fiscal year. However, this would still be 6.3 per cent less than the foodgrain production target set for FY2008-09 fixed at 34.32 mln metric tons. Higher production of foodgrains in FY2008-09 can be attributed to the good harvest of rice in all the three seasons of Aus, Aman and Boro.

FIGURE 13: ESTIMATED PRODUCTION OF FOODGRAINS IN FY2008-09



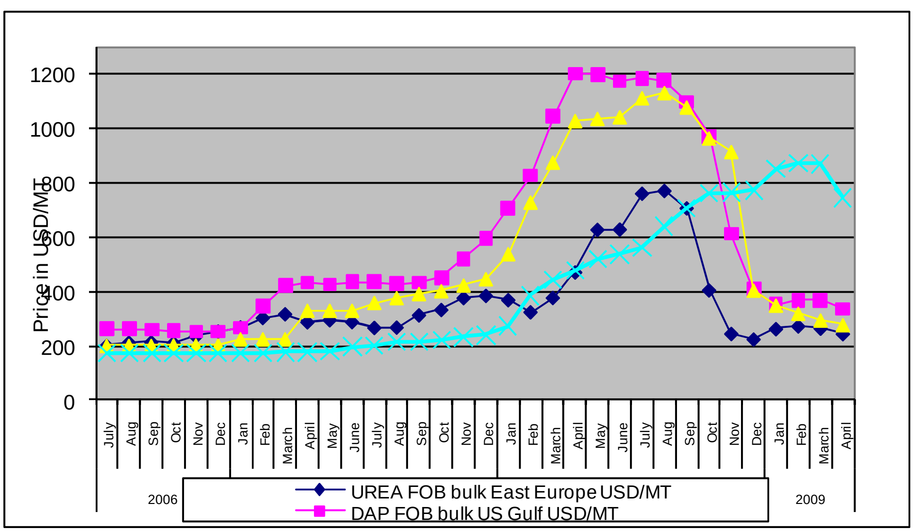
Source: BBS for production of Aus and Aman rice, CPD for estimates of Boro rice and wheat.

Fertiliser production and Subsidy
There was no major complaint about fertiliser availability in FY2008-09, but price of fertiliser was of concern to farmers. Between May and December 2008, farm level prices of all types of fertilisers increased significantly. Over this period, price of Urea and TSP (triple super phosphate) more than doubled while price of MoP rose by 1.5 times. Because of high price, farmers used lower quantity of non-urea fertiliser in the Aman season. Under this circumstance, on 13 January 2009, the newly elected government fixed the price of TSP, MoP and DAP at Tk. 40, Tk. 35 and Tk. 45 per Kg respectively, which implied a high level of subsidy. This was a very timely decision that was aimed at providing subsidy on non-Urea fertiliser to promote balanced fertiliser use and reduce the cost of production. The government was able to implement the decision at the field level, and farmers were able to obtain fertiliser at the declared prices.

Recent decision to shut down three fertiliser factories (Chittagong Urea Fertiliser Factory Limited, Palash Urea Fertiliser Factory and Ghorashal Urea Fertiliser Factory), because of the need to divert gas supply for electricity production, would require additional import of three lakh metric tons of Urea. At the current international prices (USD 300 per metric ton, plus USD 60 for insurance and freight from China), this will cost about Tk. 739.80 crore against the domestic production cost of Tk. 270.00 crore. Thus, *the country will have to bear an additional amount of Tk. 469.80 crore for not being able to make gas available for domestic fertiliser production.*

International prices of all types of fertilisers except for MoP declined substantially between July 2008 and April 2009 (Figure 14). During this period, price of urea, TSP and DAP decreased by 67, 75 and 72 per cent, respectively. On the other hand, price of MoP increased by 33 per cent. In April 2009, international prices of a metric ton of Urea, TSP and DAP were USD 245, USD 278 and USD 335 respectively, while MoP was sold at USD 745. Thus, *after rapid and high escalation of prices of urea, TSP and DAP in 2007 and 2008, prices are now reverting back to the trends of 2006. In case of MoP, price was lower in April 2009 than in March 2009, but much higher than in 2006.*

FIGURE 14: INTERNATIONAL PRICE OF FERTILISERS (UREA, DAP, TSP & MOP): JULY 2006 TO APRIL 2009



Source: Commodity market review, World Bank.

If the current international market price prevails and the government does not change the administered prices of fertilisers, then sale of TSP and DAP will bring some profit to the government whilst there will be a need to provide subsidy for imported Urea and MoP. In this case, *the government may have to provide subsidy to the tune of Tk. 1069 crore in FY2009-10 (for planned supply of Urea: 29.51 lakh mt, TSP: 6.70 lakh mt, MoP: 2.63 lakh mt). On the other hand, if the government is ready to provide Tk. 2836 crore as fertiliser subsidy, then it would be possible to further reduce administered prices of TSP and DAP to Tk. 30 (from the existing Tk. 40 per kg of TSP and Tk. 45 per kg of DAP) and supply adequate amount of fertilisers to farmers (Urea: 35 lakh mt, TSP: 6.70 lakh mt, DAP: 2.63 lakh mt and MoP: 5.0 lakh mt).*

Import of Foodgrains

Total import of foodgrains (26.38 lakh mt) and rice (5.97 lakh mt) during July-April of FY2008-09 were respectively 19 per cent and 69 per cent lower than that of comparable months in FY2007-08; however, wheat import (20.41 lakh mt) was 58 per cent higher. Rice was mainly imported by the public sector whilst about 84 per cent of the wheat import was done by the private sector (Table 3).

TABLE 3: FOOD IMPORT IN FY2008-09

(in '000 metric tons)

Category of imports	FY2007-08 (July-April)			FY2008-09 (July- April)		
	Rice	Wheat	Total Foodgrains	Rice	Wheat	Total Foodgrains
Food Aid	73.1	134.6	207.7	26.6	64.2	90.8
Public Commercial Import	201.9	0.0	201.9	385.1	268.1	653.2
Private Import	1680.9	1158.6	2839.5	185.5	1708.9	1894.4
Total	1955.9	1293.2	3249.1	597.2	2041.2	2638.4

Source: Food Planning and Monitoring Unit (FPMU), Ministry of Food and Disaster Management.

Procurement of Boro rice

The government has started procurement of Boro rice on 1 May 2009 and it will continue till the end of September 2009. Procurement price of paddy is fixed at Tk. 14 /kg and rice at Tk. 22 /kg with a procurement target of 12 lakh mt of rice (comprising 11 lakh mt of rice and 1.5 lakh mt of paddy). However, progress so far has been rather very slow (only about 203 thousand mt of rice and about 23 thousand mt of paddy until May 30, 2009).

In mid-May, a team of CPD researchers visited selected areas of Naogaon, Rangpur, Bogra and Mymensingh. The team discussed with relevant stakeholders including farmers, traders, millers, food procurement officers. Major findings of the field visit are: (i) Estimated cost of per kg production of Boro rice varied between Tk. 11.73 and Tk. 12.75, depending on type of the Boro paddy (Hybrid or HYV) and method of irrigation (electricity-operated or diesel-operated). Cost of production was higher for diesel-irrigated Boro rice compared to electricity-irrigated Boro rice. Estimated weighted average cost of production of Boro paddy was Tk. 12.49/kg and Boro rice was Tk. 20.14/kg. (Table 4); (ii) farmers were selling wet paddy to the traders. In terms of dry paddy equivalent, farmers were obtaining Tk. 10.00 to Tk. 11.67 per kg by selling hybrid paddy, Tk. 11.67 to Tk. 12.50 per kg for BR28 paddy and Tk. 14.06 per kg for BR29 paddy; (iii) average price of worse paddy (Tk 10.85 per kg) at the farm level is lower than average production cost of paddy (Tk 12.49 per kg); (iv) At the current market price farmers were losing about Tk.1000 - Tk.1200 per bigha. The ban on rice export of rice for the next six months effective from May 22, 2009 is likely to work against the farmers' interests through lowering in rice price. The government must strengthen its rice procurement programme to safeguard the interests of the rice farmers. Government should devise a mechanism to purchase paddy directly from farmers, and from the hats and bazaars. An upward revision of procurement target to the tune of 20 lakh metric tons will be required to have any significant influence on prices at the farm level. To expand current storage facility of foodgrains, the government should immediately use underutilized storage facility of BADC and create new storage facilities in 2009-10. In addition, import duty at the rate of 15 per cent may be imposed on rice to discourage import of rice.

In view of the gaps between the procurement price and the price received by farmers, there is a renewed need to identify institutional mechanisms so that direct procurements can be made at farm gate. Whether farmers could be co-owners of rice mills through cooperatives so that they could be in a position to reap the benefits of procurement by the government from mills, is one area which needs to be explored further. Perhaps this could be another area of public private partnership. Modalities aimed at closer involvement of local government institutions could be another possible avenue. In a nut shell, since the issue of the gap between procurement price and farm gate price is likely to be a recurring problem in the years ahead as well, perhaps time has come to explore possible avenues to address this issue through broad based consultations between government and all relevant stakeholders.

TABLE 4: ESTIMATED PER ACRE PRODUCTION COST OF BORO RICE IN BANGLADESH DURING THE APRIL-JUNE 2009 HARVESTING SEASON

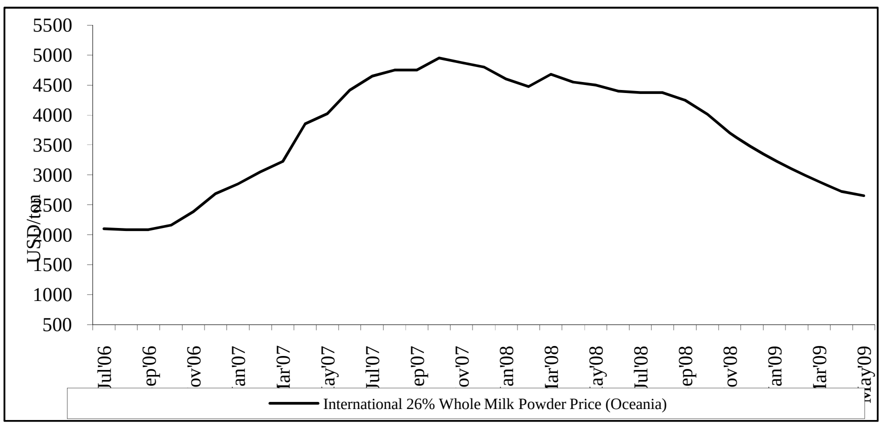
	HYV Boro Rice (2008/09)		Hybrid Boro Rice (2008/09)	
Input use	Diesel Irrigated (Tk)	Electricity driven (Tk)	Diesel Irrigated (Tk)	Electricity driven (Tk)
Seed	600.00	600.00	1,320.00	1,320.00
Fertiliser	4,308.00	4,308.00	5,225.00	5,225.00
Manure	400.00	400.00	400.00	400.00
Pesticide	500.00	500.00	860.00	860.00
Human labour	10,600.00	10,600.00	11,720.00	11,720.00
Land cultivation (bullock/PT)	1,800.00	1,800.00	1,800.00	1,800.00
Irrigation	4,000.00	2,000.00	4,000.00	2,000.00
Interest on operating capital	1,110.40	1,010.40	1,266.25	1,166.25
Land rent	6,000.00	6,000.00	6,000.00	6,000.00
Total cost (Tk/acre)	29,318.40	27,218.40	32,591.25	30,491.25
Production cost of Paddy (Tk/kg)	**12.75**	**11.83**	**12.54**	**11.73**
Yield (Kg/acre)	2300	2300	2600	2600
Production cost of Rice (Tk/kg)	**20.53**	**19.13**	**20.21**	**18.97**

Note: The conversion rate of paddy to rice was calculated at 1 kg Paddy = 0.65 kg Rice and Milling cost (including parboiling) was calculated @0.60 Tk/kg
Source: CPD Field Survey, 2009.

Fall in international price of milk powder and its impact on Bangladeshi milk producers

International price of milk powder decreased significantly in recent months which have had an adverse impact on domestic milk producers. During first three months (January-March) of 2009, average price of milk powder declined by 33 per cent (from USD 4586 to USD 3065 per metric ton) against comparable months of 2008 (Figure 15). As a consequence, Bangladesh's import of milk powders (HS040210 (Milk powder, not exceeding 1.5 per cent fat) and HS040221 (Milk and cream in powder forms >1.5 per cent fat) increased to USD 20.995 million (2.3 times of import in comparable months of 2008). In quantity terms, this would be about 3.5 times of the imports during comparable months of 2008. Sudden and high import at low prices has created problem for domestic milk producers and companies. In mid-May 2009, a CPD team visited Sirajgonj area and held discussion with dairy farmers, feed sellers, Milk Vita and other company officials. Major findings are: (i) farmers enjoyed good business in 2007 and 2008 due to high demand for liquid milk originating from high international price and melamine scare, however they are currently facing difficulties due to lack of demand for their milk; (ii) demand for milk by consumers and sweetmeat industry has declined due to availability of low cost milk powder; (iii) companies have reduced both quantity and price of purchase (Tk. 4 to 6 per litre) of milk, (iv) feed cost in March-April 2009, against comparable months of 2008, has decreased by about 15 per cent. Some options to support the milk producers and milk industry under the current circumstances are: (i) withdrawal of existing 15 per cent VAT on production of milk powder; (ii) review of import duty on milk powder to make a balance between producer and consumer interests; (iii) better technical support to farmers through Livestock Department by appointing higher number livestock officers (veterinarians and animal husbandry specialists) intensive milk production areas and (iv) supply of medicines and vaccines at a subsidised rate.

FIGURE 15: INTERNATIONAL PRICE OF WHOLE CREAM MILK POWDER: JULY 2006 TO MAY 2009



Source: International Dairy Market News Reports, USDA.

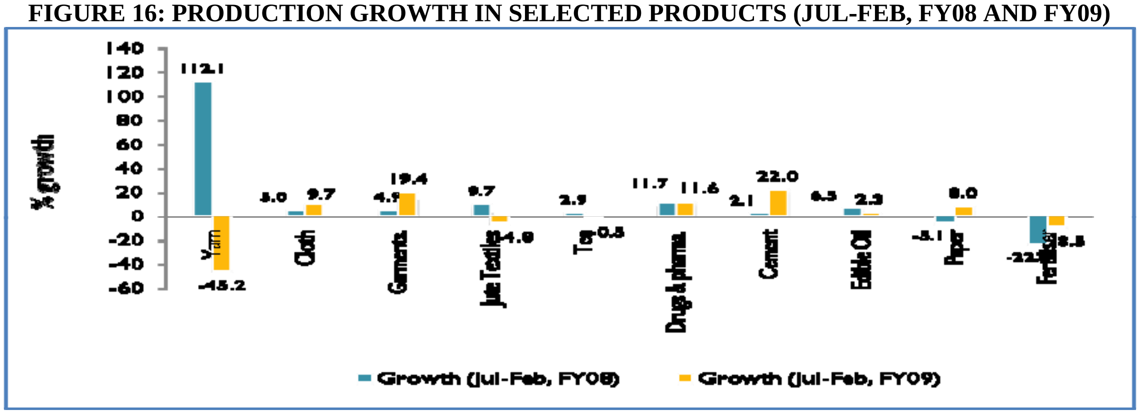
By any measure, performance of agriculture sector in FY2008-09 has been quite impressive. Production of rice and foodgrains reached new record levels. However, the price that farmers received for Boro was even below their cost of production. On the other hand, significant decrease in international price of milk powder created an adverse impact on local dairy producers and milk processing companies. Thus, major challenge for the next year will be to sustain the current momentum of high growth in agriculture, particularly in rice production, and more importantly, there will be a need to provide incentives for farmers to go for higher production.

5.2 INDUSTRIAL SECTOR

5.2.1 Manufacturing Industries

Manufacturing sector component of the GDP registered a relatively low level of growth in FY2008-09 (5.92 per cent vis-à-vis 7.42 per cent in FY2007-08). This is corroborated by slow or negative growth of major industries, according to actual level of production during July-February FY2008-09. This was particularly evident in case of production of export-oriented industries, such as cloth (9.7 per cent), cotton yarn (-45.2 per cent), jute textiles (-4.8 per cent) and tea (-0.5 per cent) (Figure 16). Importantly, readymade garments industry has maintained a high level of growth (19.4 per cent) during July-February FY2009. Growth performance of domestic market based industries does not indicate any specific trend. Performance of small scale manufacturing industries appears to be better (growth of QIP in Q1 and Q2 was 9.3 per cent and 7.1 per cent) compared to that of large and medium industries (8.4 per cent during July-February, FY2009). It is pertinent to mention here that, manufacturing sector component of the GDP has been posting declining growth trends over the last four years (10.77 per cent in FY2006, 9.72 per cent in FY2007 and 7.42 in FY2008 along with decline in FY2008-09) because of not only adverse impact of the ongoing challenges (such as global financial crisis) but also various systemic issues (such as lack of availability of electricity and gas and uncertainties related to domestic political environment). A gradual rise of ICOR over the last four years (from 3.74 in FY2006 to 4.11 in FY2009), which indicate lower levels of productivity of capital, call for more investment in infrastructure and human resource development in order to attain higher productivity over the medium term. The public sector will need to play the leading role in this.

FIGURE 16: PRODUCTION GROWTH IN SELECTED PRODUCTS (JUL-FEB, FY08 AND FY09)

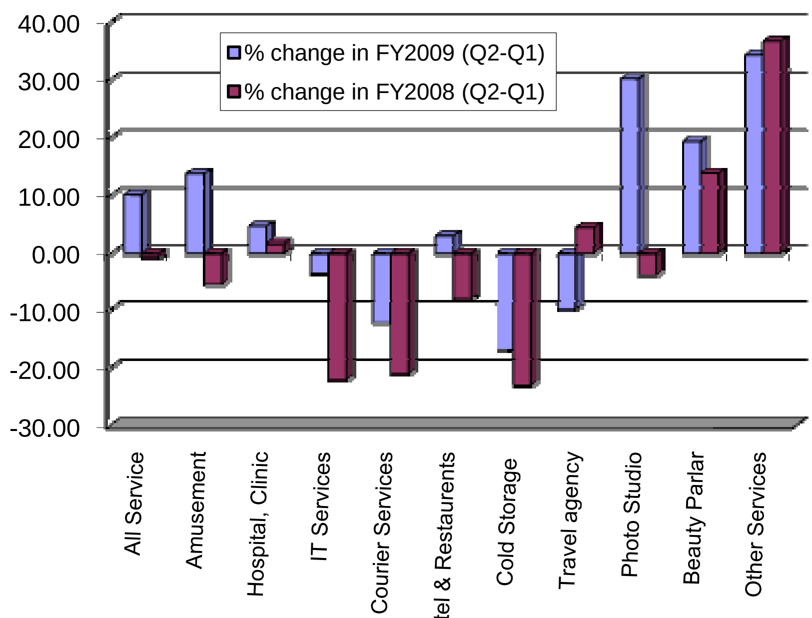


During July-February, 2009 advances made to export-oriented industries (as term loan) was low compared to corresponding period of the previous year; their import of capital machineries was also low (-11.1 per cent) underwritten perhaps by pessimistic short term business outlook in view of the ongoing global economic slow-down. However, higher level of growth of RMG industry in July-February, 2009 period is reflected by higher level of disbursement of term loan (growth 25.3 per cent in Q2 over Q1 in FY2009) and higher import of textile articles during July-February, 2009 (5.6 per cent). Some of the domestic market-oriented industries have performed well. These include cement, iron and steel and tobacco. A significant rise in advances to SMEs (74 per cent in Q3 over Q2 in FY2009 *vis-à-vis* 3 per cent over the same comparable period in FY2008), particularly made by the private commercial banks, indicate better performance of domestic market based industries during the period under review. In general, manufacturing sector is likely to pass through challenging times over the next fiscal year. Hence, a strong monitoring of the performance of manufacturing industries, particularly export-oriented industries, is called for. The national budget FY2009-10 should continue with the support provided to export-oriented industries as part of the stimulus package and replenish it with additional allocations for FY2009-10 to strengthen their capacity to compete in the global market.

5.2.2 Services Industries

Services industries, as in many other developing countries, demonstrated some resilience in spite of the economic slow-down. The sector is likely to achieve a growth of 6.25 per cent in FY2009 which was only marginally low compared to that of FY2008 (6.49 per cent). The sector received higher levels of advances (other than working capital) during Q2 over Q1 in FY2009 (by about 10.1 per cent) though working capital disbursed to their sector was lower over the same period (growth -1.8 per cent) (Figure 17). It would appear that most of the service industries, being mostly of domestic market-oriented nature, have performed well (such as hospital, entertainment, hotel and restaurants); however performance record of some of the other industries was rather unsatisfactory including that of IT, travel and tourism, possibly because of their business linkages with the global market.

FIGURE 17: CHANGES IN ADVANCES IN SERVICES INDUSTRIES

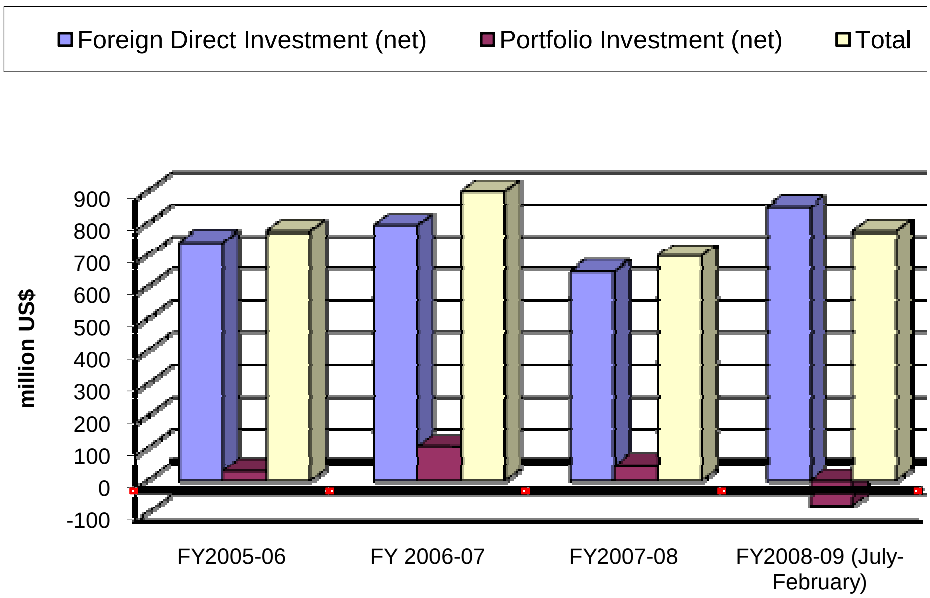


CPD carried out a rapid perception survey among 90 leading entrepreneurs during February-April, 2009 to appreciate and assess possible impact of global financial crisis on Bangladesh economy particularly on production, investment and employment during 2009. About 49.3 per cent respondents were concerned about the negative impact of the global economic crisis in 2009 (36 per cent remained undecided); only about 14.7 per cent felt that business situation would improve in 2009. A large number of entrepreneurs have taken various cost cutting measures in view of the adverse impact of the crisis. These included increasing of working hours, reduction of fringe benefits, reduction of firm's capacity utilisation or even closing down of some production units. Retrenchment of workers was not evident as per the information provided by the respondents. However, a large proportion of sample entrepreneurs indicated that if the demand for their outputs declined further, they would go for such measures. Thus, any slump in demand could have visible adverse consequences for the domestic labour market.

5.2.3 Foreign Direct Investment

In the backdrop of negative growth in the global flow of FDI in FY2008 (-28 per cent), which is expected to decline further in 2009, improvement in FDI flow to Bangladesh in FY2009 is of interest to note. FDI flow during July-February, 2009 was US$851 million which was 91 per cent higher compared to the same period of the previous year; however, the amount was low by regional comparison (Figure 18). Lower FDI flow (52.2 per cent low) to the EPZs was perhaps because of lack of interest from foreign investors to invest in export-oriented industries at a time of global economic crisis. Net portfolio investment was negative during July-February, FY2009 underwritten mainly by the outflow of capital from the capital market in the wake of the global financial crisis. Consistently low level of share price indices over the past several months was possibly the other reason. Large scale foreign investment was likely to be discouraged as long as there will be dearth of adequate infrastructural facilities (such as availability of gas and electricity) in the country. Exploration of new sources of gas, both on-shore and offshore and meeting the increasing demand for gas and electricity ought to be given highest priority in the upcoming budget.

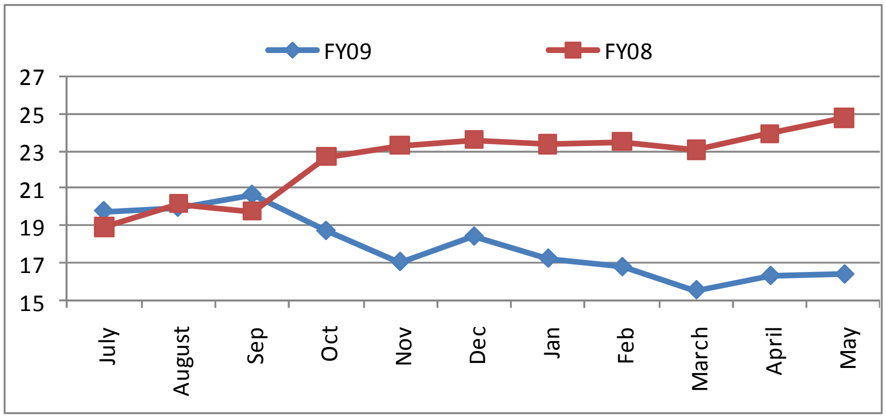
FIGURE 18 FOREIGN INVESTMENT IN BANGLADES



5.2.4 Capital Market

Capital market has witnessed a sharp fall since the second quarter of FY2009 (DSI dropped by 18.6 per cent: DSE 20 dropped by 23.3 per cent) which is possibly because of slowdown of growth of major industries and their consequent impact on domestic financial sector which had the largest share in the capital market. With the falling share price indices, the P/E ratio of market shares has declined in the DSE by -33.8 per cent which is indicative of some market corrections (Figure 19). Capital market of Bangladesh has continued to suffer from systemic concerns. It appears that most of the investors come to the capital market for short term capital gain; For example, investment in blue chips companies (DSE20) is not necessarily because of their higher dividend payment, since there are at least four companies in DSE20 which could not maintain consistency in payment of reasonable amount of dividend (e.g. 15 per cent) over last three years. Making capital gains appear to be the major motive. Shallow depth of the capital market was evident from the fact that a majority of small investors suffered from liquidity shortages. Offloading of shares of large scale multinational companies (i.e. Grameen Phone) or state owned enterprises (SOEs) was either very slow or did not make any progress. In order to improve the systemic issues related to the market, Securities and Exchange Commission (SEC) needs to undertake the required measures. Some of these suggested initiatives are: introduction of a market-based system to categorize shares of different companies, making the Annual reports of enlisted companies available to prospective investors, setting up a separate judiciary for settlement of disputes and mobilisation of funds for large scale infrastructural projects (e.g. Padma Bridge) from the capital market.

FIGURE 19: COMPARISON OF P/E RATIO



5.2.5 Privatisation of State-owed Enterprises

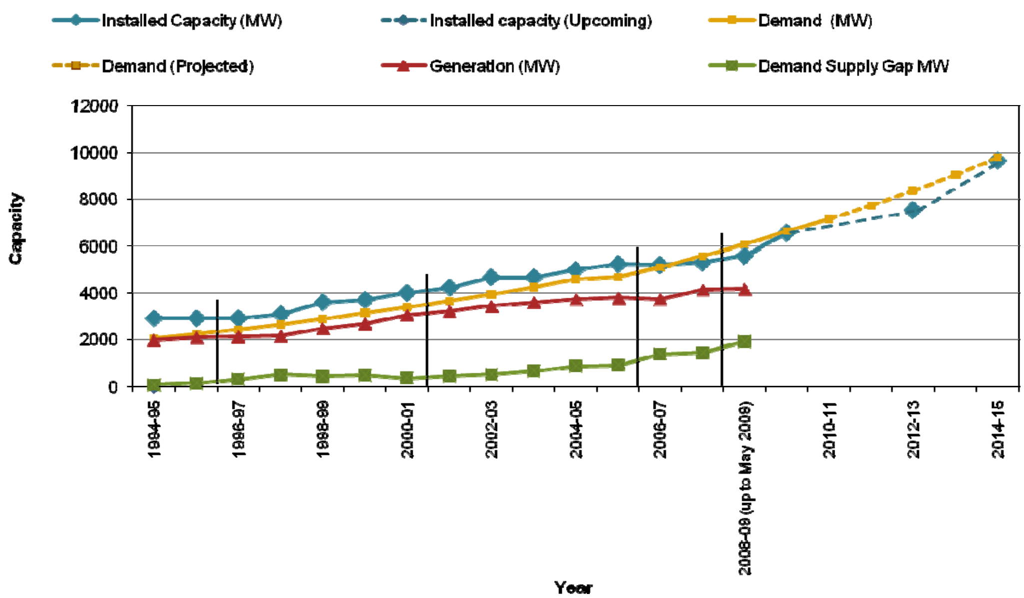
At present 25 SOEs have been placed with the Privatisation Commission. These enterprises are at different stages of privatization. Only three are at the final stage of privatization, whilst a large number of the remaining enterprises are at early stages of privatization: in case of 14 enterprises preparatory work is being carried out before these enterprises could be placed for bidding/open tender; another 7 enterprises are at the stage of valuation of assets; only one enterprise was at the biding/open tender stage while another two are at final stage of privatization. Among the nine textiles and handloom enterprises four are at the initial stage of privatisation; however, government has recently decided not to privatize two of those. Two of the enterprises have problems in valuation of assets, while one is facing litigation problems regarding the land of the mill and the other one is constrained by debt-related problem. Privatisation Commission has decided to include another 12 SOEs for privatization; most of these are textile and jute mills. As per the particulars of SOEs to be privatized, all liabilities of these SOEs will be borne by the government which was expected to encourage private entrepreneurs to come forward. However, it was not clear as to how the significant debt burden this will entail will be absorbed by the government. It is important to mention here that government policy stance, particularly as mentioned in the *Draft Industrial Policy 2009* (IP 2009), had some ambiguity with regard to the policy to be pursued in respect of privatization. This policy stance was not in line with other related policy documents including *Privatisation Act 2005* and *Jute Policy 2005*. The draft IP 2009 should be in consonance with the government's overall policy stance with regard to privatisation and should make clear government's position as regards restructuring of the public sector enterprises. The idea of enhancing public-private partnership with regard to operating and managing the SOEs, whilst welcome, needs to be spelt out in a more detailed and definitive fashion.

5.3 ENERGY & INFRASTRUCTURE

Electricity generation

The newly elected Government came to the power on January 08, 2009 with benchmark demand of electricity of around 4100 MW against a generation of 3860.6 MW. Up to April, 2009, 301.4 MW (maximum) electricity was added to the national grid (through RPP, overhauling and closed down of fertilizer factory). Between January 2007 to December 2008, capacity of electricity generation increased to 782 MW (27.1 percent growth) of which 324 MW was added as new generation and the rest 458 MW came from overhauling of the existing power plants. In January 2009, demand-supply gap was 575.2 MW (maximum) which further escalated to 915 and 1134.1 MW in February and March 09 respectively. Average load shedding from January to March, 2009 was 381.5 MW. From the Figure 20, it is seen that the demand-supply gap is gradually on the rise. In FY95, the gap was only 68 MW which has reached 1904 MW (in May 2009) in FY09. Electricity generation as percentage of installed capacity registered highest growth (78 per cent) during the CTG, thanks to better maintenance and management improvement.

FIGURE 20: INSTALLED CAPACITY, GENERATION OF ELECTRICITY, DEMAND FOR POWER AND DEMAND-SUPPLY GAP



Source: BPDB and Power System Master Plan update

Power projects awarded in the past, up until now, are expected to generate 4069 MW by 2014, whereas the new AL government has planned to generate 3325 MW (with a 400 MW immediate fuel based RPP) by 2015. In their election manifesto, AL projected generation of 5000 MW by 2011 and 7000 MW by 2013. However, this would not be possible under the ongoing and recently planned generation activities. By the end of 2011, government is likely to face a shortfall of 3281 MW against the targeted 5000 MW, and 3241 MW shortfall against the targeted 7000 at the end of 2013. However, by the end of 2015 total generation is expected to reach 7349 MW.

A yawning gap between capacity and generation is emerging due to a number of reasons including (a) gas shortage; (b) ageing of power plants and most recently (c) due to lack of rainfall in Kaptai Lake. It is estimated that during April, 2009 due to the above mentioned reasons, there was a shortage of 845 MW of generation of power.

Gas production

Bangladesh has 21.3 tcf of proven gas (P1) of which 15.41 tcf (used 8.05 and remaining 7.36) is recoverable. With regard to the recoverable scenario, 8.05 tcf of gas has already been used till December 2008; the rest 7.36 tcf is in reserves. However, this level of reserve will not be able to meet the the country's requirement beyond 2015. According to *Energy Expert*, 24 tcf is required to meet the energy demand up to 2025 (for which estimated investment requirement is about USD 8 bln).

Gas production has increased at a rate of 6 to 8 per cent per year in the recent past. In FY 09 (up to April 2009) record 9.01 per cent of growth was achieved with a total production of 15248.2 mmcm (IOC 49 per cent and Petrobangla 51 per cent) indicating an increased exploitation of the current reserves. However, the demand-supply gap is on the rise on a daily basis. Currently (as of February 2009) Bangladesh has a shortfall of 265 mmscfd of which 82 per cent is borne by bulk purchasers such as power and fertilizer and nearly 18 percent is consumed by the non-bulk purchasers. The present gas-electricity arithmetic would suggest that to achieve the target to generate of 5000 MW electricity by 2011 (as announced in the AL manifesto) would require 1000 mmscfd gas, more than 40 percent increase over the current supply of 675 mmscfd of gas.

Policy Implications

Lack of adequate power supply has been a major bottleneck which has severely constrained investment and business activities in the country. This has discouraged new investments; the existing ones are bearing the brunt of frequent outages, leading to damage of equipments, production disruption. Cost escalation originating from more costly alternative sources is undermining the competitiveness of Bangladeshi enterprises, both in the domestic as well as the global market. It should be noted that not everything is on account of lack of adequate policies. There are various policies, often appropriate, but what appears to be lacking are policy synchronisation (generation, transmission and distribution entities), policy stability (carrying forward initiatives taken previously) and policy implementation (meet the targeted commissioning date). Realising targets of the government and adding the required new generation capacities will critically hinge on setting up transparent processes and subjecting politically inclined businessmen to play by the rules of the game. Energy sector should not be seen as a source of raising finances for political parties or building up private fortunes through illegal means. Rather the sector should be treated as the singlemost important area to stimulate productive activities in the economy and all initiatives should be speedily implemented in an environment of transparency, accountability and good governance.

Some of the suggested initiatives are:

- There is no alternative to going for new capacities to generate electricity. Initiative is needed on an urgent basis to settle the dispute over the Fenchuganj 90 MW CCPP (waiting for generation since January, 2009) with the NBR and Chinese counterparts.
- Government has recently (May 2009) planned to set up a number power plants (5) under *Public-Private Partnership,* which is a welcome move. However, transparency is needed with respect to institutional and procedural requirements in this regard.
- Limited gas reserves of the country calls for rational policies covering both inter-temporal choice of gas production and allocation among various uses. There is no

time left for a comprehensive coal policy to be adopted by the government which would give clear indication as to how the government would like to develop the sector in short and medium term and what would be the rules of game for the private sector. Diversification of fuel-mix for power generation appears to be a necessity in view of the present reserve situation with regard to gas. Initiatives to set up a number of liquid fuel based co-generation power plants is a praiseworthy move of the government in this context.

- Given the increasing investment needs of the country, an improvement in implementation capacity was called for this year, rather than a reduction in the size of ADP. Till March 2009, only 39 per cent and a meagre 9 per cent of total ADP allocation, respectively for power and energy and mineral resources, could be utilised. This must be seen as quite frustrating in view of the current power availability scenario and the increasing demand for power.
- A coordinated and strengthened effort is required with regard to gas exploration; resolution of territorial issues with Myanmar and India over offshore gas blocks should be given priority so that exploration could be initiated in as early a date as possible.

6. PERFORMANCE OF THE EXTERNAL SECTOR

Bangladesh's external sector performance in FY2008-09 was informed by a number of developments, both domestic and global, resulting in a high degree of uncertainty with regard to outcomes. As a consequence, the sector ended up with fluctuating fortunes, at different points of times, over the period under review. The first quarter of FY2008-09 had to bear the brunt of the high inflationary pressures in domestic and global prices which impacted by way of high import payments, rising cost of production and erosion of export competitiveness. Over the next two quarters, the recessionary developments following the global economic crisis impacted through falling global commodity prices and slump in demand for many of Bangladesh's export items in the global market. The dynamics of these changes has had corresponding implications for export and remittance earnings as well as import payments, balance of payment (BOP) situation and overall performance of the external sector in FY2008-09.

Export Sector Performance

Total export earnings over the first ten months (July-April) of FY2008-09 stood at USD 12.8 billion, posting a double-digit growth of 12.7 per cent over the corresponding period of FY2007-08. Against the backdrop of fall in exports of almost all developing and emerging countries, this high growth, by any measure, was indeed remarkable. However, this track record is underpinned by several factors. Firstly, after growing at a phenomenal rate of 42.4 per cent in Q1 (albeit in the backdrop of negative growth of Q1 in FY2007-08), exports slowed down considerably over the subsequent two quarters, with Q2 depicting a deceleration (-1.6 per cent) and Q3 indicating, a recovery, but still a significant slowdown (6.5 per cent) (Table 5). The April export figure, however, is indicative of the volatility mentioned above, with earnings recording a negative growth of (-) 2.3 per cent compared to April 2008. Indeed, between October 2008 and April 2009 of FY2008-09 export earnings of Bangladesh rose by 1.7 per cent only. It is of importance to note that, on a month-on-month basis Bangladesh had experienced a slump in her export for 3 months in FY2009 in reference to FY2008: October (-7.8 per cent), December (-10.1 per cent) and April (-2.3 per cent). Secondly, though RMG growth was high at 18.1 per cent in the first ten months, non-RMG growth was negative at (-) 3.8 per cent, with leather (-36.1 per cent), raw jute and jute goods (-17.7 per cent) and shrimp (-14.3 per cent) export coming down sharply. Thirdly, in view of the above, the target of USD 16.3 billion, that would require a 26.9 per cent growth of export in May and June of FY2009, is highly unlikely to be achieved.

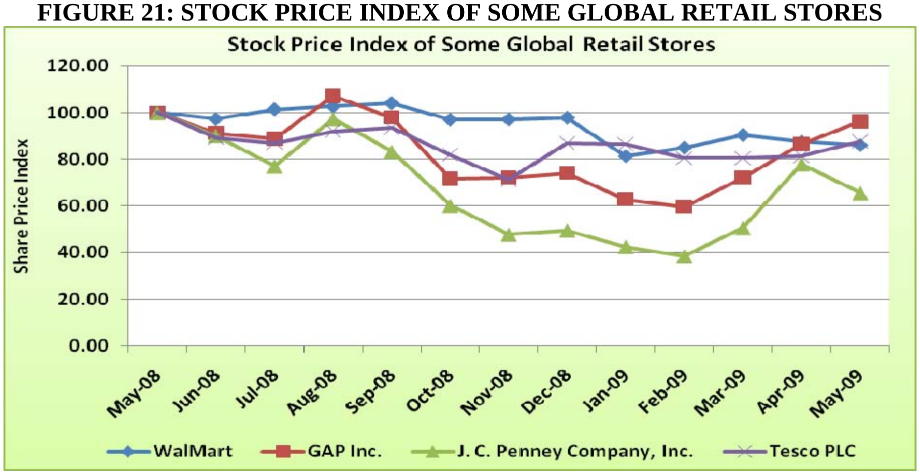
TABLE 5: QUARTERLY EXPORT GROWTH OF BANGLADESH'S MAJOR COMMODITIES (FY2009 VS FY2008, JUL – MAR)

	Q1	Q2	Q3	April	July - April
RMG	44.64	5.41	12.72	2.62	**18.13**
Non-RMG	35.71	-22.23	-14.29	-14.47	**-3.76**
Of Which					
Raw Jute & Jute Goods	*-11.49*	*-18.87*	*-25.28*	*-10.74*	***-17.74***
Leather	*-6.34*	*-50.24*	*-41.57*	*-49.98*	***-36.13***
Frozen Food	*15.69*	*-24.31*	*-32.48*	*-26.91*	***-14.26***
Others	*62.42*	*-17.61*	*-4.33*	*-8.54*	***6.99***
Total Export	***42.45***	***-1.60***	***6.50***	***-2.30***	***12.76***

Source: CPD Trade Database, 2009.

Notwithstanding the recent deceleration, the high performance of Bangladesh's apparels sector (accounting for three-fourths of all her exports) in FY2008-09 needs to be seen in the context of the negative growth of imports of apparels in both the US (-5.1 per cent growth in global import against 15.3 per cent rise in import from Bangladesh between July-March) and the EU (-0.9 per cent growth in global import against 9.5 per cent rise in import from Bangladesh between July-February). Although issuance of *Utilisation Declaration* certificates (- 8.92 per cent growth in Q1 of 2009) indicate that slowdown in order placement would continue for some more months, in recent times some of the major global buyers of low-tier apparels from Bangladesh appear to have weathered their worst period and are showing resurgence in confidence. This augurs well for Bangladesh. Excepting J.C. Penny, other major US retailers have seen their share prices going up, which may be interpreted as transmitting positive signals about future business prospects in apparels (Figure 21).

FIGURE 21: STOCK PRICE INDEX OF SOME GLOBAL RETAIL STORES



Source: CPD Calculation based on Information from Yahoo Finance.

As is known, after posting a rise of 70 per cent between 2002 and 2008, global trade is expected to decline by 9 per cent in volume terms and 6 per cent by value terms in 2009. In view of this alarming backdrop, Bangladesh's trade performance as of now, by all measures, should be considered a quite commendable record. However, over the coming months a number of developments will need to be carefully monitored. The April, 2009 export figure allude to some disquieting developments with the overall export declining by (-) 2.3 per cent; growth of RMG export in April was 2.6 per cent and non-RMG growth was (-) 14.5 per cent. A voluntary export restriction is in operation for six months (starting from 1 June, 2009) on export of shrimp to the EU on account of presence of antibiotic *nitrofuran*. Impact of competitive depreciation of currencies, resurgent China in a quota-free US market when recovery sets in, the implications of the stimulus packages of Bangladesh's competitors (such as China, India and Vietnam) on her future competitiveness in the global market, market access initiatives at both bilateral (US) and multilateral (WTO) levels, are some of the developments that will need to be closely monitored by the policy makers and entrepreneurs in the coming months.

The fact of falling *terms of trade* should also be seen as a major concern. Exports have continued to remain volume-driven; in (July – April) FY2009-export growth of 12.8 per cent was contributed by rise in volume of 12 per cent and rise in price of only 0.08 per cent. As indicated by Table 6, inspite of falling commodity prices providing Bangladesh some cushion, purchasing power of Bangladesh's exports, in view of continuing concentration at the lower-end of the market where prices have tended to be stagnant, has not changed much when compared to 2006. Increasingly, Bangladesh is having to export more in order to pay for the same level of import.

TABLE 6: FALLING PURCHASING POWER OF EXPORTS

	Dozens of RMG			Rise (in times) b/a	Rise (in times) c/a	Tons of Jute Goods			Rise (in times) e/d	Rise (in times) f/d
	2006 (Avg) (a)	2008 (Avg) (b)	2009 (Apr) (c)			2006 (Avg) (d)	2008 (Avg) (e)	2009 (Apr) (f)		
1 barrel of Oil (Fuel)	2.34	3.44	2.33	1.5	1.0	0.11	0.17	0.11	1.5	1.0
1 ton of rice	10.97	23.18	21.86	2.1	2.0	0.52	1.14	1.04	2.2	2.0
1 ton of wheat	7.07	11.25	8.31	1.6	1.2	0.33	0.55	0.39	1.7	1.2
1 MT Soyabean Oil	21.19	39.12	26.28	1.8	1.2	1.00	1.93	1.25	1.9	1.2

Source: CPD Trade Database, 2009.

Import Sector Performance

Inspite of the falling global commodity prices, import payments rose by 12.4 per cent over the July-March, FY2008-09 period compared to the corresponding period of FY2008, in value terms. If non-food, non-oil imports are considered, the rise would be 17.2 per cent. Since prices of many imported items have been posting a declining trend in recent times, the growth in volume terms, in many instances, may have indeed been higher. However, since there is no indication of fall in its prices in the global market, the negative growth of import payments for capital machineries, at (-) 12.1 per cent, should be seen as a concern; this is further substantiated by matching L/C openings for capital machineries (-31.5 per cent growth). In addition, the rising price of oil (which has started to rise after having bottomed at about USD 40/barrel and now stands at about USD 68/barrel) could also push up the import bill in the coming months, as is indicated particularly by the movement of oil prices in *futures market*. Relatively high growth of raw materials and intermediate inputs such as raw cotton (11.6 per cent), yarn (23.9 per cent) and iron, steel and base metals (35.3 per cent), in contrast to negative growth of capital machineries possibly indicates higher capacity utilisation rather than investment in new ventures.

Remittance Flow

As has been noted in earlier recessions as well, remittance flows tend to be more resilient than exports. Notwithstanding this, a number of developing countries have experienced fall in remittance flows. However, Bangladesh is an outlier even here with a robust rise of 22.4 per cent in remittance flows between July-May of FY2009 compared to the corresponding period of FY2008. Lower cost of transfer of remittance (a 50 per cent fall in recent times), rising share of skilled migrant labour and facilitation for sending remittance home (inducing switch from informal to formal thanks to collaboration between banks and local agents), also may have contributed to this growth. Remittance flow from developing countries of Middle East has been high, whilst those from Eurozone countries indicate some fall underpinned by impact of economic crisis and the consequent pressure on their respective labour markets. Indeed, number of workers leaving abroad between July-March of FY2008-09 shows a sharp drop of 36 per cent (from 728 thousand to 537 thousand). Whilst the flow versus stock side of the story could, to some extent, explain the rise in remittance flow inspite of lower number of people going abroad, this was likely to put more pressure on domestic labour market and will likely result in reduced rise in remittance flow in near future. According to BMET, 28 thousand workers have returned home during the first quarter of 2009. This number, in all likelihood, was an underestimate. The stimulus package announced by the government does not have any targeted support scheme for terminal returnees. There ought to be appropriate initiatives on the part of the government in support of the returnee migrants through credit support to start new businesses and also settlement support (possibly with some help from the *Expatriate Welfare Fund*).

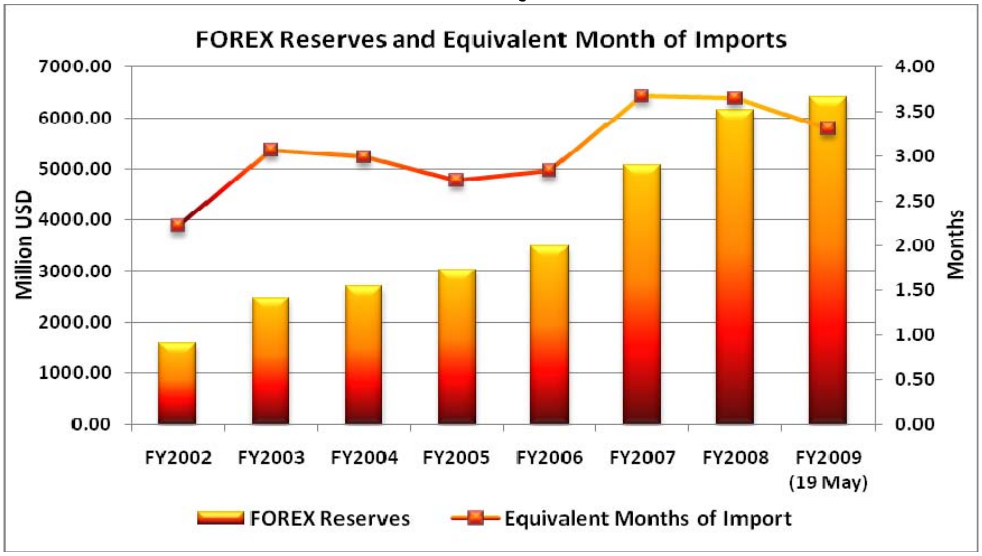
Balance of Payment

Bangladesh's current account balance for the first eight months, as distinct from many other developing countries, has indeed improved (from USD 299 million to USD 816 million) compared to the corresponding period of FY2007-08. This was underwritten by robust exports and remittance earnings (combinedly by 16.3 per cent), and slowdown in import payments (12.4 per cent). Although the deficit in the trade balance was higher, at (-) USD 3560 million compared to (-) USD 3087 million, significantly high private transfers has contributed to the aforesaid improvement in the current account balance. Indeed, the overall balance improved from USD 310 million to USD 773 million over the same period. As imports pick up and exports slow down, the balances are likely to come under pressure in near future.

Foreign Exchange Reserves

Foreign exchange reserves have been replenished by buoyant growth in remittance flow to the country, coupled with impressive growth in export earnings. Foreign exchange (forex) reserves stood at USD 6410.3 million (on 19 May 2009) which was higher by 21.27 per cent when compared against the corresponding month of FY2008. Figure 22 depicts the growth in forex reserves and its equivalence in terms of months of import. At 3.3 months, this was somewhat higher than the generally accepted reserve requirements of three months. This cushion, crucial in terms of keeping a stable exchange rate, providing capacity to underwrite the import and meeting debt-servicing liabilities, will be crucial to maintaining macroeconomic stability in the coming period.

FIGURE 22: FOREX RESERVES AND EQUIVALENT MONTHS OF IMPORT



Source: CPD Trade Database, 2009.

Monitoring the changes in the composition of forex reserves and safeguarding the purchasing power of the reserves will be important.

Foreign Aid

Latest figures available for FY2009 (July-March) indicate that a total amount of USD 1.35 billion was disbursed in the current fiscal, almost the same as in the last year. Net foreign aid receipts in FY2009 stood at USD 731.99 million, somewhat lower than the USD 823.76 million recorded over the corresponding period of FY2008.

TABLE 7: DISBURSEMENT OF GRANTS AND LOANS, AND PAYMENTS MADE

	Aid Scenario			Financing scenario (Million USD)		
Fiscal Years	**Total Aid (Million USD)**	**Share of Grants (%)**	**Share of Loans (%)**	**Principal**	**Interest**	**Total**
FY1985	1269.44	55.40	44.60	106	64	**170**
FY1994	1558.64	45.56	54.44	263	139	**402**
FY2006	1365.197	36.66	63.34	502	176	**678**
FY2007	1630.57	36.19	63.81	540	182	**722**
FY2008	2061.52	31.92	68.08	586	184	**770**
FY2009 (Jul – Mar)	1356.80	27.99	72.01	410.97	135.8	**546.88**

Source: CPD Trade Database, 2009.

It is to be noted that, the share of grants in the total disbursed aid has been on the decline in recent times indicating the possibility of higher debt-servicing liabilities in future (Table 7). The share of commercial lending (often at *LIBOR plus* rates) is also on the rise. In this context, measures aimed at ensuring timely disbursement, appropriate and effective utilisation of aid and access to aid in the form of budgetary support will gain increasing importance.

Overall, till now, Bangladesh’s external sector has been able to demonstrate both resilience and stability in the face of formidable challenges and uncertainties with regard to domestic investment environment, volatility in the global market and the adverse implications of the ongoing financial crisis. As was noted above, a number of recent developments should be kept in the perspective, though, that could undermine continuity of this record in the coming months and over the next fiscal year. Firstly, the fact of recent slowdown in the pace of export growth; secondly, possibility of reversal of the trend of falling global commodity prices; thirdly, adverse impact of stimulus packages and counter-cyclical policies pursued by Bangladesh’s competitors; and, fourthly reduced number of workers going abroad and its consequence for domestic labour market and future remittance flow. A renewed effort at enhancing external sector performance through appropriate investments, skill upgradation, adequate incentives, productivity enhancements and product diversification, will be called for in view of these emerging developments.

Sustaining the positive current account balance, maintaining stability of BDT’s exchange rate and prudent management of financial flows appear to be critical areas in order to ensure continuity of the current robust performance of the external sector indicators over the next fiscal year. In view of the performance of the export sector in April this year and the signals stemming from the global market, the stimulus package may need to be revisited to identify additional measures and incentives which could be put in place in support of export-oriented sectors and activities. Bangladesh should also be well prepared to take advantage of the global recovery once it takes off, perhaps, in early 2010. Towards this end, the groundwork will have to be initiated well in advance in FY2009-10.

7. SOCIAL SECTORS

Social sectors have traditionally received high priority from successive governments in Bangladesh. However, attaining high quality of expenditure and output has always remained a challenging task. As Table 8 shows, in FY2008-09 allocation of Tk.6204.36 crore (more than 24 per cent of the total ADP of Tk.25,600 crore) was kept for line ministries dealing with health, education and technology, women advancement and children affairs, and social safety net. With the newly elected government set to announce its first budget within a few days, it needs to be seen as to how the issues of social sector development get reflected in the budget for FY2009-10.

TABLE 8: SECTOR WISE ADP ALLOCATION AND EXPENDITURE TILL MARCH 2009

(in crore Tk.)

Sub-Sectors	ADP Allocation (FY09)	Implementation (July-April, FY09)	
		Total	*% of Allocation*
Health			
M/O Health and Family Welfare	2416.43	1099.89	46%
Education and Technology			
M/O Primary and Mass Education	2369.35	1341.54	57%
M/O Education	826.05	523.20	63%
M/O Science, Information and Communication Technology	126.39	52.43	41%
Women Advancement and Children Affairs			
M/O Women and Children Affairs	118.16	87.46	74%
Social Safety Net			
M/O Social Welfare	47.70	25.23	53%
M/O Food and Disaster Management	210.66	139.76	66%
M/O Labour and Employment	89.62	46.86	52%

Source: IMED, Ministry of Planning, GoB

7.1 Health

Utilisation of around 46 per cent of the total ADP allocation for the MoHFW during July-April period of FY2008-09 transmits disquieting signals as regards pace of implementation and attainment of targets set out for the current fiscal year. Nevertheless, most of the programmes under the HNPSP have registered laudable progress (ranging between 63.8 to 99.7 per cent) against disbursement during July-March of the same fiscal. However, it is a matter of concern that only about 58 per cent of total allocation for the current fiscal year has been released till end-March, 2009. Furthermore, progress against both allocation and disbursement in sector wide programme management, human resource management and financial management has thus far been critically low. This, certainly, is a matter of grave concern as successful implementation of any programme critically depends on healthy and flawless management performance. Same has been the case with the National Nutrition Programme with only 50 per cent of the allocated fund having been released during July-April of FY2008-09.

Community Clinic: Easing Access to Basic Health Care Services

As of April 2009, a total of 10,349 CCs have been handed over to the Community Groups (CGs) out of which 8,464 are in operation. Since the new government came to power, medicine supply worth Tk.6 crore has been distributed at the district level for the CCs with another consignment worth Tk.10 crore in the pipeline. Annual budget to the tune of at least Tk.230 crore will be required to ensure proper functioning of the operational CCs throughout the country. This has to be further strengthened by deployment of trained health workers and competent assistants, coordination among the members of the CGs, and regular monitoring and evaluation by relevant government agencies.

The newly elected government will need to play a proactive role in ensuring timely release and appropriate utilisation of funds not only during the next few months of the current fiscal but also in the coming years to create a health system that caters to the needs and priorities of the beneficiary groups.

7.2 Education and Technology

Pace of ADP utilisation by the Ministry of Primary and Mass Education (MoPME) and Ministry of Education (MoE) during July to April of FY2008-09 stood at only 57 per cent and 63 per cent respectively. Although PEDP II has registered 69 per cent utilisation against RADP during the said period, progress in other programmes such as Primary Education Stipend Project (Phase II), Reaching Out of School Children (ROSC) and Secondary Education Quality and Access Enhancement Project (SEQAEP) has been abysmally low.

Efforts need to be geared up for successful implementation of these projects to expedite the journey towards achieving the Millennium Development Goal of ensuring universal primary education for all children. However, time has come to give more attention to quality aspects of education. Government should also consider setting up an e-Education cell under the Prime Minister's Office (PMO) to reach the goal of creating the declared objective of Digital Bangladesh.

7.3 Social Safety Net

Progress with regard to most of the cash allowance programmes for the poor and vulnerable has been significantly positive during the July-April period of FY2008-09 both in terms of coverage and distribution. However, particular attention needs to be given to addressing violence against women (VAW) and ensuring timely disbursement of allowance for poor lactating mothers as disbursement in both these cases was only to the tune of 50 per cent of allocation.

Employment Generation Scheme

Anecdotal data and information suggest that the government is expected to allocate Tk.1,500-Tk.2,000 crore in the next fiscal to provide technical and vocational training to 20 thousand unemployed HSC graduates and to create employment opportunities for the returnee migrants who fell victim to early job retrenchment in various countries due to the ongoing global economic crisis. The government is also planning to initiate a *Cash for Work* programme instead of the 100-Day Employment Generation Scheme. However, it is not yet clear as to whether allocation for the new programme will be a stand alone one or a combination of the outstanding amount from the previous scheme and new allocations in the upcoming budget.

The government should use the New Poverty Map to identify poverty-prone areas where social safety net programmes need to be further strengthened. Particular attention needs to be given to monga-prone northern districts and areas that have been hit by cyclone Aila. Government should also continue the Five Year Guaranteed Employment Scheme of the CTG in addition to the new initiatives. In addition, Fund for Climate Change (Tk.300 crore) needs to be effectively utilised to ensure support for the potential climate change refugees.

Public Food Distribution System (PFDS)

Distribution of food grains through both priced and non-priced channels during July-February period of FY2008-09 has been lower than that of the comparable period of the previous fiscal. Besides, preparation of lists of beneficiaries for various safety net and allowance programme has often been found to be biased and influenced by local and national politics. This trend needs to be reversed to raise the efficacy of PFDS.

Given the present circumstances, both VGD and VGF programmes will need to be expanded and expedited in the coastal areas that have been badly hit by cyclone Aila. Such efforts may call for further procurement and allocation of food grains by the government. Bangladesh should also try to get funds from Global Food Crisis Response Program (GFRP) by World Bank to expand its VGF Programs. Besides, a fresh beneficiary list should be prepared to support the deserving deprived and disadvantaged people. The government may use the National ID card to make the system monitorable, simple, speedy and objective.

8. CONCLUDING REMARKS

FY2008-09 was an extraordinary time for Bangladesh. It was a year of democratic transition, volatility in domestic economy, global financial meltdown and political transition. In this backdrop, the Bangladesh economy, at aggregate level, performed quite appreciably, with a near-six per cent GDP growth and four and a half per cent per capita income growth. Bangladesh remained one of the very few low income countries that was able to record this level of performance in FY2008-09. It speaks of significant resilience of the Bangladesh economy. Most of the macroeconomic indicators, notwithstanding their structural flaws, demonstrated overall robustness. Many of the fault lines which afflicted the benchmark of FY2008-09 were much less pronounced at the end of the fiscal year. Thus, FY2009-10 will kick off on a much sounder basis compared to the preceding year. However, during this period a number of new in addition to the set of pending issues will continue to undermine the growth and poverty alleviation prospect of the country. This is not to say that the new circumstances will not offer any new opportunities.

In the following paragraphs an attempt has been made to highlight some of these challenges to be addressed and opportunities to be seized by the Bangladesh economy in the context of the upcoming fiscal year.

Energising Investment

In the backdrop of the deceleration in investment performance in FY2008-09, a renewed effort will need to be taken in FY2009-10 to improve both the quantitative and the qualitative aspects of the ADP which is then able to stimulate and crowd-in private sector investment. Towards this, institutional as well as human resources capacities of relevant agencies of the Government will need to be substantively strengthened and improved by putting in place adequate resources, capacity-building mechanisms and incentive structure. Quality of output and monitoring of outcomes will need to be given highest priority in implementing the ADP. Infrastructure development, particularly in power and energy, will be critical and, in this context, public-private partnership will need to be given due importance. To stimulate private sector investment, interest rate policy will play a crucial role and here the Bangladesh Bank will need to play a leading role to reduce the spread between lending and deposit rates, if need be by pursuing a proactive policy both in the context of ceiling on lending and also floor on deposit rates. In view of the constrains in mobilising adequate domestic resources, FDI will need to be encouraged both in infrastructure and in modern sectors, focusing on both domestic and international markets.

Consolidating Agriculture

Food security, given the experience in FY2008-09, should continue to merit highest priority in FY2009-10. Here the challenge will be to balance the apparently conflicting interest of consumers and producers. Of critical importance in this connection will be to stimulate productivity of agriculture through prudent subsidy policy, incentives to promote adoption of high-yielding varieties and technology adoption and adaptation. Procurement price should benefit the farmers and appropriate institutional mechanisms will need to be designed towards this. Timely delivery of fertiliser and wider availability of HYV seeds should be ensured through appropriate delivery mechanisms. Food storage facilities should be built up and there should be timely intervention in the market to ensure price stability. Whilst government can not substitute market, TCB should be brought into play whenever there is a strategic need.

Protecting External Sector

The overall robust performance of export sector in FY2008-09 conceals the recent significant deceleration in export growth. This is perhaps indicative of the lagged nature of impact of the ongoing global financial crisis on the performance of Bangladesh's external sector. Thus, the performance of external sector over first half of FY2009-10 will need to be closely monitored. This will require speedy steps to address the negative fall outs of the crisis with regard to markets of both goods and services export of Bangladesh. The stimulus package, already announced, should be further consolidated by taking cognisance of the recent developments. Workers returning from abroad due to the global financial crisis should be extended the required help in terms of access to credit as well as safety net programmes, and appropriate support services should be placed for them in due earnest. Bangladesh will also need to further strengthen efforts towards market and product diversification so that once recovery of the global economy sets in, her exporters of goods and services are well-positioned to take advantage of the global recovery. The interest shown by Japanese importers of apparels, the great promise of the export-oriented ship building industry, export prospects in the regional markets are just a few areas that are indicative of the prospects in this context.

Strengthening Public Finance

In FY2009-10 emphasis will need to be given to strengthening the capacity of revenue mobilisation authorities, particularly in the area of generating direct taxes. Since the size of deficits is likely to be higher in FY2009-10, its financing will need to be done in a prudent manner. Of critical importance will be to ensure that financing of deficit is non-inflationary and is done through budgetary support from the aid component as much as possible.

Reviving Development Administration

As regards injecting momentum in development administration, the focus should be on continuation and consolidation of the reforms undertaken in the recent past to raise the efficacy of governance. Strengthening of local governments and bringing them under the ambit of budgetary process, by ensuring their broader participation in designing, implementing, and monitoring of the developmental works will be critically important. Private sector's interest in PPP will need to be ensured through appropriate institutional support and incentives. A PPP act may need to be enacted towards this. Relationship with NGOs, to ensure broader partnership and effective delivery of services in such areas as health and education, should be strengthened by taking an enlightened view with regard to such partnership and collaboration.

In the backdrop of high public expectations on delivery of electoral promises and with the lurking apprehensions that Bangladesh may be increasingly affected by the continuing global crisis, economic management will be a challenging task in FY2009-10. Adequate addressing of the attendant challenges will entail design of a set of appropriate budgetary measures, but much more on the efficacy of their delivery. And such delivery will need, in the coming days more than ever before, a coherent, coordinated and committed participation of the total government machinery and all other development actors and stakeholders.

ANNEX: STATE OF THE BANGLADESH ECONOMY FY2008-09: *A BALANCE SHEET*

Indicators	Positive Developments	Negative Developments	Observations
Growth	• A near 6% growth rate during global economic downturn and domestic transition is appreciable.	• 5.9% growth in GDP would be the lowest growth recorded over the last five years.	• Growth target of 5.5% for FY10, whilst lowest in recent years, will be a challenging task in view of the deepening global economic crisis.
Savings a. Domestic b. National	• National savings rate increased further in FY09, reaching 32.36% of GDP from 30.21% of GDP in FY08.	• Domestic savings declined from 20.31% in FY08 to 20.02% in FY09 for the second consecutive year.	• The difference between national and domestic savings is mainly caused by remittance.
Investment a. Aggregate b. Public c. Private	• Share of private investment in GDP (covers four-fifths of total investment) increased marginally	• Aggregate investment as a % of GDP has declined for the third consecutive year (FY06-09) 24.185% in FY09 compared to 24.21% in FY08. Lower than the MTMF target of (24.40% for FY09) • Public investment continued to plunge to record a historic low rate of 4.63% of GDP.	• Gap between national savings and investment is on the rise which will need to be bridged through higher levels of investment.
Per Capita Income	• Per capita GDP stood at $690 in FY09 while per capita GNI stood at USD 690	• This comes in the backdrop of worsening poverty situation as a consequence of high inflation of the recent past.	• Reflection of moderate growth. • Stable exchange rate. • Good flow of remittance for GNI.
Revenue Receipts a. Aggregate b. NBR c. Non-NBR d. Other	• Non-NBR tax collection posted 19.0% growth during July-Feb, FY09 (despite a negative growth target of -1.0%).	• NBR revenue growth target for FY09 is 19.2%, but 12.7% of the growth was achieved over July-Apr, FY08 • Non-tax revenue collection recorded 15.3% growth during Jul-Feb period (lower than the targeted growth of 24.0%).	• CPD estimated a shortfall of Tk 1374 crore in revenue collection in current year.
Public Expenditure a. Revenue Mobilisation b. Revenue Expenditure c. ADP	• Revenue expenditure during Jul-Feb of FY09 indicates deceleration.	• ADP implementation for the first 10 months of FY09 was only around 46.3%. • Use of ADP allocation for almost all sectors will be lower in FY09.	• Low implementation of ADP remains the weakest feature of public expenditure.
Fiscal Deficit a. Size of Deficit b. Financing of Deficit	• Total deficit stood at Tk. 10,959.1 crore during Jul-Feb of FY09 a decline of (-) 34.3% compared to Jul-Feb, FY08 • Domestic financing during Jul-Feb period of FY09 also declined by (-) 28.8%.	• Only 9.7% of the deficit has been met by foreign financing component (target for FY09 was 44.4%).	• Deficit is lower by default, in FY09 because of non implementation of ADP and lower subsidy needs.
Domestic Credit Expansion a. Aggregate b. Public c. Private	• Total domestic credit increased by 18.74%at the end of March 2009 on a point-to-point basis. • Public sector borrowing increased by 20.52%. • Private sector borrowing posted a growth of 18.18%.	• Domestic credit to other public sectors decreased by 5.72% over the same period.	• Credit to SMEs will need to be further increased.
Industrial Credit a. Disburdenment b. Recovery c. Net Disbursement	• Working capital disbursement to the industrial sector increased by 15.5% during July-Mar of FY09 • Recovery of term loan and working capital has increased by 15.7% and 32.9% respectively during July-Mar of FY09	• Term loan disbursement to the industrial sector decreased by (-) 9.6% during July-Mar of FY09 • Net disbursement of term loan and working capital decelerated by (-) 60.1%and (-) 26.9% during July-Mar FY09	• A fall in credit disbursement, particularly Q2 and Q3 of FY09 raises concern about the prospect of industrial development.
Agriculture Credit a. Total Disbursement b. Recovery c. Net Disbursement	• Credit disbursement to the agricultural sector posted a positive growth of 14.82% for July-Apr FY09. • Total recovery was 34.0% during July-Apr of FY09.	• Agriculture credit disbursement from PCBs and the BRDB decreased somewhat, by 0.77% and 6.22% respectively during Jul-Apr of FY09 compared to Jul-Apr of FY08. • Poverty alleviation credit decreased by 6.78 % in July-Apr of FY09 compared to July-Apr of FY08.	• Disbursement of agricultural credit in the first ten months was good. Need to be raised further.

Indicators	Positive Developments	Negative Developments	Observations
Loan Classification	• Total classified loan decreased by (-) 1.1 % as of March FY09. • Classified loans in SCBs posted a (-) 6.70 % decrease.	• Classified loans increased in Mar FY09 relative to Mar FY08. • PCBs: 8.69 % • FBs : 26.10 % • DFIs: 3.89 %	• Measure should be strengthened towards recovery of classified debt.
Price Inflation a. Annual Average b. Rural c. Urban	• The annual average rate of inflation decreased to 7.49 % in Apr FY09 from 9.94 % in Apr FY08. • Both rural and urban inflation have come down to 7.71 % and 6.95 % respectively in Apr FY09 from Apr FY08.	• Rural inflation rate (both point-to-point and average) tended to be above the urban level.	• Although lower inflation may have improved the real income position for many relative to last year, those with no improvement in nominal wages have seen significant purchasing power erosion.
Exchange Rate	• Exchange rate stood at Tk. 68.9 per dollar in Mar FY09 from Tk 68.6 in Mar FY08	• The appreciation of BDT versus the Euro can thus be a major impediment in improving Bangladeshi products' price competitiveness in the EU zone.	• Stability of exchange rate will need to be maintained by taking cognizance of the interests of macroeconomic stability.
Commercial Interest Rate a. Lending Rate b. Deposit Rate	• Deposit rate stood at 8.17% in Apr FY09 from 7.26% in Apr FY08	• Commercial lending rate was 13.53% in Apr FY09, which was 12.87% in Apr FY08	• Along with ceiling, the idea of a floor rate may be considered.
Agriculture Output	• Total production was 8.0% higher than last year. • Wholesale prices of coarse rice decreased from Tk.32.17 to Tk.19.79 per kg.	• However, total production fell 6.3% short of target. • Farmers are losing about Tk.1000 - Tk.1200 per bigha, at the current market price • Cost of production was higher for diesel-irrigated boro rice than electricity-irrigated.	• Food security ought to receive highest priority.
Industrial Production	• Some of the export-oriented sectors such as RMG posted rise in QIP.	• Production in terms of QIP posted low level of growth (8% during Jul-Feb FY09), even over the low benchmark of FY08 • Term loan for industrial sector and import of capital machineries have fallen.	• Energetic effort required to improve (lower) ICOR by raising productivity of both capital and labour.
Foreign Investment	• US$851 million worth of FDI was received during July-Feb FY09 (91% growth) • This was the highest FDI inflow to Bangladesh till.	• Portfolio investment indicates liquidation of investment from the capital market in the backdrop of the global financial crisis.	• FDI high because of one transaction of local purchase of US$300 million. • More effort to attract FDI by building the infrastructure.
Capital Market	• 12 new IPO listing in FY09 (9 in FY08)	• All share price index (DSI) has dropped from 2498.5 in Sep, FY08 to 2033.3 in May FY09 with a fall of (-) 18.62%.	• Market capitalization of the DSE remained rather same. • Share price fall coincided with global crisis although very low foreign exposure.
Export	• Overall export growth has been 12.7% during July-Apr FY09. • RMG posted 18.13% growth despite recession.	• Very low export growth in Q2 and Q3 of FY09 (2.59% only). • Other major forex earners have seen falls, with leather falling 34.57% and frozen foods falling by 13.01%.	• Share price index of low-tier apparels buyers is on the rise alluding to future rise in demand. Bangladesh should strive to seize the opportunities of a global recovery.
Import	• Moderate Import growth of 12.39%. • All non-food items registered positive growth.	• Capital machineries registered negative growth. • Opening of LCs declined by -10.09% during Jul-Apr FY09.	• Crude Petroleum Import has grown by only 0.53% in July-Mar FY09, but with rise of oil price import burden expected to rise in FY10.
Remittances	• Impressive growth of remittances (22.5%) during Jul-Apr FY09. • Highest amount ever remitted in a month was USD 886.67 million (Mar FY09).	• During Q1 of FY09 more than 28,000 workers returned. • Average monthly number of outgoing workers falling.	• There exists fear of retrenchment due to the global financial crisis and subsequent slowdown in remittance flow.

Indicators	Positive Developments	Negative Developments	Observations
Foreign Aid	• Total aid disbursement in FY09 (Jul – Mar) was USD 1.35 billion, compared to USD 1.33 billion in FY08 (July-Mar)	• Grant component of foreign aid falling and loan component rising.	• Future debt burden will increase with increase of share of loan component in aid. • More aid in the form of budgetary support was required.
Foreign Exchange Reserves	• Historically high FOREX reserves of USD 6410.24 million were recorded on 19 May 2009. • This is equivalent to 3.3 months of import payments.	• With the prospect of import bill rising, forex reserves will be under pressure.	• Composition of FOREX reserves need to be monitored on a regular basis. • Maintain and safeguard purchasing power of the country's FOREX reserves. • More effort to ensure higher export earnings and remittance flow.
Balance of Payments	• Overall healthy BoP: USD 773 million, against USD 310 million during Jul – Feb FY08. • Surplus in Current Account rose to USD 816 million, from USD 299 million.	• Trade balance deteriorated further to USD (-) 3560 million, from USD (-) 3087 million.	• Movement of commodity prices, export earnings, remittance flow and aid disbursement will impact on BoP in future. The dynamics of BoP scenario will need to be carefully monitored.