STATE OF THE BANGLADESH ECONOMY IN FY 2002-2003
- A MACROECONOMIC OVERVIEW

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I. INTRODUCTION

At the beginning of the fiscal year 2001-2002 (FY02), the Centre for Policy Dialogue (CPD), in its annual *Independent Review of Bangladesh's Development* (IRBD), benchmarking the initial conditions of the economy observed that "the economy is facing possibly the most severe exigency since the macro-economic crisis of the late 1980s. The twin shocks emanating from the yawning fiscal deficit and deteriorating balance of payment have exposed the entrenched vulnerabilities of the Bangladesh economy. Both the successes of the macro-economy, achieved during 1990s, *viz.* stability and growth are in peril" (Bhattacharya, 2003a).

CPD-IRBD 2002 raised the question "whether the emerging negative trends in the macro-economy will lead to an extensive loss of employment and income for a protracted period or whether the present predicament is a short-term phenomenon to be overcome through prudent policy management and institutional reforms" (*ibid*).

Towards the end of the FY02, as part of its reaction to the National Budget for FY03, CPD undertook a year-ending assessment of the economy. Three major developments observed in FY02 were recorded in this assessment. *First*, deterioration in the fiscal balance has been harnessed. *Second*, pressure on balance of payments has been partly contained. *Third*, recessionary trends continue to afflict the economy. CPD's review emphasised that the inability to address the prevailing stagnation in the investment scenario may jeopardise the recent gains (Bhattacharya, 2003b).

In June 2003, CPD further observed that it was open to speculation whether the National Budget for FY03 would be able to catalyse investment growth. It was pointed out in the CPD's review that in spite of all the positive measures envisaged under the Budget FY03, investment will remain constrained due to lack of reforms, particularly in improving performance in the trade-supportive infrastructure, financial sector, public administration, and, last but not the least, because of the deteriorating law and order situation (Bhattacharya, 2003c).

In its *Interim Report* on state of the Bangladesh economy in FY03, CPD pointed out, referring to deployment of army under "Operation Clean Heart", that "the government has resorted to rather non-conventional measures to improve the law and order situation" (Bhattacharya, 2003d). During FY03, a number of government committees also tried to give shape to reform measures in different areas of economic management. Now with the results of the all four quarters of the FY03 behind us, we may seek to identify and interpret the major developments in the current fiscal year.

It is in this context that the present paper reviews a set of major variables defining the state of the Bangladesh economy in FY03. The analysis, based on official data, is divided into five broad parts. It starts off with a discussion of the growth, savings and investment scenario. Thereon, it sequentially addresses the developments in (i) public finance, (ii) credit and monetary sector, (iii) real economy, and (iv) external sector. The review concludes by highlighting some issues which in the coming months will serve to influence the performance of the economy.

II. GROWTH, SAVINGS AND INVESTMENT

II.1 Improved Growth, Not Good Enough

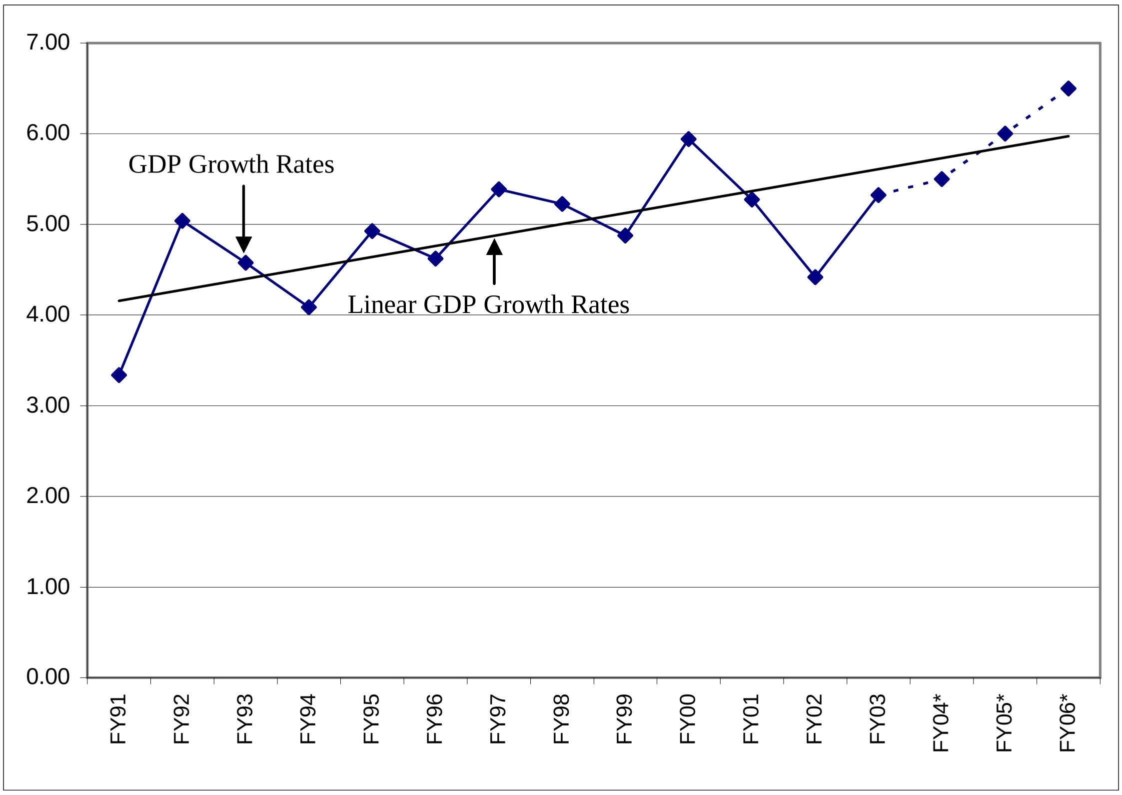
According to the BBS, the Bangladesh economy posted an improved growth of 5.3 percent during FY03 as against 4.4 percent in FY02. It may be recalled that economic growth experienced acceleration during 1990s (linear growth rate 4.8 percent) in comparison to 1980s (linear growth rate 3.6 percent). In 1990s, the growth momentum was higher during the second half of the decade in comparison to the first half: average growth rate 4.4 percent (FY 91-95) and 5.2 percent (FY 96-00) (Bhattacharya, 2003a).

The provisional growth figure for FY03 is marginally above the matching target rate of 5.2 percent as indicated in the country's Interim Poverty Reduction Strategy Paper (I-PRSP)[1] (See Figure 1). However, the improved growth rate still remains below the recent record figure of 5.9 percent achieved in FY00. According to the I-PRSP, Bangladesh economy is

[1] The Bangladesh version of the PRSP is known as the "A National Strategy for Economic Growth, Poverty Reduction and Social Development". The latest available draft was published in March 2003 (See ERD 2003).

programmed to grow at 5.5 percent in FY04 and 6.0 percent in FY05, reaching 6.5 percent in FY06 (ERD, 2003).

Figure 1: Trend in GDP Growth



Note: * indicates I-PRSP projections
Source: Computed from ERD (2003).

The acceleration of the economic growth momentum which took place during the 1990s, seems to have plateaued at 5 percent plus level in the early 2000s, resulting in annual per capita income growth of little above 3 percent. Admittedly, such "mediocre" level of per capita income growth has failed to make a perceptible dent on the prevailing poverty situation. As per the latest (2000) Household Income and Expenditure Survey (HIES 2000) about 40 percent of the total population in Bangladesh, live below the poverty line (BBS, 2003a).

II.2 Skewed Structural Transformation

The contribution of the real economic sectors[2] ("tradable sectors") to incremental growth has jumped from 19.7 percent in FY02 to 34.2 percent in FY03. This is largely due to the 12.1

[2]Include Crop, Livestock, Forestry, Fisheries, Manufacturing and Mining & Quarrying.

percent recovery growth of the agriculture and forestry sector, which recorded negative (-)2.6 percent growth in FY02.

It may be noted that, notwithstanding the improvement observed above, the incremental contribution of the "tradable sectors" remains lower than its sectoral share in the GDP (36.8 percent in FY03), implying that the service sectors have played the decisive role in improving the growth rate at the margin. On the other hand, the incremental contribution from the service sectors has decreased from 77.8 percent in FY 02 to 63.2 percent in FY 03.

The ongoing structural transformation of the Bangladesh economy is characterised by falling share of the agriculture sector with marginal increase of the manufacturing, in the backdrop of increasing contribution of the service sector. In FY 03, the real economic sectors accounted for 40.5 percent of the GDP; the said proportion was 43 percent a decade back (CPD, 2003). This suggests that in spite of improved growth, the evolution of the Bangladesh economy remains biased against modern and industrial transformation, having concomitant implications for sustained growth and equitable income distribution.

II.3 Deteriorating Income Distribution

Notwithstanding the observed improved growth, income distribution deteriorated during 1990s coupled with slow pace of poverty alleviation. Population below absolute poverty line declined from 47.52 percent in 1991 - 92 to 44.33 percent in 2000. During the same period, incidence of extreme poverty[3] decreased from 25.06 percent to 19.98 percent (BBS, 2003a). This implied that the poverty alleviation rates were quite modest being 0.40 percent and 0.60 percent per annum for absolute and extreme poverty lines respectively. More importantly, the incremental growth had an anti-poor bias, which resulted in deterioration in income distribution.

For example, analysis of the data from the Household Income and Expenditure Survey 2000 (HIES 2000) reveals that, between 1995 - 96 and 2000, national income attributable to the poorest 10 percent of the population declined further from a miniscule proportion of 2.24 percent to 1.84 percent. Conversely, the control on the national income by the richest 10 percent of the population increased from 34.68 percent to 40.72 percent (BBS, 2003a). In

[3] By Head Count Ratio-Daily Calorie Intake (HCR-DCI) method absolute poverty line is 2122 K.cal person/day and extreme poverty line is 1805 K.cal person/day.

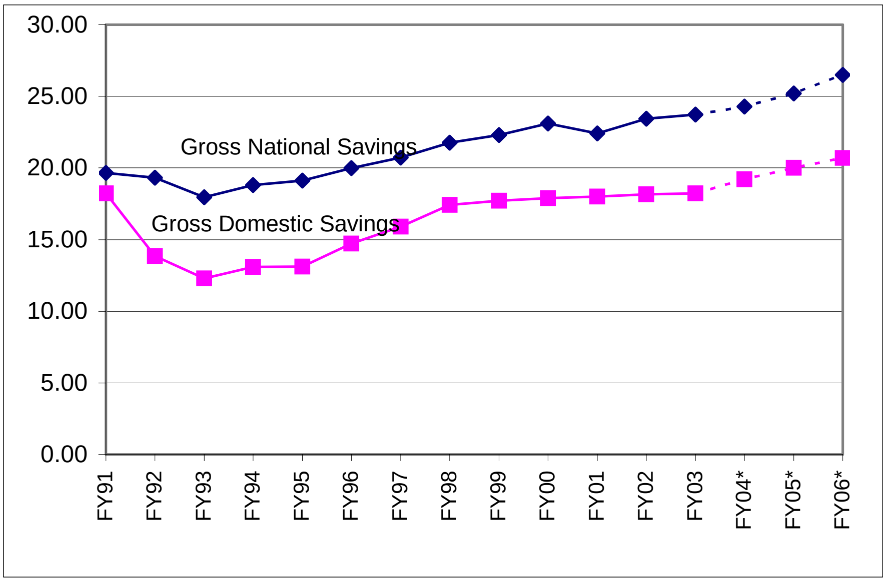
other words, the income differential between the poorest and the richest increased from 35.7 times to 53.4 times during the second half of 1990s. There is no evidence which suggests that this trend has been reversed during the last couple of years.

The bottom line is, incremental growth did not automatically benefit the poor in Bangladesh. While the I-PRSP do outline a strategy for poverty alleviation, the elements of pro-poor economic growth is not quite obvious from the document. It is not clear how the budget for FY04, apart from adopting more of the same traditional measures, is going to change the situation.

II.4 Stagnating Domestic Savings Scenario

Domestic savings rate continues to stagnate at 18.2 percent of GDP (See Figure 2), whereas the national savings rate increased marginally from 23.4 percent in FY 02 to 23.7 percent in FY03 (Finance Division, 2003a). The marginal increase of the latter is underpinned by increasing flow of foreign remittances from expatriate Bangladeshi workers. The prolonged stagnation of the domestic savings may possibly be largely explained by the deteriorating income distribution scenario in the Bangladesh economy as the poor, who demonstrate higher propensity to save, are being deprived of their proportionate share in incremental national income.

Figure 2: Trends in Savings Rate
(as of GDP)



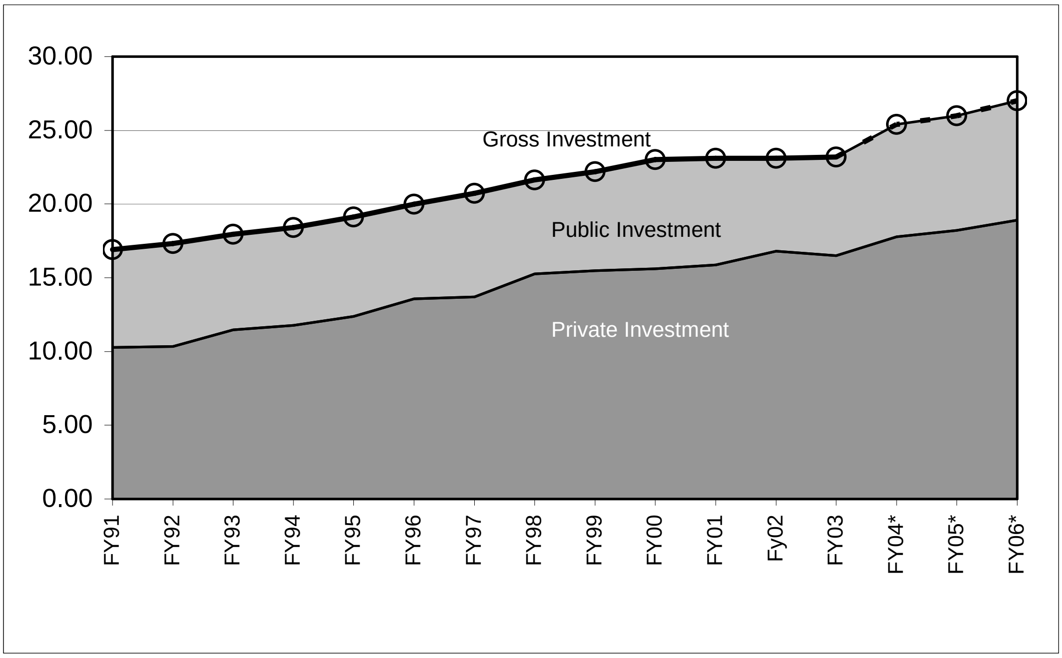
Note: * indicates I-PRSP projections
Source: Computed from Finance Division (2003a) and ERD (2003).

One will have to wait in anticipation to see the extent to which the domestic and national savings rates, as projected by the I-PRSP for the FY04 to reach 18.7 percent and 23.4 percent of the GDP respectively, will be achieved.

II.5 Stagnating Investment Situation

The gross investment rate also stagnated during FY03 at 23.2 percent of GDP (See Figure 3). More importantly, the role of the private investment, depicted by its share in the GDP, in fact declined from 16.8 percent in FY02 to 16.5 percent in FY03. The marginal increase in public investment from 6.4 percent (FY02) to 6.7 percent (FY03) allowed the gross investment figure to retain its preceding year's benchmark.

Figure 3: Investment Trend
(as of GDP)



Note: * indicates I-PRSP projections
Source: Computed from Finance Division (2003a) and ERD (2003).

The revealed decline in share of private investment in gross capital formation vindicates CPD's express concern about the continuing investment recession in the economy (Bhattacharya, 2003e). Our subsequent analysis of the state of the economy corroborates the above view. One wonders whether the fiscal measures announced through National Budget for FY04 are going to ensure the targeted of gross investment rate to 23.58 percent of GDP in FY04.

III. FISCAL CONSOLIDATION IN PUBLIC FINANCE

III.1 Mixed Results in Revenue Collection

The total revenue collection target for FY03 was 19.57 percent higher than the realised benchmark of FY02. The collection in FY03 was actually 12.47 percent more, i.e. about 94 percent of the target. Such a feat was possible thanks to spectacular success on the part of the National Board of Revenue (NBR) in meeting the revenue collection target. In contrast, the achievement rate in case of non-NBR taxes was less than 70 percent and in case of non-tax revenues – a little above 80 percent (Finance Division: 2003b).

As may be observed from Table 1, the total revenue collection in FY03 was 12.5 percent above the earlier year's receipts and it pushed the revenue-GDP share to 10.36 percent. This still leaves Bangladesh with one of the lowest revenue-GDP ratio, even amongst the low income countries.

TABLE 1

Trend in Total Revenue Receipts

(In Billion Taka)

Year	Tax Revenue			Non-tax Revenue			Total Revenue			Total Revenue as % of GDP
	Target	Realised	Difference as % of Target	Target	Realised	Difference as % of Target	Target	Realised	Difference as % of Target	
1997/98	161.53	150.01	-7.13	34.71	37.76	8.79	196.24	187.77	-4.32	9.38
	(15.17)	*(6.59)*		*(12.15)*	*(22.96)*		*(14.63)*	*(9.52)*		
1998/99	166.17	158.55	-4.59	41.59	38.45	-7.55	207.77	197.00	-5.18	8.97
	(2.87)	*(5.69)*		*(19.82)*	*(1.83)*		*(5.88)*	*(4.92)*		
1999/00	186.35	170.96	-8.26	55.16	42.49	-22.97	241.51	213.45	-11.62	9.00
	(12.14)	*(7.83)*		*(32.63)*	*(10.51)*		*(16.24)*	*(8.35)*		
2000/01	192.78	194.90	1.10	49.20	46.83	-4.82	241.98	241.73	-0.10	9.53
	(3.45)	*(14.00)*		*(-10.80)*	*(10.21)*		*(0.19)*	*(13.25)*		
2001/02	220.23	219.30	-0.42	64.33	57.40	-10.77	284.56	276.70	-2.76	10.13
	(14.24)	*(12.52)*		*(30.75)*	*(22.57)*		*(17.60)*	*(14.47)*		
2002/03	255.00	249.5	-2.15	75.84	61.70	-18.64	330.84	311.20	-5.94	10.36
	(15.79)	*(13.77)*		*(17.89)*	*(7.49)*		*(16.26)*	*(12.47)*		
2003/04	290.71	n.a.	n.a.	71.00	n.a.	n.a.	361.71	n.a.	n.a.	10.94
	(14.00)			*(-6.38)*			*(9.33)*			

Notes: Figures in the parentheses depict annual growth rates.
GDP for FY04 is estimated based on 10 percent nominal growth, assuming 6 percent real growth and 4 per cent inflation.
n.a.: not available/not applicable.

Source: Computed from CPD (2003b) and Finance Division (2003b).

The National Budget for FY04, with a projection of about 16.2 percent growth, fixed a target of Tk. 361.71 billion to be collected as revenue in FY04. The largest contribution to this growth is expected to originate from NBR tax revenue (16.52 percent), followed by non-NBR tax revenue (15.07 percent).

III.1.1 NBR Component

The impressive overall trend in revenue receipt by the NBR, however, is underwritten by higher collection rate of internal trade-related taxes in comparison to import related taxes revenue. Whatsoever, the underbelly of the NBR's tax portfolio remains to be the income tax.

According to Table 2, the revenue collection from NBR sources during FY03 was 17.53 percent more than the matching period of FY02. This was Tk 0.20 billion (0.09 percent) more than the revised target. In this connection, it is important to note that in FY03 collection of internal trade-related taxes has grown by 22.39 percent as against 15.14 percent growth of total import-related taxes. This is because total internal trade related taxes were realised more than 100 percent of the annual target, but import-related taxes recorded a shortfall of more than 2 percent with respect to its target. This shortfall is largely attributable to relatively low (in comparison to target) collection in case of Value Added Tax (VAT) (Import) and Supplementary Duty (SD) (Import).

TABLE 2

Composition of Tax Revenue Receipts

(NBR Component: FY02-FY03)

(In Billion Tk.)

No.	Source of Revenue	FY03				FY02				Percent change of collection (FY03 over FY02)
		Revised Target	Achieved	Difference	Collection as % of target	Revised Target	Achieved	Difference	Collection as % of target	
1	Import Duty	58.90	66.87	7.97	113.53	53.50	53.95	0.45	100.84	23.95
2	Value Added Tax (Import)	43.75	41.14	-2.61	94.02	39.60	37.58	-2.02	94.89	9.47
3	Supplementary Duty (Import)	15.50	12.72	-2.78	82.06	14.00	13.32	-0.68	95.13	-4.50
	Total Import Related Revenue	*118.15*	*120.73*	*2.57*	*102.18*	*107.10*	*104.85*	-2.25	*97.90*	*15.14*
4	Excise Tax	3.10	3.18	0.08	102.62	3.00	2.93	-0.08	97.50	8.76
5	Value Added Tax (Local)	36.96	36.41	-0.55	98.50	30.00	32.29	2.29	107.65	12.73
6	Supplementary Duty (Local)	28.25	31.37	3.12	111.05	24.50	22.76	-1.74	92.89	37.84

	Total Internal Trade Related Revenue	*68.31*	*70.96*	*2.65*	*103.88*	*57.50*	*57.98*	0.48	*100.83*	*22.39*
7	Income Tax	47.88	43.72	-4.16	91.31	41.00	37.89	-3.11	92.42	15.38
8	Other Taxes	3.16	2.30	-0.86	72.78	1.70	1.53	-0.17	89.89	50.51
	Total Revenue Earnings	*237.50*	*237.70*	*0.20*	*100.09*	*207.30*	*202.24*	-5.06	*97.56*	*17.53*

Source: Computed from CPD (2003b) and Finance Division (2003b).

However, income tax collection suffered the largest shortfall in the period FY03 – about 9.13 percent less than the target. It appears that recent initiatives of the NBR to identify potential taxpayers are yet to translate into actual yield.

III.1.2 Non-NBR Component

The outlandish 45.83 percent growth target for non-NBR taxes remained miserably unachieved in FY03. In fact, it recorded less than 1 percent growth. Shortfalls in land revenue and stamp duty collection are the major reasons for non-fulfilment of the non-NBR targets in FY03. The modest growth of 10.08 percent programmed for non-NBR taxes in FY04 seems more plausible. However, the budget does not spell out any special measure towards achieving the target this time around.

III.1.3 Non-Tax Revenue

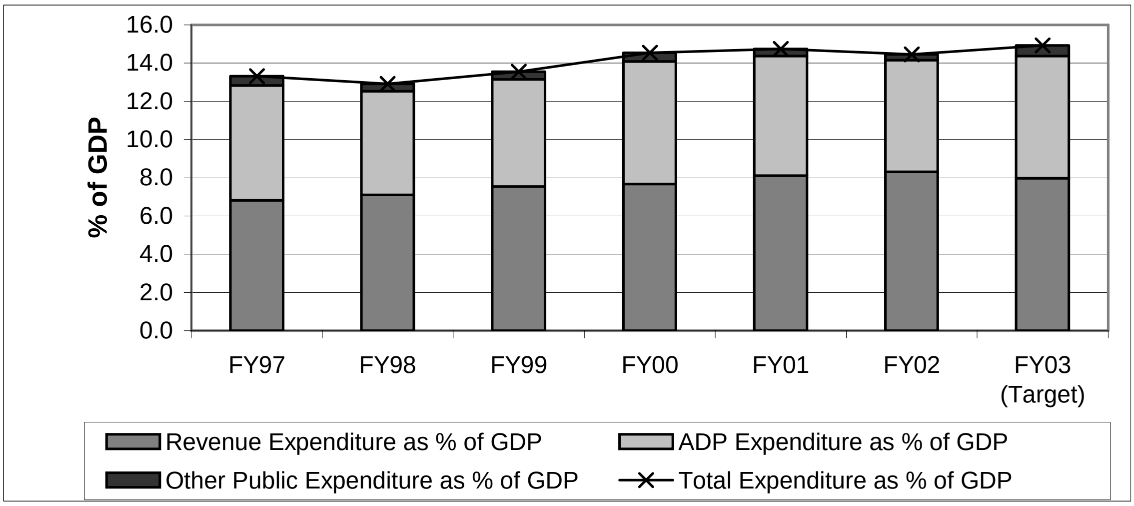
Collection of non-tax revenue in FY03 was 18.64 percent less than the target but 7-87 percent more than the benchmark of in FY02. The major contributing factors in this regard had been low collection in dividend and profit, administrative fees and charges, rent, leases and **r**ecovery, and capital revenue. Thus, the Ministry of Finance has set a much humbler target of 15.07 percent growth for non-tax revenues in FY04.

As mentioned earlier, the budget for FY04 has not spelt out any special initiative to augment revenue collection in the area of non-NBR taxes and non-tax revenues which currently together account for about 23 percent of the total revenue receipt. One observes that collections on account of non-NBR tax revenue and non-tax revenue are systematically remaining behind their respective targets. It is also becoming obvious that performance in these two areas will, at the margin, define the success of aggregate revenue collection at the end of fiscal year.

III.2 Disturbing Render in Public Expenditure

Total public expenditure in FY03 accounted for about 14.6 percent of GDP in Bangladesh (See Figure 4), of which The Annual Development Programme (ADP) commanded about 39 percent of the total public expenditure, whilst revenue expenditure and other expenditures accounted for the rest 61 percent.

Figure 4: Composition of Public Expenditure



Source: Computed from CPD (2003b) and Finance Division (2003b).

If the target volume of public expenditure, as expressed in the National Budget, is realised in FY04, its share in GDP will increase to 15.7 percent without significantly changing the split between ADP and non-ADP heads (Finance Division, 2003b). It is important to note that public expenditure in FY04 is targeted to grow at a faster rate than revenue earning, particularly through ADP expansion underwritten by a higher inflow of foreign aid. Notwithstanding such possible gains, public expenditure ratio in Bangladesh (less than 16 percent) remains quite low when in comparable countries the said share is around 20 percent of GDP.

III.2.1 Overshooting Revenue Expenditure

The revenue expenditure increased from Tk.226.92 billion in FY02 to Tk.259.07 billion in FY03. As a result, the revenue expenditure overshot the budgeted amount in FY03 and recorded an increase of more than 11.5 percent over the preceding year’s benchmark (see Table 3). The revenue expenditure is to grow by about 14.5 percent in FY04 (Table 4). The structural rigidities of the revenue expenditure portfolio are well known. Economic analysis of the composition of revenue expenditure for FY03 indicates that only three heads account for about 80 percent of the total. These three heads are: salary and allowances (about 29 percent), subsidies and transfers (28 percent), and debt servicing liability (22 percent). (See Table 4)

In this connection, it may be noted that expenditure on account of defence services as a share of total revenue spending has secularly come down from its peak 18.2 percent in FY98 to 13.5 percent in FY03 (CPD, 2003b).

TABLE 3

Trend in Revenue Expenditure

(In Billion. Tk.)

Year	Expenditure			Annual Growth of Expenditure		Revenue Earning-Expenditure Ratio	Revenue Expenditure as % of GDP
	Target	Actual	Difference as % of target	Target	Actual		
FY98	145.44	145.00	-0.30	20.17	15.68	1.29	7.24
FY99	159.37	167.65	5.20	9.58	15.62	1.18	7.63
FY00	178.00	184.44	3.62	11.69	10.01	1.16	7.78
FY01	196.33	206.62	5.24	10.30	12.03	1.17	8.01
FY02	220.38	226.92	2.97	12.25	9.82	1.21	8.31
FY03	239.72	253.07	5.57	8.78	11.52	1.23	8.42
FY04	289.69	-	-	20.85	_-	1.25[b]	8.76[b]

Notes: [a] Based on target figure.
[b] Based on total target revenue and estimated current GDP for FY04. GDP for FY04 is estimated based on 10 percent nominal growth, assuming 6 percent real growth and 4 percent inflation.
Source: Computed from CPD (2003b) and Finance Division (2003b).

TABLE 4

Economic Analysis of Revenue Expenditures in FY03

(In Billion Tk.)

Item	FY03			FY04 (Target)	Annual Growth	
	Target	Actual	Actual as % of Target		Actual FY03 over Actual FY02	Target FY03 over Actual FY02
Pay of Officer and Establishment; and Allowance	73.19	72.82	99.49	75.02	7.07	7.62
	(30.53)	(28.77)		(25.90)		
Goods and Services	36.12	42.65	118.08	44.69	23.55	4.63
	(15.07)	(16.85)		(15.43)		
Interest Payment	46.14	55.74	120.81	64.37	23.32	2.08
	(19.25)	(22.03)		(22.22)		
Domestic	35.89	46.17	128.64	54.61	28.79	0.11
	(14.97)	(18.24)		(18.85)		
Foreign	10.25	9.57	93.37	9.76	2.35	9.63
	(4.28)	(3.78)		(3.37)		
Subsidies and Current Transfer	65.73	70.84	107.77	78.08	19.76	11.12

	(27.42)	(27.99)		(26.95)		
Block Allocation	14.39	5.66	39.33	19.67	-54.02	16.90
	(6.00)	(2.24)		(6.79)		
Acquisition of Asset and Workers	10.16	10.53	103.64	12.43	-4.79	-8.14
	(4.24)	(4.16)		(4.29)		
Recoveries(-)	6.01	5.17	86.02	4.57	55.26	80.48
	(2.51)	(2.04)		(1.58)		
Total	239.72	253.07	105.57	289.69	11.52	5.64
	(100.00)	(100.00)		(100.00)		

Note: Figures in the parentheses give the percent of total revenue expenditure.
Source: Computed from CPD (2003b) and Finance Division (2003b).

The trend growth in revenue expenditure during the past twenty years had been about 10.6 percent (Bhattacharya, 2003). One of the highest increase in revenue expenditures in FY03 had been in public debt servicing liabilities (DSL) - more than 23 percent. This has been largely due to domestic borrowing by the government and as such domestic DSL grew by about 29 percent. Concurrently subsidies and current transfer increased by about 20 percent. Both these trends reinforced the structural rigidities in revenue expenditure portfolio which are observed earlier.

III.2.2 Annual Development Programme (ADP) – Subdued Implementation

The ADP for FY03 has to be reduced to Tk. 17 billion by slashing it by more than 10 percent (Table 5). In reality, the realised (actual) size of the ADP was to the tune of Tk. 154.34 billion, i.e. about 80 percent of the original target. The actual ADP constitutes only about 61 percent of the revenue expenditure (Finance Division, 2003a).

As table 5 further shows that in FY03, implementation of ADP was 80.38 percent and 90.26 percent of its original and revised targets respectively. Because of the sub deed implementation of ADP, the share of ADP came down to only 61 percent of revenue expenditure in FY03, while the matching figures in FY00 and FY01 were 83.9 and 78.2 percent respectively. The ADP for FY03 contained a total of 1289 projects including 188 new ones (CPD, 2003b).

As mentioned earlier, the total public expenditure in Bangladesh as a share of GDP is still low in comparison to other low-income countries – it was only 14.6 percent in FY03. Thus, it is not the overall size of the public expenditure, but its composition and quality remain a matter of concern. *First*, the ADP is routinely underachieved. The government reduced the ADP for FY03 by Tk.21 billion, and yet could not fully implement the substantially scaled down figure. Thus, a development expenditure target of Tk. 203 billion for FY04 will be daunting figure to chase. *Second*, whatever may be the size of the ADP; it is the prioritisation and selection of the included projects as well as the quality of their envisaged expenditure lines which have always remained suspect. *Third*, in the backdrop of weak implementation of the ADP, whilst the revenue expenditures have systematically crossed the budget any limit, the composition of public expenditures is assuming an unhealthy structural rigidity. The revenue expenditure-basket is assuming an immutable character where three-quarter of the revenue budget remains committed to salaries and allowances, subsidies and transfers, and interest payments.

TABLE 5
ANNUAL DEVELOPMENT PROGRAMME

(In Billion Tk.)

Year	Annual Development Programme			Actual as % of original	Actual as % of Revised	Annual Growth of Actual ADP	Actual ADP as % of Revenue Expenditure	Actual ADP as % GDP
	Original	Revised	Actual					
FY98	128.00	122.00	110.40	86.20	90.50	0.00	76.10	5.50
	(2.40)	*(4.30)*	*(0.00)*					
FY99	136.00	140.00	125.10	92.00	89.40	13.30	74.60	5.70
	(6.30)	*(14.80)*	*(13.30)*					
FY00	155.00	165.00	154.70	99.80	93.80	23.70	83.90	6.50
	(14.00)	*(17.90)*	*(23.70)*					
FY01	175.00	182.00	161.50	92.30	88.70	4.40	78.20	6.40
	(12.90)	*(10.30)*	*(4.40)*					
FY02	190.00	160.00	140.90	74.10	88.00	-12.80	62.00	5.20
	(8.60)	*(-12.10)*	*(-12.80)*					
FY03	192.00	171.00	154.34	80.38	90.26	9.54	61.00	5.10
	(1.10)	*(6.87)*	*(9.54)*					
FY04	203.00	n.a.	n.a.	n.a.	n.a.	32.71[a]	70..07[a]	6.10[a]
	(5.73)							

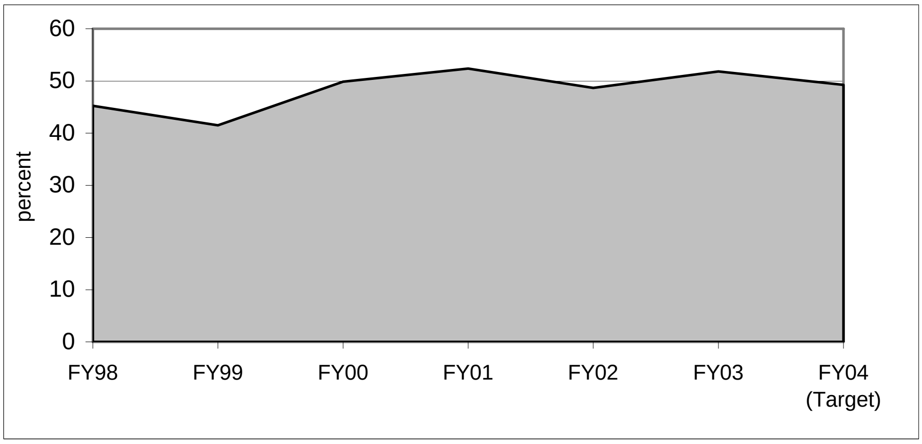
Notes: Figures in parentheses depict annual growth rates over preceding year.
[a] Based on Target ADP of FY04.
Source: Computed from CPD (2003b) and Finance Division (2003a).

Financing of the ADP

The share of internal resources in ADP financing in FY03 was 51.81 percent according to the revised budget, while the said share in FY02 was 48.66 percent. In FY00 and FY01 the comparable proportion was 49.85 and 52.36 percent respectively (See Figure 5). The share of internal resources in ADP financing in FY04 is supposed to increase to 49.26 percent

Figure 5: Share of Internal Resources in ADP (Revised)

(FY98-FY03)



Source: Computed from CPD (2003b) and Finance Division (2003a).

Admittedly, not all of the internal (domestic) resources in revenue surplus while ?? percent of the domestic financing for the ADP in FY03 came from revenue surplus, the rest (?? percent from Bank following. In the case of foreign financing ?? percent came as grant while the rest ?? percent as loan.

Indirect evidence, such as the trend in government borrowing, suggests that the government has been following a tight expenditure policy during FY03. In spite of the comfortable revenue collection situation, it is quite prudent on the part of the government to pursue such a conservative approach to budgetary management, given the softness in the foreign exchange reserve. In case of any exigency, this will also allow the government to cutback on expenditures (possibly ADP) to maintain the fiscal balance. However, this implies that a substantial part of the programmed expenditure will be back-loaded, taking away the smoothness in the expenditure trend.

The size of the ADP for FY04 has been fixed at Tk. 203 billion. Taking note of the development need of the country and public expenditure-GDP ratio in comparable countries, the said size does not seem to be inappropriate. Rather, the question is whether the government is capable of effectively implementing such a portfolio.

III.3 Fiscal Deficit Revenues Under Control

The budget deficit has been brought down sequentially during the last two years. In FY03, the actual budget deficit accounted for 4.3 percent of the GDP, which was same in the preceding matching period. During the FY03, the foreign financing accounted for 55 percent and the rest (45 percent) was from domestic sources.

It has been programmed that the overall budget deficit (without grants) will increase from 4.25 percent in FY03 to 4.81 percent in FY04 (Finance Division, 2003b). Once foreign grants are accounted for, the budget deficit figure comes down to a more sustainable level of 3.4 percent.

About two third of the foreign financing component of the budget deficit in FY03 was sourced from foreign loans and the rest (one third) by foreign grants. This combination of foreign financing will increase the foreign debt servicing liability of the country. Incidentally the original budget for FY03 provided for Tk.135.8 million as bank borrowing. Accordingly, while the size of the budget is not a concern, its current forms of financing demand review.

TABLE 6
BUDGET DEFICIT AND FINANCING

(In Billion Tk.)

Year	Budget Deficit			Actual Budget Deficit as % of GDP	Financing Deficit (as % of GDP)	
	Target	Actual	Difference as % of Target		Domestic Financing	Foreign Financing
FY98	81.60	82.90	1.60	4.10	1.50	2.60
FY99	108.00	135.10	25.10	6.10	2.10	4.00
FY00	120.30	166.10	38.10	7.00	3.30	3.70
FY01	168.60	178.20	5.70	7.00	3.50	3.50
FY02	149.10	118.30	-20.70	4.30	2.10	2.30
FY03	117.70	127.80	8.60	4.30	1.90	2.10
FY04	158.10	-	-	4.80[a]	2.00[a]	2.80[a]

Note: GDP for FY04 is estimated based on 10 percent nominal growth, assuming 6 percent real growth and 4 percent inflation.
[a]Based on Target figures.
Source: Computed from CPD (2003b) and Finance Division (2003b).

IV. DEVELOPMENTS IN THE MONETARY SECTOR

IV.1 Slowdown in Domestic Credit Expansion

Following expansion of domestic credit at the high rate of more than 17.6 percent in FY01, domestic credit growth was brought down to below 13 percent in FY02 as part of the overall strategy of fiscal consolidation (See Table 7). The most disturbing feature of the credit growth in FY01 had been greater increase in borrowings by the government and quasi-government sector in comparison to the private sector. In contrast, both the aggregate and inter-sectoral balance were largely restored in FY02.

Figures for FY03, as depicted in Table 7, reveal that the overall domestic credit flow has further slowed down recording a fall in aggregate growth from 12.9 percent in FY02 to 9.5 percent in FY03. This slowdown is largely attributable to the government sector which experienced a reverse flow of (-) 5.5 percent.

TABLE 7
DOMESTIC CREDIT EXPANSION

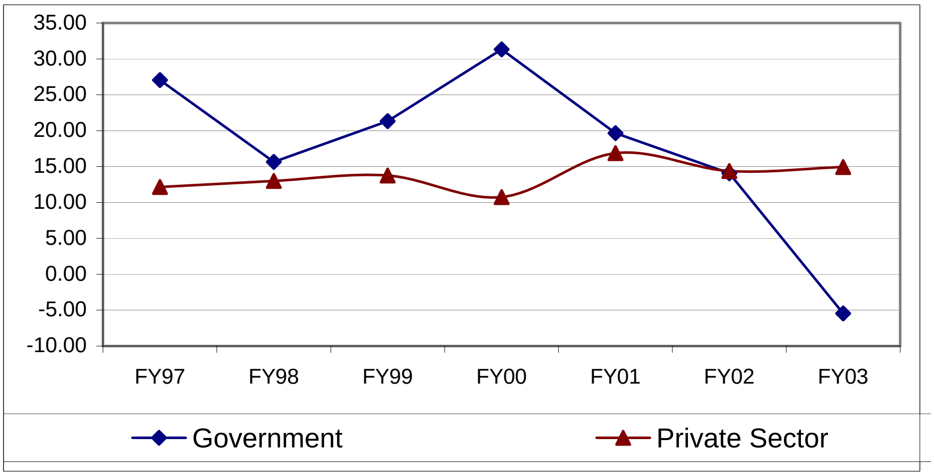
(In Billion Tk)

Year	Government		Other Public		Private Sector		Total		Share of Private Sector in Total Credit
	Amount	Annual Growth Rate	Amount	Annual Growth Rate	Amount	Annual Growth Rate	Amount	Annual Growth Rate	
FY98	92.70	15.70	62.50	6.40	401.20	13.00	556.40	12.60	72.10
FY99	112.50	21.30	60.20	-3.70	456.40	13.80	629.10	13.10	72.50
FY00	147.70	31.30	61.70	2.50	505.40	10.70	714.90	13.60	70.70
FY01	176.80	19.70	73.60	19.20	590.70	16.90	841.10	17.70	70.20
FY02	201.60	14.10	72.40	-1.60	675.70	14.40	949.80	12.90	71.10
FY03	190.60	-5.50	72.60	0.20	776.60	14.90	1039.80	9.50	74.70

Source: Computed from CPD (2003b) and Bangladesh Bank (1991-2003).

However, inter-temporal growth of credit flow to the private sector (as shown in Figure 6) marginally increased from 14.4 percent in FY02 to 14.9 percent in FY03. In case of accessing credit from other public sector entities, it experienced only 0.20 percent growth.

Figure 6: Trends in Annual Growth Rate of Domestic Credit



Source: Computed from Bangladesh Bank (1991-2003).

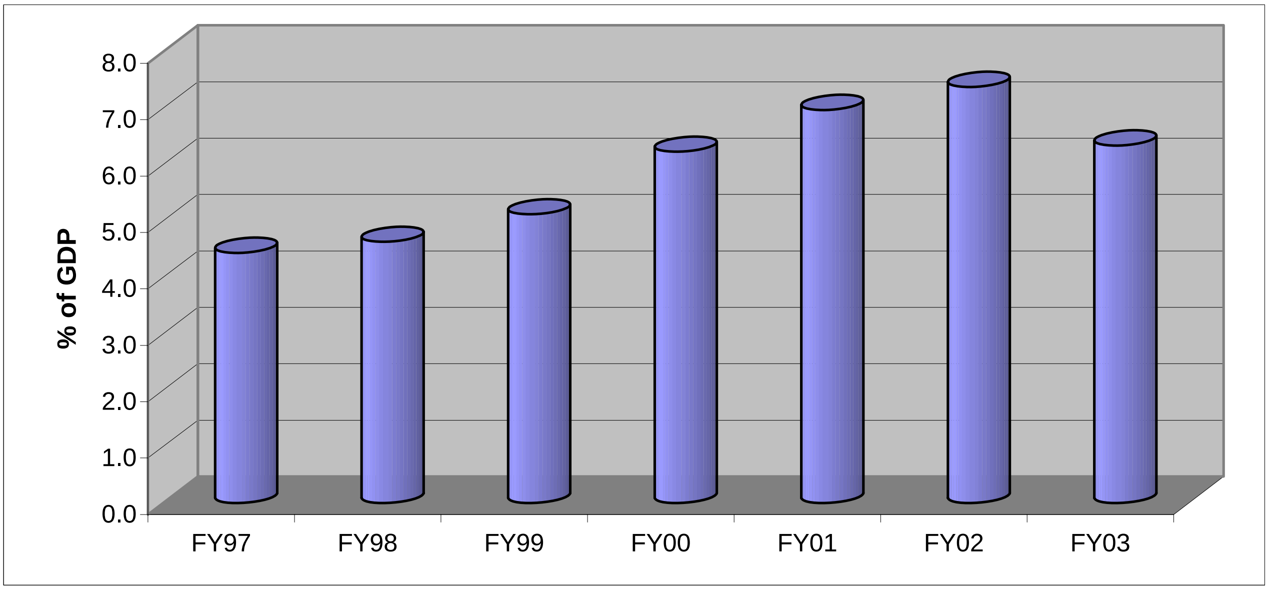
The low off-take of credit by the government and its related agencies during the period of FY03 apparently suggests of fiscal prudence; but the low demand for credit on the part of the government was basically determined by low level of its development expenditures. The private sector could pick up the slack in this context, but it seems that credit expansion in here as well remained constrained.

IV.2 Government Borrowing and Public Debt

High levels of government borrowing from the Bangladesh Bank as well as from the scheduled banks dominated the macroeconomic concerns since FY00. Total domestic outstanding debt as a share of GDP secularly rose from 13.0 percent in FY00 to 16.6 percent in FY02 (CPD, 2003). During this period one observes a change in the fiscal stance of the government as it moved away, partly from borrowing from the banking system to raising of funds through sale of savings certificates to the public and treasury bonds to non-bank financial institutions.

At the end of FY03, the net flow from the banking system (including both Bangladesh Bank and scheduled banks) to the government stood at Tk.190.6 billion. In FY03, the net decrease in government borrowing from the banking system amounted to Tk.11.03 billion, which was 144.35 percent less than the comparable figure in FY02. The outstanding government borrowing from the banking sector as share of GDP, as shown in Figure 7, decreased to 6.3 percent in FY03, while the comparable figure in FY02 was 7.4 percent.

Figure 7: Outstanding Government Borrowing from Banking Sector (Bangladesh Bank and Scheduled Bank)



Source: CPD (2003b) and Bangladesh Bank (1991-2003).

On the other hand, the government borrowing through National Savings Department (NSD) during FY03 was Tk. 94.19 billion and repayment of principal amounted to Tk 51.13 billion (CPD, 2003b). So the net sale amounted to Tk. 43.06 billion in 2003 which is 9.08 percent lower than that of in FY02 (Table 8). The government has lowered the interest rate in FY03 for savings certificates with the dual purpose of lowering cost of borrowing and channelling funds to the capital market. But the trend shows that the government's desire to push the small savers towards the capital market through decreasing the rate of assured return on public savings instruments has not yet yielded its results. The public continued to buy Tk. 7.85 billion worth of NSD certificates every month during FY03 in comparison to Tk. 7.30 billion in FY02.

Whatsoever, Table 8 indicates that the total government borrowing (net) from both banking and non-banking sources in FY03 amounted to Tk. 32.03 billion which was less than half (-55.66%) of the preceding year's draw. It has resulted in reverse borrowing by the government as it paid up more than borrowed. However, each a process was most evident in case of bank borrowing.

TABLE 8

NET GOVERNMENT BORROWING

(In Billion Tk)

Sources	FY02	FY03	Growth Rate (FY03 over FY02)
Net Government Borrowing from the Banking Sector	24.87	- 11.03	- 144.35
Net Non-bank Borrowing of the Government from the Public	47.36	43.06	-9.08
Total Government Borrowing (Net)	72.23	32.03	- 55.66

Source: Computed from CPD (2003b), Bangladesh Bank (1991-2003) and National Savings Directorate data.

IV.3 Agricultural Credit- Recover Higher than Disbursement

The agricultural credit delivery system since the post-1998 flood programmes had been low on disbursement and high on recovery. This resulted in net outflow of resources from the rural areas through the institutional credit system.

As per Table 9, during the period of FY03, against a target of Tk. 35.61 billion, a total amount of Tk. 32.79 billion was disbursed. This resulted in 10.96 percent growth in agricultural credit disbursement. Conversely, recovery grew in FY03 by 7.85 percent, indicating a net outflow of Tk. 2.37 billion from the rural economy.

TABLE 9
AGRICULTURAL CREDIT EXPANSION

(In Billion Tk.)

Year	Disbursement		Actual Recovery	Net Flow
	Target	Actual		
FY98	23.53	18.15	17.79	0.36
FY99	32.69	30.19	19.16	11.03
FY00	33.31	28.51	29.96	-1.45
FY01	32.66	30.20	28.78	1.42
FY02	33.27	29.55	32.60	-3.05
FY03	35.61	32.79	35.16	-2.37

Source: Computed from Bangladesh Bank (2002-2003)

At the end of FY03, default loan in the agriculture sector stood at Tk 119.13 billion, i.e. about percent of total outstanding balance which is about 4.91 percent higher than the comparable figure of the previous year (FY02). This being the elapsed fiscal year, net flow of agricultural credit continued to remain negative and share of default loans continued to rise.

IV.4 Industrial Credit

Term Loan

The flow of industrial credit (both sanctioned and disbursement) registered significant raise during the FY03 (Table 10). Against a disbursement of Tk.39.60 billion, recovery was Tk. 38.35 billion. In FY03 disbursement grew by 13.0 percent, while recovery grew by 19.62 percent. In FY02, the comparable figures were 14.7 percent and 15.1 percent. In FY01, the matching figures were 87.9 percent and 69.1 percent respectively (BB, 2003).

Term Loan

The flow of industrial credit, both sanctioned and disbursement registered a significant growth in FY03. Growth in recovery was also impressive (See Table 11). In FY03, a total amount of Tk.54.07 billion was sanctioned as term loan which was about 38 percent higher than the comparable figure of the preceding year. However, actual disbursement was for less roboust as it grew by only 13 percent which, in terms of annual flow, was little less than Tk. 40 billion. In contrast, Tk.38.40 billion was recovered on account of outstanding loans recording a 19.62 percent growth. In other words, the flow of industrial credit was marginally positive.

TABLE 10

SANCTION, DISBURSEMENT AND RECOVERY OF TERM LOAN

(In Billion Tk.)

Year	Sanction		Disbursement		Recovery	
	Amount	Growth Rate	Amount	Growth Rate	Amount	Growth Rate
FY98	16.08	39.58	11.20	-6.70	8.60	-3.40
FY99	17.41	8.27	13.30	18.80	10.90	26.70
FY00	25.26	45.03	16.30	22.30	16.50	51.40
FY01	37.71	49.35	30.60	87.90	27.90	69.10
FY02	39.24	4.06	35.10	14.70	32.10	15.10
FY03	54.07	37.79	39.60	13.00	38.40	19.50

Source: Computed from Bangladesh Bank (2002-2003).

An interesting trend regarding term loan financing, which has set in from FY01, needs to be pointed out in this respect. The nationalised commercial banks (NCBs) and development finance institutions (DFIs) together are no more the major source of industrial loans in Bangladesh (See Table 11). In FY03, only about 20 percent loan of the total term loan disbursed was provided by these two sources together.

TABLE 11

SANCTION AND DISBURSEMENT OF TERM LOAN

(In Billion Tk)

Year	NCB		DFI		PCB(D)		PCB(F)		NBFI		Total	
	Sanc-tioned	Dis-bursed	Sanc-tioned	Dis-bursed	Sanc-tioned	Dis-bursed	Sanc-tioned	Dis-bursed	Sanc-tioned	Dis-bursed	Sanc-tioned	Dis-bursed
FY98	3.90	2.53	0.86	1.54	2.54	2.33	6.35	2.39	2.44	2.41	16.08	11.20
FY99	5.93	3.48	0.35	0.65	2.98	2.99	3.69	2.69	4.46	3.49	17.40	13.30
FY00	5.61	3.33	0.61	0.79	9.28	5.28	4.41	2.60	5.34	4.27	25.25	16.27
FY01	7.83	5.26	1.42	1.21	16.65	12.55	3.36	4.51	8.44	7.02	37.71	30.57
FY02	9.46	4.99	0.89	0.48	16.05	16.59	4.43	5.38	8.40	7.60	39.24	35.05
FY03	13.95	6.69	2.42	1.36	20.57	16.01	5.64	6.09	11.49	9.47	54.07	39.62

Source: Computed from CPD (2003b) and Bangladesh Bank (2002-2003).

Conversely, the Private Commercial Banks of domestic (PCBs(D)) origin financed more than 40 percent of the disbursed term loans in FY03. Further, the non-banking financial institutions (NBFIs) underwrote about 24 percent of the term loan flow. On the other hand, foreign Private Commercial Banks (PCBs (f)) contributed about 15 percent of the amount flow. These trends signal positive changes in industrial financing in Bangladesh.

Working Capital

The flow of working capital also showed a significant increase in FY03- both in terms of sanction and disbursement (See Table 13). In FY02 the sanctioned amount increased by 9.34 percent, while the disbursement grew by 2.86 percent. On the other hand, in FY03 sanction and disbursement of working capital stood at Tk.137.66 billion and Tk.156.72 billion, accounting annual growth of 19.57 percent and 13.85 percent respectively.

TABLE 12

SANCTION AND DISBURSEMENT OF WORKING CAPITAL

(In Billion Tk.)

Year	NCB		DFI		PCB (D)		PCB (F)		NBFI		Total	
	Sanc-tioned	Dis-bursed	Sanc-tioned	Dis-bursed	Sanc-tioned	Dis-bursed	Sanc-tioned	Dis-bursed	Sanc-tioned	Dis-bursed	Sanc-tioned	Dis-bursed
FY98	39.64	35.42	0.73	1.00	11.33	16.35	27.32	13.03	0.12	0.12	79.14	65.91
FY99	40.58	37.52	1.35	1.30	15.98	22.85	27.73	17.14	0.26	0.25	85.89	79.06
FY00	43.77	43.43	1.51	1.45	24.56	32.22	28.14	28.55	0.86	1.17	98.84	106.82
FY01	39.79	39.82	2.75	3.61	35.42	51.26	25.25	33.52	2.09	5.62	105.30	133.82
FY02	40.45	39.20	2.90	4.00	49.17	68.23	21.80	23.45	0.81	2.76	115.13	137.65
FY03	37.67	34.30	2.18	2.74	67.85	87.33	29.31	29.71	0.64	2.64	137.66	156.72

Source: Computed from CPD (2003b) and Bangladesh Bank (2002-2003).

The expanding role of the PCBs(D) in support of the industrial sector get more pronounced in case of working capital financing (see Table 13). About 55.7 percent of the total working capital disbursed in FY03 is attributable to the PCBs(D). On the other hand, the NCBs and DFIs together financed 23.6 percent of the total working capital flow. It further transpires that the NBFIs contribute less than 2 percent of the total flow as it does not deal with short term financial transactions, usually not beyond its own projects. The foreign commercial banks accounted for about 18 percent of the annual working capital flow in FY2003.

IV.5 Loan Default Scenario Improves Marginally

The total amount of classified loans decreased to Tk. 219.7 billion in FY03 (as of June 30, 2003) from Tk. 244.6billio in FY02 n (as of June 30, 2002), registering a negative growth of about (-) 10.2 percent (See Table 13). Consequently, the share of classified loans in total outstanding loans decreased to 25.26 percent in FY03 from 31.08 percent in the preceding year.

TABLE 13

CLASSIFIED LOAN

(In Billion Tk.)

Type of Bank	As of 30-06-2003			As of 30-06-2002			Annual growth of total classified
	Total Outstanding	Total Classified	Classified as % of Total	Total Outstanding	Total Classified	Classified as % of Total	
NCBs	359.20	117.89	32.82	339.58	130.70	38.49	-9.80
DFIs	100.03	48.24	48.23	108.44	61.68	56.88	-21.79
PCB(D)	351.34	52.31	14.89	293.32	50.98	17.38	2.61
PCB(F)	59.27	1.28	2.16	45.56	1.24	2.72	3.23
All Banks	869.84	219.72	25.26	786.90	244.60	31.08	-10.17

Source: Computed from CPD (2003b) and Bangladesh Bank-BRPD Data.

Both the NCBs and DFIs made significant progress in FY03 in reducing the total classified loan by recording negative growth rates of (-) 9.8 percent and (-) 21.8 percent respectively over the preceding year (FY02). For NCBs and DFIs, the share of classified loans in total outstanding loans also decreased from 38.5 percent and 56.9 percent in FY02 to 32.8 percent and 48.2 percent respectively in FY03. Curiously, for both the domestic and foreign PCBs, the total classified loan has increased in FY03, registering annual growth of 2.6 percent and 3.2 percent respectively over the previous year.

IV.6 Consumer Price Inflation UP

Till FY02, the Bangladesh Bureau of Statistics (BBS) reported Consumer Price Index (CPI) inflation data with reference to the consumption weights and prices of FY86 as the base year. From FY03, the BBS has commenced reporting inflation data using FY96 as the new base year. The principal changes arising from the rebasing are: (i) the consumption baskets for both rural and urban CPI have higher numbers of items, with weights based on the FY96 Household Expenditure Survey (HES), (ii) the food component in both rural and urban CPI baskets now has lower weight than before, although it still remains dominant in the rural CPI basket, and (iii) in aggregation for national level CPI, the rural CPI has lower weight in the new case reflecting increased urbanisation of the country side.

The general inflation rate based on Consumer Price Index (CPI), on a point to point basis (FY96=100), increased from 3.58 percent in end June FY02 to 5.03 percent in end June of FY03 end June (See Table 14 and Figure 8). However, two disturbing features of the recent rise in the price level may be noted. First, the inflation rate during the period FY03 had been higher in the rural area in comparison to its urban counter part. Second, increase in both food price and non-food prices during abovementioned period had been higher in the rural areas.

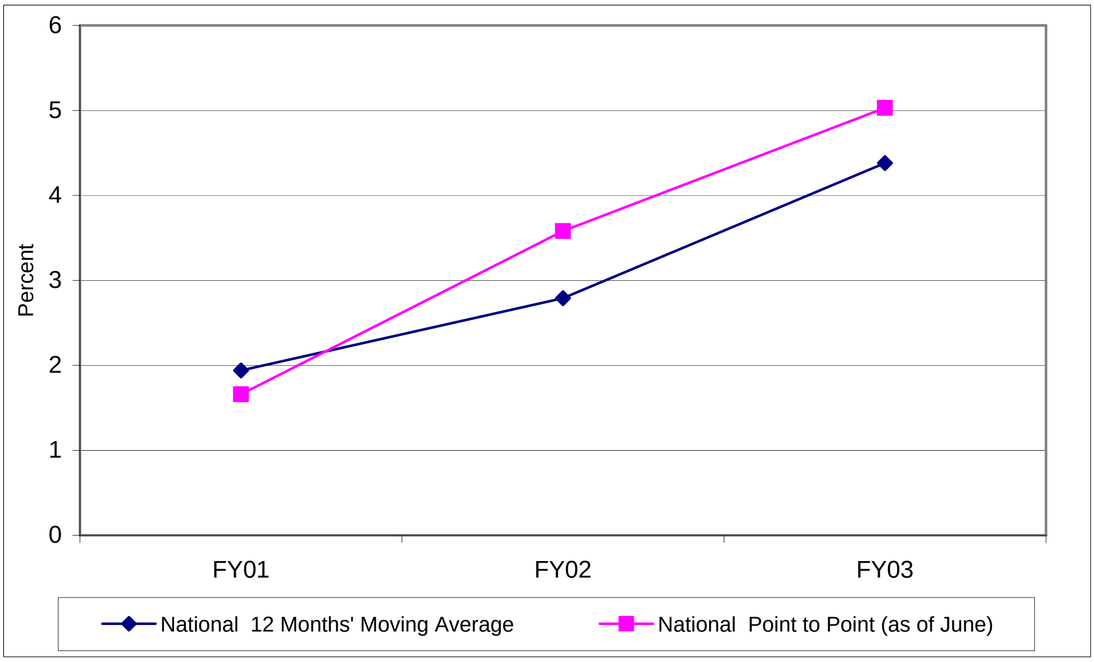
TABLE 14
INFLATION RATE
(Base: FY1996=100)

Year	National		Rural		Urban	
	12 Month Moving Average	Point to Point (as of June)	12 Month Moving Average	Point to Point (as of June)	12 Month Moving Average	Point to Point (as of June)
FY01	1.94	1.66	2.11	1.52	1.52	1.99
FY02	2.79	3.58	2.57	3.40	3.35	4.03
FY03	4.38	5.03	4.73	5.34	3.52	4.27

Source: Computed from CPD (2003b) and BBS (1995-2003a).

The inflation rate, expressed through a moving average of 12 months observations, also demonstrates an increasing trend. The inflation rate (moving average) has increased from 2.79 percent in FY02 end June to 4.38 percent in FY03 end June.

Figure 8: National Inflation FY01-FY03



Source: Computed from CPD (2003b) and BBS (1995-2003a).

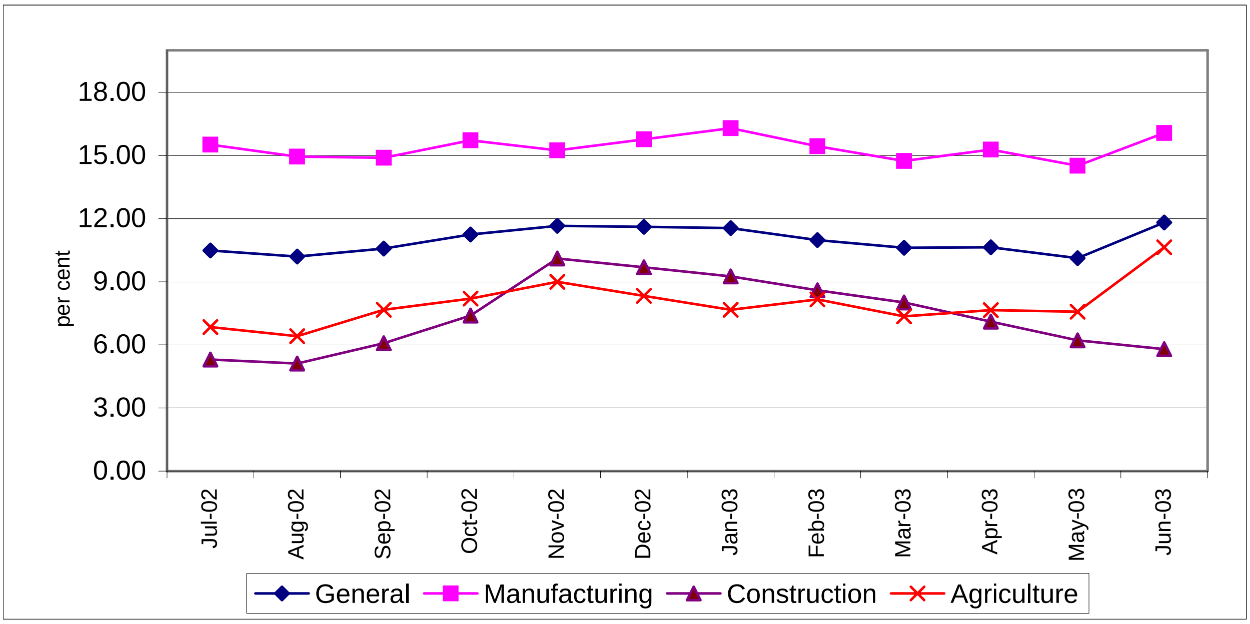
The food inflation, on point to point basis, was higher than the non-food inflation, but the non-food inflation (moving average) was higher than food inflation. For instance, non-food inflation in FY03 on point-to-point and moving average basis was 4.68 and 5.66 percent respectively. The matching figures for food inflation were 5.22 and 3.46 percent respectively.

Of course, there is no reason yet for panic because of the current level of inflation. Indeed some would say that a "little inflation" is good for stimulating investment. However, the recent moderate rise in price level is largely a “cost push” rather than a “demand pull” phenomenon. Increase in price of fuel, public utility rates and exchange rate adjustment may have been responsible for this. Temporary disruption in the domestic supply chain due to limited floods may have contributed to it as well.

IV.7 Wage Inflation also on Rise

The concern for price inflation becomes serious when we consider the recent trend in wage inflation. The general wage index grew by more than 10 percent during FY03; it was only 7.37 percent in FY02 (See Figure 9). The point-to-point increase in manufacturing wage index grew to 16.07 percent in FY03 compared to 8.68 percent in FY02. On the other hand, agricultural wage index was 10.64 percent in FY03 against 6.59 percent in FY02. However, construction wage index remained more or less steady 5.8 percent in FY03 in comparison to 5.55 percent in FY02.

Figure 9: Wage Inflation by Sectors



Source: Computed from CPD (2003b) and BBS (1995-2003a).

In an economy with strong unionised collective bargaining for wages, this could have signified a pressure of wage push inflation. In Bangladesh collective wage bargaining is yet to gain strong ground, with only about a fifth of the total labour force in formal sector employment. The wage rate index increase probably reflects actual increase in demand for the related skills in the economy, which gained momentum after the FY02 slowdown. Migration of workers to job markets abroad is also likely to have an impact in pushing up wage levels in the domestic labour market. That wage rate increases exceeded the consumer price inflation levels even for the relatively lower skilled agriculture and fisheries sectors signifies the gradual decline of poverty in the lowest income brackets of the population.

V. PERFORMANCE OF THE REAL ECONOMY

V.1 Agriculture Sector Varying Performance

Growth in overall agriculture sector in FY03 has been estimated to be 3.6 percent. However, different components of the sector demonstrated varying growth (See Table 15). While growth in the forestry sub-sector is estimated to be the 4.96 highest (4.96 percent), followed by that in livestock (4.51 percent) moderate growth was demonstrated by crop and horticulture sub-sector with fisheries recording only 2.33 percent growth. Performance of different sub-sectors of agriculture and the underlying reasons for such performance have been discussed below.

TABLE 15

ANNUAL GROWTH OF AGRICULTURAL OUTPUT

(Base FY1996=100)

(Percent)

Year	Agriculture	Crops and Horticulture	Forestry	Livestock	Fisheries
FY98	1.64	1.07	4.49	2.65	8.98
FY99	3.24	3.12	5.19	2.69	9.95
FY00	6.92	8.10	4.93	2.74	8.87
FY01	5.53	6.18	4.84	2.80	-4.53
FY02	-0.62	-2.39	4.92	4.70	2.23
FY03	3.59	3.21	4.96	4.51	2.33

Source: Computed from CPD (2003b) and Bangladesh Bureau of Statistics.

Foodgrain Production Below Trend

As per final estimate of the BBS, actual foodgrain production for FY03 was 25.96 million metric tons which was 7.55 percent lower than the target of 28.08 million metric tons (See Table 16). Contribution of various seasonal harvests to the aggregate production in FY03 was as follows: Aus rice - 1.85 million metric ton (7.1 percent) Aman rice - 11.11 million metric ton (42.8 percent), Boro - 11.60 million metric tons (44.7 percent) and wheat - 1.4 million metric ton (5.4 percent). Aus production was slightly more than the target, while Aman production was 3 percent less than the target and Boro production was 10.97 percent less than the target. On the other hand, wheat production in FY03 had been less by 20 percent than that of the targeted amount of 1.75 million metric ton.

In other words, total rice production was 1.03 percent higher than that of FY02. Total foodgrain production in FY03 increased by only 0.15 percent. More importantly, the total foodgrain production in FY02 was 3.14 percent lower than that of FY01, while the rice production was 3.11 percent less.

TABLE 16
FOODGRAIN PRODUCTION

(In Mln. M Ton)

Year	Rice				Annual Growth of Rice Production (%)	Wheat	Total Foodgrain	Annual Growth of Foodgrain Production (%)
	Aus	Aman	Boro	Total				
FY97	1.87	9.55	7.46	18.88	6.73	1.45	20.34	6.70
FY98	1.87	8.85	8.14	18.86	-0.11	1.80	20.66	1.62
FY99	1.62	7.73	10.05	19.40	2.86	1.91	21.31	3.15
FY00	1.73	10.30	11.03	23.06	18.87	1.84	24.90	16.85
FY01	1.92	11.25	11.92	25.09	8.80	1.67	26.76	7.47
FY02	1.81	10.73	11.77	24.31	-3.11	1.61	25.92	-3.14
FY03	1.85	11.11	11.60	24.56	1.03	1.40	25.96	0.15
FY04 (Target Figures)	1.85	11.74	13.03	26.62	9.50	1.50	28.12	8.32

Source: Computed from CPD (2003b) and BBS- Agricultural Division data.

Rising Import of Foodgrain

It may be pointed out that foodgrain import increased significantly during FY03 as its value amounted to US$ 412.7 million, i.e. about 100 percent more than the matching figure for FY02 (US$ 186.0 million). During FY03, value of new L/Cs opened for importing foodgrains amounted to about US$ 642.06 million which is about 200 percent more than the comparable figure for FY02 (BB, 2002-2003). Increase in import of foodgrain was encouraged by low import duty of rice (reduced to 7.5 percent in July 2002 from 34 percent) and low production of wheat as well as by subsidised export of foodgrain by India. Food Corporation of India (FCI) off loaded rice and wheat for export purpose at half of their economic cost during FY03.

V.2 Lacklustre Manufacturing Production

According to the estimates, 1988/89 as base year provided by the BBS, the industrial sector (including manufacturing, electricity, and mining and quarrying) has grown at the rate of 4.6 percent in FY03, against the growth rate of 4.7 percent in FY02(see Table 17), The Quantum Index of production in FY03 grew by 4.57 percent over the period of FY02. On the other hand, small enterprise grew by 5.48 percent.

TABLE 17

GROWTH OF INDUSTRIAL PRODUCTION

(Base = 1988/89)

Year	All Industry	Mining and Quarrying	Manufacturing		Electricity
			Large and Medium	Small (1995/96=100)	
FY 98	8.17	7.14	9.28	6.77	8.65
FY99	5.35	3.52	4.20	0.63	7.68
FY00	5.22	14.20	4.97	15.00	6.25
FY01	7.01	12.34	6.59	9.77	10.28
FY02	4.75	5.03	4.52	7.65	7.13
FY03	4.61	5.86	4.57	5.48	4.78

Source: Computed from CPD (2003b) and BBS (1995-2003b).

As reported in Table 18, the frontrunners in terms of output growth included fertiliser (28 percent), pharmaceuticals (11 percent), cloth (11 percent), garments (7 percent) and soap & detergent (6 percent). In contrast, negative growth of output was posted by M.S rod (-90 percent), paper (-19 percent), and jute sacking (-12 percent), jute Hessian (11 percent) (BB 1995-2003b). The manufacturing sector in FY03 was greatly affected by the severe deceleration of the jute textile and M.S rod production.

TABLE 18

TREND IN PRODUCTION OF MAJOR INDUSTRIES IN FY03

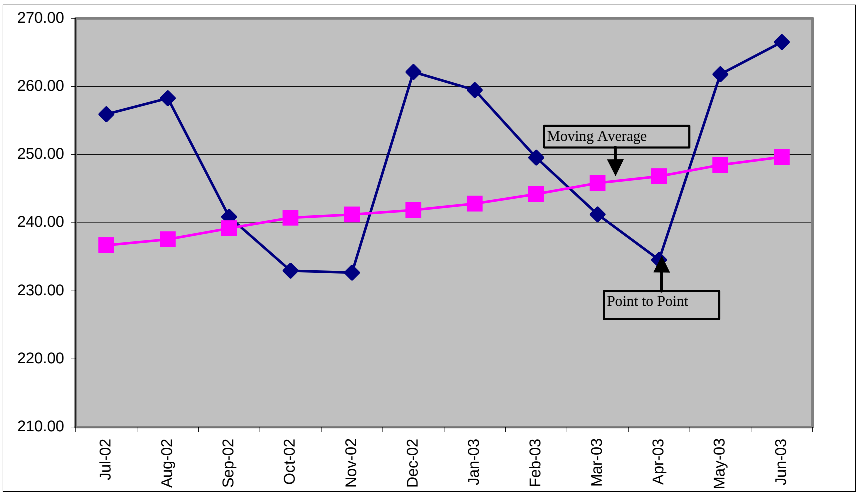
Industry	Unit	Weight	July-June FY03	July-June FY02	percent change Point to Point	percent change x Weight
1. Jute Textile	mt	14.07	312053	351864	-11.31	-159.19
Hessian	mt		66024	73948	-10.72	-150.77
Sacking	mt		181483	205580	-11.72	-164.92
Carpet backing cloth	mt		34416	37655	-8.60	-121.03
Others	mt		30130	34681	-13.12	-184.63
2. Cotton Textiles		7.83				
Yarn	mt		64401	65576	-1.79	-14.03
Cloth	000' metre		17834	16138	10.51	82.29
3. Garments	million Tk.	9.13	191471	179381	6.74	61.53
4. Paper	mt	2.26	30212	37387	-19.19	-43.37
5. Fertiliser	mt	11.34	2236518	1753530	27.54	312.35
6. M.S. Rod	mt	1.91	16946	162773	-89.59	-171.12
7. Cement	mt	1.17	1735759	1729406	0.37	0.43
8. Petroleum Products	mt	0.66	1351080	1331113	1.50	0.99
9. Cigarettes	million sticks	2.10	20418	20384	0.17	0.35
10. Matches	000' gross box	0.35	12127	11875	2.12	0.74
11. Drugs & Pharmaceuticals	000" Tk.	7.01	18787861	16963040	10.76	75.41
12. Tea	mt	7.87	55455	55916	-0.82	-6.49
13. Salt	mt	0.30	39491	40575	-2.67	-0.80

14. Edible Oil	mt	0.44	31833	31438	1.26	0.55
15. Soap & Detergent	mt	1.74	44982	42436	6.00	10.44
Sum		**68.18**				**-312.07**
Weighted Growth Rate						-4.58

Notes: 1. mt means Metric Ton.
2. The growth of the cotton textiles reflects only the performance of yarn textiles.

Source: Computed from CPD (2003b) and BBS (1995-2003b).

Figure 10: QIP of Large and Medium Manufacturing Industries



Source: Computed from CPD (2003b) and BBS (1995-2003b).

The lacklustre growth of the manufacturing sector is largely attributable to the visible withering away of the jute industry in Bangladesh. During the period FY03 production fell in all categories of jute products (i.e. hessian, sacking, carpet backing, etc.), both in public and private sector enterprises. This process has been accelerated by the liquidation of the Adamjee Jute Mills. The weight of the jute textiles, as reported under the QIP, is still as high as 14.1 percent (18). Along with the jute sector, among the major industries, the fall in production of paper and petroleum products is also discernible.

V.3 Foreign Investment Marginally Decreases

A new round of debate on estimates of foreign direct investment has once again remerged following publication of foreign direct investment (FDI) inflow data for the first half of the calendar year 2003 by the Board of Investment (BOI). There is no scope for an elaborate discussion here on whether internationally accepted accounting methods of FDI, in the context of practices in Bangladesh, have been used by the BOI. Although there is a high probability that FDI flow remains underreported in the BOI statement in Bangladesh as it often does not fully capture capital machinery brought in, reinvested earning and intercompany loans under appropriate heads. Curiously, the BOI statement in Both Currently do not include foreign investments in the EPZs. However, the central bank still remains the final authority to confirm the FDI estimates.

In FY03, Bangladesh received a net amount of US$196.63 million as foreign investment, of which US$92 million i.e. 46 percent came as foreign direct investment (FDI) in the domestic tariff area (DTA) and another US$103.13 million (i.e. 5.2 percent) in the Export Processing Zone (EPZ) (See Table 19). Net flow of FDI has increased 42.1 percent in FY03. In contrast, foreign investment in the EPZ recorded a more than 85 percent increase in FY03, continuing the recovery since the drop in FY00, consequent to the controversy surrounding the trade union rights issues in the country's EPZs (CPD 2003).

After a secular fall from the peak in FY98 (i.e. the days of high FDI flow to the energy sector) till FY02, foreign investment for the first time recorded an increase in FY03 (US$196.63 million from US$114.80 million). It seems that the figure may rise further in FY04, but largely in the EPZs. However, the resurgence of the controversy regarding trade union rights in the EPZs, reflecting the concerns of Bangladesh's largest export market, the USA vis-a-vis the concerns of some of Bangladesh's largest sources is investment in the EPZ, drawn from Japan and the Republic of Korea needs to be reserved without prejudice either to Bangladesh's export or investment prospects. This may be no easy task.

However, notifying the recorded increase to a meager US$200 million current level of PRDF flow appears very pale in comparison to other comparable countries, for example Vietnam. This, in spite of all the proactive policy pronouncement and expensive road, shows FDI continues to sly away from Bangladesh.

TABLE 19
FOREIGN INVESTMENT

(In Million US$)

Year	FDI			Portfolio Investment			Foreign Investment in EPZ	Total Net Inflow of Foreign Investment
	Inflow	Outflow	Net Inflow	Inflow	Outflow	Net Inflow	(Net Inflow) [a]	
1996/97	17.00	1.00	16.00	16.00	148.00	-132.00	53.88	-62.12
1997/98	273.00	24.00	249.00	14.00	11.00	3.00	68.82	320.82
1998/99	200.00	2.00	198.00	3.00	9.00	-6.00	70.61	262.61
1999/00	194.40	0.80	193.60	10.70	10.60	0.10	34.98	228.68
2000/01	166.10	0.10	166.00	5.90	6.30	-0.40	48.41	214.01

2001/02	65.24	0.56	64.68	0.50	6.09	-5.59	55.71	114.80
2002/03	94.90	3.00	91.90	2.00	0.40	1.60	103.13	196.63

Note: [a] Includes investments in joint-venture enterprises with local entrepreneurs.
Source: CPD (2003) and unpublished data from Bangladesh Bank and BEPZA.

V.4 Capital Market

The recovery of the capital market remains painfully slow since the boom and bust episode of the 1996. New investment through Initial Public Offer (IPO) was Tk.311 million in FY03, (See Table 20). The amount of total market capitalisation at the Dhaka Stock Exchange (DSE) at the end of FY03 was US$ 1.26 billion which was 10.53 percent higher (in dollar terms) than that of in compare to FY02. On the other hand, amount of total market capitalisation at the Chittagong Stock Exchange (CSE) increased by 7.15 percent from Tk.56.19 billion in FY02 to Tk.60.21 billion in FY03 (See Table 22).

The capital market in Bangladesh remains shallow, and is yet to emerge as a major source of equity financing in the industrialisation process. It appears the discrete benefits offered in the budget for FY03 along with cuts in the interest rates of the NSD certificates have yet failed to bring back the small investors to the secondary market of shares and securities.

At the end of FY03, the All Share Price Index of DSE increased to 830.46 compared to 792.56 in FY02 that is 4.78 percent higher than previous period. Eight companies raised new equity through the primary market in FY03 compare to nine companies in FY02 (DSE 2003). In case of CSE at the end of FY03 the all share price index increased to 1395.04 compare to 1315.68 in FY02 that is 6.03 percent higher than the previous period (CSE 2003).

TABLE 20
INITIAL PUBLIC OFFERINGS (DSE)

(*In Million Tk.)*

Year	Number of Company	Sponsors Equity	Securities Offered	Amount Subscribed	Rate of Over-subscription (%)
FY97	18	2998	1384	17582	1170.40
FY98	10	1064	410	1166	184.10
FY99	7	946	406	669	65.00
FY00	11	2047	298	653	119.60
FY01	10	857	175	902	415.40
FY02	9	1138	183	640	249.90
FY03	8	48630	311	1921	517.70

Source: Computed from CPD (2003) and DSE (2003).

TABLE 21
CAPITAL MARKET (DSE)

Year (End June)	All Share Price Index (As of End June)	Market Capitalisation (in Billion US$)	Listed Securities (Including Mutual Fund and Debenture)
FY98	676.47	1.30	224
FY99	546.79	1.06	230
FY00	561.00	1.07	239
FY01	716.06	1.34	244
FY02	792.56	1.14	257
FY03	830.46	1.26	260

Source: Computed from CPD (2003) and DSE (2003).

TABLE 22
CAPITAL MARKET (CSE)

Year (End June)	All Share Price Index (As of End June)	Market Capitalisation (In Billion Tk.)	Listed Securities (Including Mutual Fund and Debenture)
FY99	222.06	40.95	154
FY00	1173.89	44.84	161
FY01	1502.40	62.82	171
FY02	1315.68	56.19	184
FY03	1395.04	60.21	185

Source: Computed from CPD (2003) and CSE (2003).

VI. EXTERNAL SECTOR[4]

VI.1 Export Recovers

In FY02 exports declined by 7.4 percent – the first ever such decline in the last two decades (See Table 22). The fall in export earnings was experienced across the board by almost all export items. The external sector in FY03 performed, in terms of total revenue, better than in the previous year, although fall in the price index of Bangladeshi exportable could be continued only marginally. With 9.4 percent of growth, the export was back to a positive trend. According to the Statistics for FY03, the chemical, raw jute, frozen food and knitwear recovered and demonstrated strong growth of 51.0 percent, 34.9 percent, 16.6 percent, and 13.3 percent respectively. However, growth of tea, leather and handicrafts was still negative (-) 11.0 percent, (-) 7.8 percent and (-) 2.8 percent respectively (EPB:2003).

The net fall in receipts from woven-RMG exports is currently the major concern regarding Bangladesh's exports. It seems that the advent of the third phase of quota integration (which started in January 1, 2002) under the WTO Agreement on Textiles is foreshadowing the

[4] For a more detail analysis of performance of the external sector, see the companion chapter of this volume.

impact of full phase-out of the Multi-Fibre Arrangement (MFA) for Bangladesh. It may be pointed out that under the third phase of ATC, two items of Bangladesh’s export internal have been made quota-free and Bangladesh has lost out significant market shares to China and India in both these commodities. For example, in terms of exports of babies garments (category 239) and robes (category 350 and 650), Bangladesh's export (in volume terms) declined by 18 percent and 6 percent respectively, whilst China was the major gainer. Thus, there is an urgent need to comprehensively review the textile and RMG related issues to undertake integrated and focused policy measures.

TABLE 23

Growth of Export

Items	FY98	FY99	FY00	FY01	FY02	FY03
Raw Jute	-7.40	-33.40	0.30	-6.70	-9.00	34.90
Tea	24.50	-18.80	-53.30	19.90	-19.50	-11.00
Leather	-2.70	-11.60	15.90	30.20	-18.40	-7.80
Frozen Food	-8.40	-6.60	25.40	5.60	-24.00	16.60
Jute Goods	-11.50	7.30	-11.90	-13.40	5.70	5.60
Handicraft	5.80	27.00	5.10	-9.90	-15.10	-2.80
Readymade Garments	27.10	5.00	3.30	9.10	-7.10	4.30
Knitwear	23.20	10.10	22.70	17.80	-2.50	13.30
Chemical	-31.60	6.80	18.00	3.90	-31.50	51.00
Others	19.80	19.30	-9.40	39.10	-7.40	26.30
Total	16.80	4.80	6.40	12.30	-7.40	9.40

Source: Computed from CPD (2003), Bangladesh Bank (2003) and Export Promotion Bureau (2003)

It seems that the export performance of the primary goods sector had been better than its manufacturing counterpart in the recent months. The primary goods sector has experienced a growth of 18.52 percent in FY03, while the growth in manufacturing sectors was only 8.76 percent. However both primary and manufacturing sector have secured more than 100 percent of their respective target. As mentioned earlier, the volume index (7.08 percent) contributed more to incremental export growth in comparison to the growth of price of 2.31percent in FY03 (EPB 2003).

VI.2 Robust Import Growth

The slowdown of imports in FY02 was due to a combination of factors which included regulatory measures taken by the government to release pressure on the depleting foreign exchange reserve. This was coupled with decline in import of raw materials for the RMG sector due to a drastic fall of exports. Thus, import payments recorded a negative growth of 8.8 percent in FY02 (CPD 2003).

The import growth demonstrated a positive streak during the FY 2003 recording 13.0 percent growth. This robust growth of imports was achieved due to high import demand of commodity such as sugar, spices, foodgrain, coconut oil and edible oil, etc. On the other hand, import of cement, oil seeds and yarn decreased by 63.3 percent, 11.7 percent and 4.7 percent respectively (Bangladesh Bank 2003b).

According to information on L/C opening, the import of consumer items had a extraordinary high growth (around 200 percent), while the import of intermediate goods was negative (-5.23 percent). The import of capital machinery experienced a positive growth (43.46 percent). Import of industrial raw materials, petroleum products and machinery for miscellaneous industries also registered a positive growth during the period. Analysis of information on L/C settlement for the period FY03 reveals import growth of 12.83 percent over the previous period FY02. However, this robust growth in aggregate import was achieved largely due to high import of certain consumer goods (foodgrain 131.95 percent).

VI.3 Remittance Flow Remains Buoyant, Foreign Reserve Surges

Remittances, in the recent past, have emerged as the saving grace of Bangladesh economy. Remittance flow for the first time crossed the threshold level of US$3.0 billion in FY03 clocking 22.4 percent annual growth (See Table 23).

The investment flow of foreign remittances was underpinned by layer number of workers going abroad. More than 240 thousand Bangladeshi workers went abroad in FY03 which was about 30 percent more than that of the previous year.

TABLE 24

FOREIGN REMITTANCE AND FOREIGN EXCHANGE RESERVE

(In Million US$)

Year	Remittance	Annual Growth Rate (%)	No. of Workers Abroad (000)	Annual Growth Rate (%)	Forex Reserve (As of 30 June)	Point to Point Growth (%)
FY98	1525.43	3.39	243	6.58	1739.24	1.18
FY99	1705.74	11.82	270	11.11	1523.26	-12.42
FY00	1949.32	14.28	248	-8.14	1602.08	5.17
FY01	1882.10	-3.45	213	-14.11	1306.74	-18.43
FY02	2501.13	32.89	186	-12.68	1582.90	21.13
FY03	3061.97	22.42	241	29.57	2469.57	56.02

Source: CPD (2003) and Bangladesh Bank (1991-2003).

VI.4 Foreign Aid Commitment Improves, Disbursement Lags

In FY03 foreign aid committed to Bangladesh amounted to about US$2179 million, whilst actual disbursement was in the region of US$1553 million (See Table 24). The level of foreign aid commitment in FY03 was more than 100 percent higher in comparison to the previous year. After a secular decline in the volume of foreign aid disbursement since FY99, a growth of more than 7.77 percent was recorded in FY03 compared to the preceding year. Foreign aid commitment and disbursement in FY02 were US$879 million and US$1442 million respectively (ERD 2003).

TABLE 25

FOREIGN AID AND DEBT SERVICES

(In Million US$)

Year	Foreign Aid			Debt Services		Outstanding External Debt[a]	Total Foreign Currency Earnings[b]	Outstanding External Debt as % of GDP	Debt Service as % of Foreign Currency Earnings
	Commi-tment	Disbur-sement	Pipe line	Principal	Interest				
FY98	1791	1251	4697	307	137	13418	6687	30.50	6.60
FY99	2648	1536	4896	373	166	14354	7019	31.40	7.70
FY00	1475	1587	5980	447	172	15727	7702	33.40	8.00
FY01	2053	1369	5752	438	159	14677	8349	31.20	7.20
FY02	879	1442	5858	435	151	15885	8487	33.40	6.90
FY03	2179	1553	5450	452	156	16953	9610	33.30	6.30

Notes: [a] Excluding the IMF loan.
[b] Total Foreign Currency Earnings = Total Export income + Annual Remittances.

Source: Computed from ERD (2003) and Finance Division (2003a).

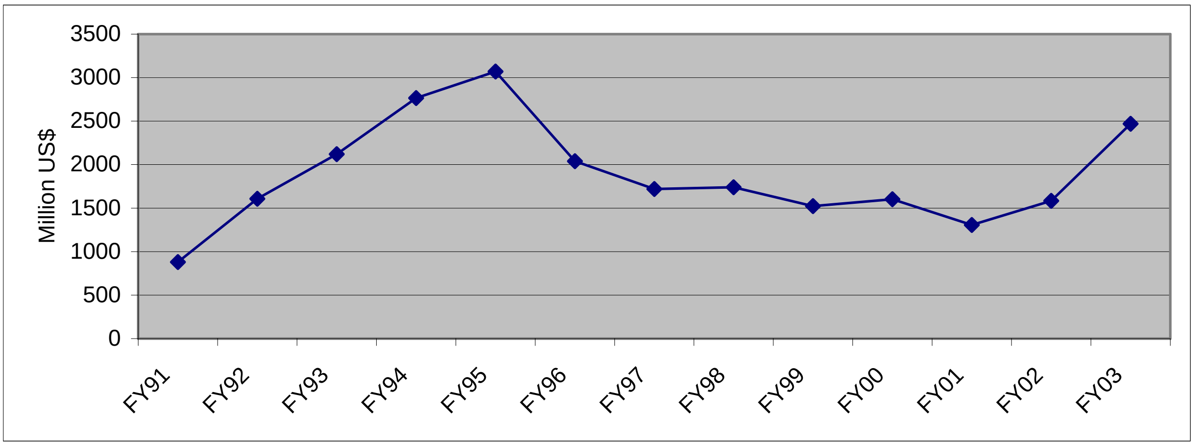
However, the foreign debt situation in Bangladesh remains under control. The total outstanding external debt of the country as of June 2003 was US$16.95 billion (a little above 33 percent of GDP), which was 6.72 percent higher than the previous year. The repayment of external debt in FY03 amounted to US$608 million with 25.7 percent accounting for interest payment. The foreign debt serving liability in FY03 accounting for a reasonable 6-3 percent of total foreign exchange earnings of the country..

VI.5 Foreign Exchange Reserve Surges

The draw down on the foreign exchange reserve, which set in FY95, was reversed in FY02 (See Figure 11). The foreign exchange reserve bounced back to US$1.58 billion at the end of FY02 from US$1.11 billion in November 2001, registering a growth of 42.34 percent. The positive trend in the growth of foreign exchange reserve continued during the FY03 and it bounced to US$2.5 billion at the end of period. This amount was equivalent to 91 days of import. In June 2002 the import equivalent of foreign exchange reserve was for 68 days only.

At the end of FY03 the point to point growth of foreign exchange reserve was as high as 56.02 percent (Bangladesh Bank: 1991-2003).

Figure 11: Foreign Exchange Reserve
(as of end June)



Source: Computed from Bangladesh Bank (1991-2003).

Further strengthening of foreign exchange reserve has taken place in the FY03 thanks to export resurgence, flow of workers' remittances and greater disbursement of foreign aid.

VI.6 Strengthening Balance of Payments

Given the movement of various external sector variables described earlier, Bangladesh's balance of payment situation, during the period FY03, has improved further (See Table 26). The positive current account balance continued to remain positive and reached US$328 million, which was more than 36.7 percent higher than the previous period. The surplus in the current account balance owed to the robust growth of remittance which was more than US$3 billion in FY03. However, the capital account did not distinguish with a pale US$92 million worth of foreign direct investment. The foreign direct investment during FY03 period was US$27 million more than it was in previous period. The suppliers' credit weakened the composition of the capital account, where the outflow amounted to US$431 million. As a whole, the balance of payments situation was under control.

TABLE 26

BANGLADESH BALANCE OF PAYMENT (FY98-FY03)

(In Million US$)

Source	FY98	FY99	FY00	FY01	FY02	FY03
Trade Balance	**-1669**	**-1934**	**-1865**	**-2011**	**-1768**	**-2207**
Export, fob (including EPZ)	5103	5283	5701	6419	5929	6492
Imports, cif (including EPZ)	-6772	-7217	-7566	-8430	-7697	-8699

Services (net)	**-570**	**-603**	**-645**	**-914**	**-499**	**-688**
Receipts	707	707	849	759	865	887
Payments	-1277	-1310	-1494	-1673	-1364	-1575
Income (net)	**-100**	**-135**	**-221**	**-264**	**-319**	**-195**
Receipt	91	91	97	97	50	64
Payment	-191	-226	-318	-361	-369	-259
Current Transfers	**1876**	**2195**	**2394**	**2171**	**2826**	**3418**
Official	126	220	165	72	69	60
Private	1750	1975	2229	2099	2757	3358
of which worker's remittances	1525	1706	1949	1882	2501	3062
Current Account Balance	**-463**	**-477**	**-337**	**-1018**	**240**	**328**
Capital Account (net)	**445**	**387**	**561**	**432**	**410**	**392**
Capital Transfers	445	387	561	432	410	392
Financial account	**237**	**-395**	**-185**	**407**	**71**	**302**
Direct Investment	249	198	194	174	65	92
Portfolio Investment	3	-6	0	0	-6	2
Other Investment	-15	-587	-379	233	12	208
MLT Loans	706	821	806	790	733	937
MLT Amortisation Payments	-308	-341	-396	-416	-421	-431
Other Long Term Loans (net)	-47	-41	127	-13	-42	-20
Other Short Term Loans (net)	168	-78	56	86	20	226
Other Assets	-41	-58	-55	-68	-52	-81
Trade Credit (net)	-522	-829	-641	-260	-253	-494
Commercial Bank	29	-61	-276	114	27	71
Assets	-19	-31	-161	147	-90	217
Liabilities	48	-30	-115	-33	117	-146
Error and Omissions	**-88**	**267**	**125**	**-47**	**-356**	**-123**
Overall Balance	**131**	**-218**	**164**	**-226**	**365**	**899**
Reserve Assets	**-82**	**218**	**-164**	**226**	**-365**	**-899**
Bangladesh Bank	-131	218	-164	226	-365	-899
Assets	-14	205	-79	302	-276	-887
Liabilities	-117	13	-85	-76	-89	-12

Source: Computed from CPD (2003) and Bangladesh Bank (2002-2003).

VII. CONCLUDING OBSERVATIONS

The foregoing analysis allows us to conclude that the three major macroeconomic trends observed by the CPD at the close of FY02 have strengthened further during FY03. Together these three trends project a mixed picture of the state of economy.

First, the fiscal balance has experienced further consolidation during FY03 due to collection of revenue (NBR component) in line with the target set by the budget. This process was complemented by high control exercised by the government on public expenditure, particularly with respect to ADP. This has contributed to restrained borrowing by the government, albeit temporarily, from the banking system. Although borrowing from the public through sale of NSD Certificates has increased in the said period. In this connection, ability to incrementally draw on foreign sources of financing for underwriting the fiscal deficit will provide necessary breathing space to the monetary policy.

Second, the country's balance of payment has also improved further due to continued high flow of foreign remittances, partial recovery in the export sector and manageable growth in import payments. Consequently, foreign exchange reserve, although still not above the safe limit, has demonstrated incremental growth. However, there is no scope to ignore the vulnerability of the external balance given the fragility of export resurgence and the unpredictability which generally characterises the remittance flow. Low disbursement of foreign aid and meager flow of FDI have accentuated the vulnerability of the external balance.

Third, signs of investment stagnation, as shown by the modest manufacturing growth, have become more manifest during the FY03. Continuation of investment stagnation is borne out by the marginal increase in off-take of term industrial loan disbursement as well as import of capital machinery. Higher level of L/C opening in FY03 (on point to point basis) does not foretell real growth in import as imports practically collapsed in the preceding year at this time subsequent to the terrorist attacks in the USA. High demand for NSD Certificates and increase in time deposits in the schedule banks, in spite of interest rate rationalisation, suggest that investors' confidence level continues to be abysmally low. The moribund state of the stock market further reinforces this observation. Thus, strengthening of the macroeconomic fundamentals and the fiscal stimuli provided in the budget for FY03 have had no discernible effect in dynamising the micro-economic behaviour in Bangladesh during the FY03.

One of the new developments of the FY03 had been the creeping rise in the inflation rate with its rural bias. Whilst the current inflation rate continues to remain moderate, it might become an issue if the government changes its fiscal stance. The other disconcerting feature relates to perceptible increase in wage rate, possibly underwritten by rise in prices of wage goods, not necessarily by productivity growth.

Need to Strengthen Domestic Demand

Under the circumstances, how will the government respond with policy and institutional measures to achieve its GDP growth target set at 6 percent for FY03? It is maintained that given the fragility of the export scenario as well as the obtaining depression in the manufacturing sector, the government may have to consider taking measures to prop up domestic demand. However, attention to cultivate domestic demand does not have to come through the neglect of our export promotion drive.

Three major vehicles of augmenting domestic demand would be (i) fiscal stimuli, (ii) credit expansion and (iii) public expenditure. The government has already exercised, up to a point, the first instrument (fiscal stimuli) through the National Budget for FY03. Regarding the second, our review has shown that the trend in agricultural credit flow has remained quite lacklustre during the elapsed months. One possibly needs to recreate the successful experience of the rural credit delivery exercise undertaken following the devastating floods of 1998.

With respect to the use of public expenditure as a tool for rejuvenating domestic demand, it may be underscored that the government currently enjoys some elbow-room for a moderate expansionary policy, thanks to the conservative approach pursued in the recent past. However, if the economy responds to such trigger mechanisms, it will not only expose itself to the risk of losing its grip on the fiscal deficit situation, but also unleashing high pressure on the soft exchange reserves in response to an investment - driven import resurgence.

PRSP Outcome and Alternative

Under the circumstances, one of the important factors defining the choice of the macro-economic policy stance during the FY03 will be the outcome of the Interim Poverty Reduction Strategy Paper (I-PRSP) preparation exercise. If the government can negotiate some soft term foreign financing in the near future, then it will be in a relatively comfortable position regarding its development expenditures and possible pressure generated from enhanced import.

However, some of the pre-conditions set by the international financial institutions (IFIs) for accessing such funds are also fraught with high risk. The demand for a free float of the exchange rate is a case in point. In this connection, the government will be well advised not to opt for a tight package of policy conditionalities; rather, it should retain its flexibility by committing itself to appropriate, but autonomously derived reform measures.

Alternatively, in anticipation of a possible absence of new and enhanced foreign aid flow, the government may like to urgently revisit its public expenditure package and priorities through the proposed mid-term review of the ADP and redesign its approach to investment stimulation by assessing the impact of incentives offered in the National Budget for FY03. The government may also like to consider more proactive use of the levers available in the financial sector.

Whatsoever, the government, in FY04, will have to continue addressing the three core objectives of macroeconomic management, *viz.* further fiscal consolidation, strengthening the balance of payment, and stimulating efficient investment.

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