Chapter I

State of the Bangladesh Economy in FY2006

1. INTRODUCTION

Fiscal year 2005-06 (FY2006) has been the last full fiscal year of the last elected government. At the same time, it was the first year of implementation of the national Poverty Reduction Strategy (PRS). The year witnessed important changes in the global market (e.g. price hike of oil, food and other commodities) and experienced diverse developments in the domestic economy. During the elapsed year, a number of important developments had taken place in bilateral, regional and WTO negotiations.

On the other hand, FY2007 is going to be the year of three governments, i.e. the outgoing government (July-October 2006), the caretaker government (November 2006-February 2007) and the new government (March-June 2007). It is in this curious context that the Second Reading of Centre for Policy Dialogue's (CPD's) *Independent Review of Bangladesh's Development* (IRBD) for FY2006 was released on the eve of the National Budget for FY2007 with a view to benchmark budget related discussions, including the assessment of outcomes of FY2006 and the outlook for FY2007. The First Reading of the IRBD 2006, a mid-year assessment, was released on 7 January 2006. The present chapter of this IRBD volume, the Final Reading of IRBD 2006, is an update of its earlier versions.

An overall assessment of the development experience of FY2006 suggests an impressive performance of the real economic sectors, *viz.* agriculture and manufacturing as well as buoyant growth of two major sources of foreign exchange earnings, i.e. exports and remittances. Conversely, FY2006 was plagued by poor economic governance manifested in shabby public policy management (e.g. distribution of fuel, fertiliser and seeds) and inability to manage external variables for maintaining macroeconomic balances (e.g. very low net inflow of foreign aid and foreign direct investment). Thus, all the incremental successes achieved in the economy in the recent past were overshadowed by developments such as price hike of essential commodities, increase in the rate of interest, electricity shortage, depreciation of Taka, etc.

Regrettably, an evidence based analysis of Bangladesh economy is becoming increasingly difficult in the absence of real time quality information. Even GDP estimates have become subject of debate, given the current state of national income accounting. Indeed, the entire process of public resource management has also become afflicted by lack of transparency and accountability leading to allegations of wastage and corruption.

Thus, the IRBD 2006 has critically and constructively scrutinised all available data and information from official sources and has blended this with primary data generated through CPD's micro-surveys. The assessment has been further enriched through in-house analytical exercises.

The chapter first highlights the distinguishing features of FY2006 and then takes a closer look at public finance, monetary sector, real economy and external sector. Finally, the chapter seeks to articulate the outlook for the next fiscal year (FY2007) and anticipate some of the challenges for the caretaker government.

2. BENCHMARK SITUATION IN FY2006

2.1 Macroeconomic Situation in the Beginning of FY2006

FY2006 commenced with a respectable growth rate of 5.3 per cent in FY2005. The economy successfully recovered from the heavy damages inflicted by the floods in July-August 2004 and was able to withstand the initial onslaught of the total phase-out of the Multi Fibre Agreement (MFA) quota on export of apparels. However, from the very beginning the economy witnessed a certain degree of pressure from multiple sources which included failure to implement public investment programmes, poor revenue collection and high growth of revenue expenditure. The macroeconomic correlates were particularly strained due to stressed state of balance of payment and creeping rise in consumer price index (particularly for foodgrains). Shortfall in foodgrain production remained a major concern, while manufacturing sector demonstrated moderate growth. A deepening state of weak governance with a stillborn Anti Corruption Commission, stagnation in the public administration and local government reforms, and absence of any significant progress in checking wastage, leakage and corruption in use of public resources undermined the overall economic management.

2.2 Major Issues in FY2006

Nevertheless, FY2006 experienced a number of positive developments which have important economic implications for the country. These include some improvements in collection of domestic revenue, robust export growth, rise in manufacturing production, buoyant remittance flows, more competition in telecommunications sector, South Asian Free Trade Area (SAFTA) agreement, installation of submarine cable, and larger flow of Initial Public Offerings (IPOs). However, the list of negative issues is longer which adversely affected the economic performance of the country. These include price rise of essential commodities (particularly food), global price hike of petroleum, food and other commodities, crisis of fertiliser, electricity and diesel for irrigation, poor implementation of ADP, low disbursement of foreign aid, power shortage, liquidity crisis in banks, volatility of call money rate and exchange rate, poor management of Chittagong port, Kansat and Demra incidences, workers unrest in the RMG sector, recent decline in All Share Price Index in Dhaka Stock Exchange (DSE), and opting out of the Asian highway. The economy also faced a number of issues which may be identified as contentious, giving rise to debates and discussions. These include outcome of the WTO Hong Kong Ministerial Conference, uncertainty with Tata's investment, huge repatriation of profits by foreign companies, coal mining by the Asia Energy, leasing out of the New Mooring Terminal at Chittagong port, and gas pipelines from Myanmar to India by-passing Bangladesh.

3. ASSESSING THE PERFORMANCE OF PRSP IN FY2006

3.1 Assessment of the MTMF

Based on the fiscal indicators presented in the budget for FY2007, a comparison of Medium Term Macroeconomic Framework (MTMF) targets and actual performances has been made. An overall assessment shows that while GDP growth surpassed the PRSP target, most of the indicators failed to achieve PRSP targets.

Overall balance remained lower than the PRSP target, while government failed to implement the ADP target by 0.73 per cent of GDP. Average inflation was also higher for the period as it reached 7.04 per cent in contrast to PRSP target of 6.5 per cent. Gross domestic investment (24.97 per cent), total revenue (10.78 per cent) and tax revenue (8.69 per cent) all fell short of PRSP targets by 0.03 per cent, 0.22 per cent and 0.31 per cent of GDP respectively. Borrowing from banking sector was 0.28 per cent higher than the PRSP target. Higher current expenditure and interest payments with respect to PRSP target (0.30 per cent and 0.11 per cent respectively) put pressure on the balance of payment.

Government's total revenue and tax revenue targets in the budget for FY2007 are also lower than their PRSP targets, whereas non-tax revenue target is higher than that of PRSP target. The budget targets for total expenditure (14.99 per cent of GDP), ADP (5.59 per cent of GDP), overall deficit (-3.70 per cent of GDP) and foreign financing (1.80 per cent) are all below their respective PRSP targets. However, current expenditure

Table 1: Measuring Budget Performance with PRSP Targets (FY2006 and FY2007)

Macroeconomic indicators	FY2006			FY2007		
	(PRSP)	(Actual)	Change	(PRSP)	(Budget)	Change
Real GDP growth (per cent)	6.50	6.70	0.20	6.80		
CPI inflation (average)	6.50	7.04	0.54	6.00		
Gross domestic investment (as% of GDP)	25.00	24.97	-0.03	25.50		
Total revenue	11.00	10.78	-0.22	11.30	11.29	-0.01
Tax	9.00	8.69	-0.31	9.30	9.22	-0.08
Non-tax	2.00	2.09	0.09	2.00	2.07	0.07
Total Expenditure (as % of GDP)	15.50	14.67	-0.83	15.70	14.99	-0.71
Current expenditure (as % of GDP)	8.60	8.90	0.30	8.80	9.09	0.29
of which: interest payments	1.70	1.81	0.11	1.70	1.64	-0.06
ADP (as % of GDP)	5.90	5.17	-0.73	6.20	5.59	-0.61
Other expenditure	1.00	0.60	-0.40	0.70	0.31	-0.39
Overall balance	-4.50	-3.89	0.61	-4.40	-3.70	0.70
Financing (net)	4.50	3.89	-0.61	4.40	3.70	-0.70
Domestic financing	2.00	1.96	-0.04	1.90	1.90	0.00
Banking system	0.90	1.18	0.28	0.80	1.17	0.37
Non-bank	1.10	0.78	-0.32	1.10	0.73	-0.37
Foreign financing	2.50	1.93	-0.57	2.50	1.80	-0.70

Source: PRSP documents and budget for FY2007.

(9.09 per cent of GDP) and domestic financing from the banking system (1.17 per cent of GDP) are higher than their PRSP targets (8.80 per cent and 0.80 per cent of GDP respectively).

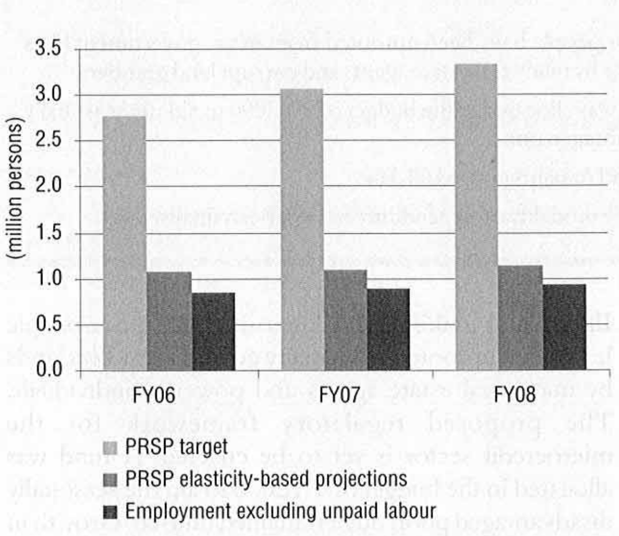
In sum, target was singularly achieved in terms of GDP growth rate. Achievement is observed in various degrees in the case of gross domestic investment, non-tax revenue, financing (net) of budget deficit and domestic financing. Targets were not achieved in the case of such important indicators as CPI inflation, total revenue collection including tax revenue, and total public expenditure including ADP. Borrowing from the banking sector was much beyond the targeted limit. Under the circumstances, there is now a serious need to revisit the MTMF. One would have expected that the budget for FY2007 to be designed under such a revised reference point.

3.2 Employment Creation

Regrettably, the different chapters of PRSP are not unanimous about projecting an employment generation target. The nominal target mentioned in the PRSP does not match with the estimation drawn from PRSP's GDP-employment elasticity.

A projection of employment generation has been made in the PRSP for the period up to FY2008. Employment is projected to increase from 48.92 million persons in FY2005 to 51.69 million persons in FY2008, creating 2.77 million new employment. On the other hand, the PRSP also suggests that Bangladesh has an employment-GDP elasticity of only 0.34. In other words, 1.0 per cent GDP growth is associated with 0.34 per cent growth in employment. Analysis of recent GDP growth trend, based on this employment-GDP elasticity, suggests that only a total of 1.09 million new jobs have been created in FY2006. This is, however, 1.68 million less than PRSP's earlier projection (see Figure 1).

Figure 1: Total Employment: FY2006-FY2008

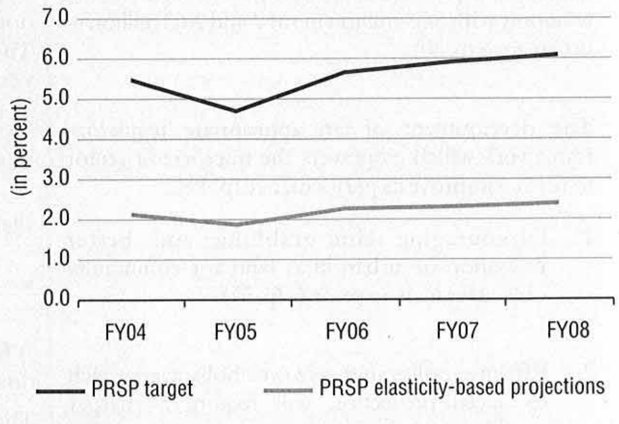


Source: CPD projections.

Using the GDP-employment elasticity approach on all employment, excluding unpaid family helper, it has been observed that a total of 0.86 million new paid jobs may have been created during FY2006. This figure is even lower than the PRSP projection. On the other hand, a total of 1.2 million people have been added in every year in the total labour force.

A wide gap is also observed in the growth rate of employment between those two (as shown in Figure 2). According to the PRSP projections, the growth rate of employment would be 5.66 per cent in FY2006, whereas it is only 2.28 per cent when estimated with GDP-employment elasticity approach. In both cases, it is observed that PRSP's employment creation projection is over-estimated when compared with its own employment-GDP elasticity.

Figure 2: Growth Rate of Total Employment: FY2004-FY2008



Source: CPD projections.

3.3 Pro-poor Growth

From a wide range of macro and micro level monitoring indicators, eight crucial promises of PRS were selected to assess the performance of the targets in FY2006 as set out in the PRSP document (Table 2).

Latest available information shows that the government failed to implement most of the targets.

Table 2: Assessing the Performance of FY2006 from PRS Requisites

PRSP Targets	Development till December 2005
Adoption of a "pro-poor" growth strategy is favoured over "growth maximisation" as a means of achieving faster decline of poverty (p. 19).	While MTMF projected a 6.5 per cent growth in FY2006- an increase from 5.5 per cent in FY2005, achieving a higher growth per se has become the main target. There is no mechanism to relate the growth figure to improvement of livelihood conditions of the poor.
The long-term strategy for food security requires actions on income distribution that provides adequate purchasing power in the hands of the poor (p. 99).	National income attributable to the poorest 10 per cent declined from the miniscule proportion of 1.7 per cent in 1999 to 1.5 per cent in 2004. Gini-coefficient deteriorated from 0.42 in 1999 to 0.45 in 2004. Indirect taxes, such as VAT, which is not mean-tested, are growing at a rate faster than direct taxes. Recent growth of direct tax (income tax) due to the contribution of middle and upper middle class wage earners, while corporate and top business people remain heavily underreported.
The future growth process must generate employment opportunities for the poorer sections of the population and the returns from employment must generate adequate earnings for them so that they can break out of poverty (p. 76).	New GDP estimate suggests that growth process is still service sector dominated, which fails to generate employment opportunities for the poorer sections of the population. Waged jobs are increasing at a slower rate.
With the increasing role of the private sector in the economy, the future prospect of employment generation depends mostly upon employment-friendly growth of the private sector (p. 77).	The MTMF, on the contrary, projects a negative (-0.3 per cent of GDP) growth in the private sector investment. Heavy government borrowing squeezed the share of private sector credit. Higher lending rate may retard private sector growth.
During the PRSP period (FY2005-FY2007), 8.02 million new jobs are estimated to be created in the economy with 5.39 million in rural and 2.63 million in urban areas (p. 80).	Annual target of 2.7 million incremental employments. Achievement of FY2005 was not reported in any government document. (Not achieved according to our estimate). There is no mechanism to estimate the number of jobs created in a year and how much of that went to the poor.
The development of an appropriate regulatory framework which empowers the microcredit sector to further improve its performance (p. 49).	Proposed regulatory framework for the microcredit sector is yet to be enacted.
1. Discouraging land-grabbing and better utilisation of urban khas land for community objectives is also a priority (p. 57).	Illegal land grabbing has intensified. • Poor people have been uprooted from many government khas lands by many real estate agents and corrupt land grabbers.
2. Effective policy initiative on a holistic approach to social protection will require a sharper profiling of risks, such as monga and seasonal poverty (p. 59).	A fund was allocated in the budget of FY2006 to aid the seasonally disadvantaged poor. The fund remains unused till date. Even the modality of expenditure has not been finalised yet.

For instance, national income attributable to the poorest 10 per cent declined from 1.70 per cent in 1999 to 1.50 per cent in 2004; Gini-coefficient also deteriorated from 0.42 in 1999 to 0.45 in 2004. GDP estimate suggests that service sector is an important source of economic growth (45.7 per cent in FY2006), this sector generally does not create much wage employment opportunities for the poorer sections. Illegal land grabbing has intensified and poor people have been uprooted from many government *khas* lands by many real estate agents and powerful individuals. The proposed regulatory framework for the microcredit sector is yet to be enacted. A fund was allocated in the budget of FY2006 to aid the seasonally disadvantaged poor, but it remained unused. Growth in the private sector investment seems to be retarded by recent heavy government borrowing and higher lending rate.

Given the state of data availability, one is not sure that the government is well equipped to report on the progress of implementation of these PRSP objectives. However, the available proxy indicators suggest that the progress is not satisfactory.

4.ASSESSMENT OF BANGLADESH ECONOMY IN FY2006

4.1 Growth, Savings And Investment

GDP Growth

According to preliminary estimates, Bangladesh economy posted a 6.71 per cent GDP growth in FY2006. This preliminary estimate was however made on the basis of six to seven months' data of the current fiscal year, when the economy was going through a momentum of high credit expansion, high export, high import, high industrial production and high inflation. To ease the pressure on fiscal and external balance, government took a number of measures such as increasing the lending rate and controlling import. All proxy indictors suggest that the economy, as a result, slowed down during the last quarter of FY2006. Hence, one can anticipate that the initial growth estimate may be revised downwards once data for full fiscal year become available.

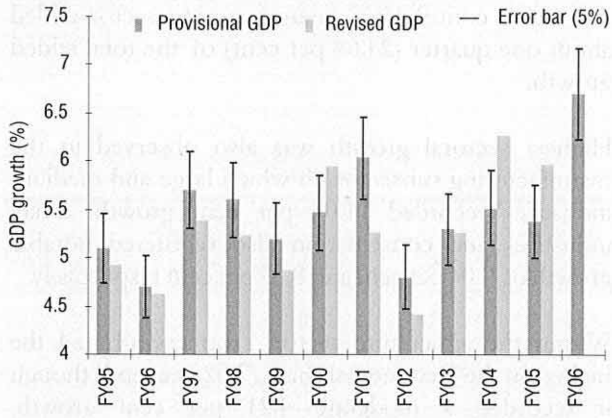
Moreover, it is becoming a practice that an outgoing government usually registers highest GDP performance in its last year, whereas the new government coming to power revises such estimates downward.

The Growth Rhetoric

Significant revision of the provisional GDP has become a tradition in Bangladesh's national income accounting. Since data for the full fiscal year are not available at the end of that particular fiscal year, when provisional estimate of GDP is calculated, revised GDP may vary from the earlier projections. As there is no dependable information for cross-checking, such substantive revisions raise questions about the empirical basis, estimation methodology and process transparency of the national income accounts of Bangladesh for a number of reasons.

Several comments regarding revision of GDP growth in Bangladesh are in order. *First*, a common trend that has been observed during the last two election years was that whereby the outgoing government's highest GDP performance was revised downward by the newly

Figure 3: Revision of GDP Growth Estimates in Bangladesh



Source: CPD-IRBD Database, 2006.

elected government of the time. For instance, GDP growth rate for FY2001 was significantly revised downward from 6.04 per cent to 5.27 per cent by the new government. Then again, GDP was revised upward in FY2004 when the first ever above 6 per cent growth in Bangladesh economy was reported. *Second*, the average gap between provisional and revised GDP was doubled after the centralisation of GDP accounting with the abolition of divisional and district level GDP calculation in 2001. *Third*, given the operational delay in finalising CMI, Quantum Index of Production (QIP) is taken as a proxy to calculate industrial contribution to GDP, though QIP is calculated with a 17-year old base (1988-89), and both its sectoral weights and data collection methodology are out of date. *Fourth*, national income accounting methodology suggests that the extrapolated preliminary estimates will be replaced in the revised GDP once the final CMI results become available. When the latest CMI provides data for only up to 2000, how come the BBS is able to estimate GDP for FY2004 and FY2005?

It seems that the country is experiencing "policymaking without information." CPD repeatedly mentioned that, since there is no dependable information for cross-checking the GDP estimates (e.g. investment and employment), such big revisions raise questions about the empirical basis, estimation methodology and process transparency of the national income accounts of Bangladesh.

Sources of Growth

One of the positive features of this year's (FY2006) growth is the increased contribution of real economic sectors that posted a notable 7.08 per cent growth. In the incremental GDP of FY2006, industry contributed 38.66 per cent and agriculture 14.30 per cent, whereas service sectors accounted for 45.70 per cent. Among the major contributors, manufacturing sector added about one quarter (24.64 per cent) of the total added growth.

Highest sectoral growth was also observed in the manufacturing subsector, in which large and medium industries recorded 11.04 per cent growth. Small industries and construction also registered notable growth of 9.04 per cent and 8.37 per cent respectively.

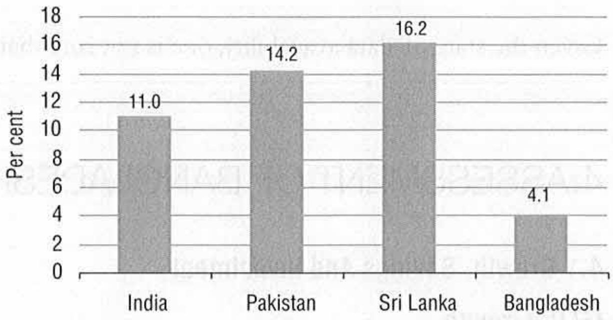
Within the agriculture sector, crop contributed the highest in the incremental share (7.52 per cent), though it recorded a moderate 4.21 per cent growth. Agriculture sector as a whole grew modestly at 4.49 per cent, recovering from the post flood low base.

Given the fact that the GDP growth in Bangladesh is dominated by the service sector, the current preoccupation with GDP growth may very well be a statistical artefact. Without any growth in the real economy, it can regularly post more than 4 per cent growth under its current service sector dominated composition. While the service sector has been a major employment generating source in many of the East Asian countries, the existing composition of Bangladesh's service and manufacturing sectors has been systematically contributing to a "jobless-growth". Hence, for both accounting and analytical reasons, there is a need to come out from this recent "hype" with high economic growth, and redirect our attention to the nature of the growth and its consequences for employment and income of the poor.

Per Capita Income

Per capita GDP stood at US$456 in FY2006, while per capita GNI stood at US$482, recording 3.4 per cent and 4.10 per cent annual growth rates respectively. Thus, per capita GDP grew by US$15, i.e. by Taka 1,000 during the last fiscal year. In other words, a person, on average, earned about Tk 82 more in each month of FY2006, which is equal to the price of one kg of rice and one kg of lintel. However, one should not

Figure 4: Per capita GNI Growth in South Asia (FY06)



Source: CPD-IRBD Database, 2006.

forget that these averages conceal a high degree of skewed income distribution.

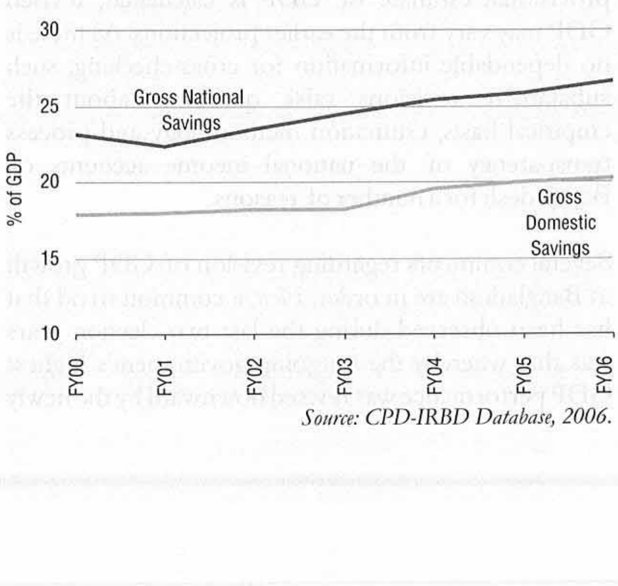
The gap between per capita GDP of Bangladesh with other South and Southeast Asian countries has widened during the past one and a half decades. The income deferential with China has increased from 1.35 times in 1990 to 2.70 times in 2003. With Malaysia and Thailand, the income deferential has increased from 9.31 times to 10.15 times and from 5.32 times to 5.76 times respectively during the same period.

Bangladesh's per capita GNI growth is also lower (4.1 per cent), when compared with India, Pakistan and Sri Lanka that experienced 11.0 per cent, 14.2 per cent and 16.20 per cent GNI growth respectively in FY2006.

Savings

Domestic savings in Bangladesh show stagnation as the rate increased marginally from 20.01 per cent in FY2005 to 20.26 per cent of the GDP in FY2006, registering a miniscule 0.05 per cent increase as a share of GDP. Increasing the domestic savings rate is a major challenge facing Bangladesh at the present economic transition.

Figure 5: Savings Rate as % of GDP



Source: CPD-IRBD Database, 2006.

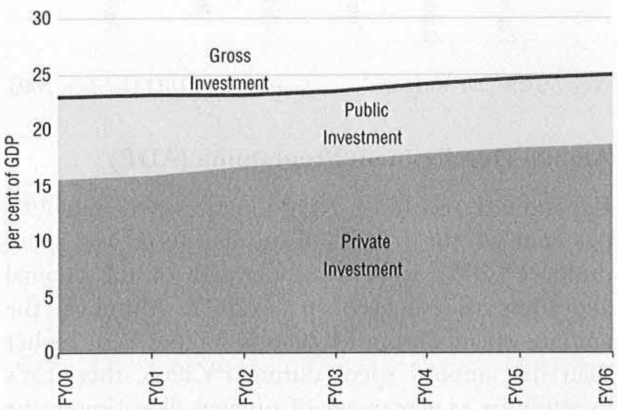
A comparison with the neighbouring countries reveals that the share of domestic savings in GDP were 29.1 per cent (FY2005) in India (i.e. about 43.63 per cent more than Bangladesh) and 14.4 per cent (FY2006) in Pakistan (i.e. about 28.92 per cent less than Bangladesh) according to the latest available statistics.

Thanks to remittances, national savings rate demonstrated encouraging movements in FY2005. The share of national savings to GDP increased significantly further in FY2006 to 26.61 per cent of GDP as against 25.84 per cent in FY2005, registering an impressive enhancement of 0.77 per cent of GDP.

Investment

During the last five years (FY2002-FY2006), the gross investment rate has increased by only 0.38 per cent of

Figure 6: Investment as % of GDP



Source: CPD-IRBD Database, 2006.

the GDP. Gross investment was 23.09 per cent of GDP in FY2001, while it crawled up to 24.97 per cent in FY2006. This is marginally lower (by Tk 12,484.64 crore) than the MTMF target of PRSP which was set at 25 per cent. However, the achieved rate is significantly lower than that of India (30.1 per cent in FY2005), although it is higher than that of Pakistan (20 per cent in FY2006).

Public investment continued to decline, though it marginally recovered from its historic low rate of 6.19 per cent of GDP in FY2004 to 6.30 per cent in FY2006. The slack left behind by annual development programme (ADP) was however somewhat picked up by "other public investment." The share of other public investment in total public investment increased from 6 per cent in FY1996 to about 18 per cent in FY2006.

Private investment as a share of GDP increased from 18.3 per cent in FY2005 to 18.7 per cent in FY2006. Bangladesh continues to remain an under-invested country while its national savings rate (26.6 per cent) remains higher than the gross investment rate (25 per cent), indicating greater availability of idle investible surplus.

According to the budget of FY2007, the incremental capital-output ratio (ICOR) is 3.72 with gross domestic investment rate 25.0 and a GDP growth rate 6.7, the target ICOR in the PRSP (3.85) was higher than the actual. It is very surprising that the ICOR in FY2006 has dropped significantly from a high ICOR (4.52) in FY2005. In the PRSP, it has been stated that the economy will grow by 6.8 per cent in this fiscal year 2006-07. The question could arise whether lower investment growth or over-estimated GDP growth is responsible for the discrepancies noted above. To achieve the target growth rate of 6.8 per cent, gross domestic investment rate has to increase from 25.0 per cent in FY2006 to 25.5 per cent of GDP in FY2007 (assuming a very favourable ICOR of 3.7).

4.2 Public Finance

Revenue Receipts

The historically low revenue-GDP ratio of Bangladesh experienced a marginal growth of 0.12 per cent of GDP per year during the last eleven years, reaching 10.6 per cent in FY2005. During the FY2006, NBR revenues registered a significant 13.5 per cent growth in which direct tax (income tax) registered a 28.1 per cent growth. It appears that the NBR's drive to enlist effective tax payees is yielding some results. During this period, collection of import duty posted a negative growth of (-) 1.1 per cent, while the share of import duty declined from 26.5 per cent in FY2005 to 23.0 per cent in FY2006. Value added tax also registered a considerable growth during this period (18.2 per cent). Achievement with respect to the annual target has improved as 95.3 per cent of the NBR target has been achieved in FY2006, while the figure was 92.9 per cent in FY2005.

On the other hand, non-NBR tax components posted a slower growth rate of 7.37 per cent during FY2006 as against an impressive growth rate of 14.9 per cent in FY2005. For the non-tax component, data is available only up to May of FY2006. The eleven months data of FY2006 shows an impressive 34.7 per cent growth over the corresponding period of FY2005. Collection of non-tax revenue may pick up further during the last month, which is usually the case every year.

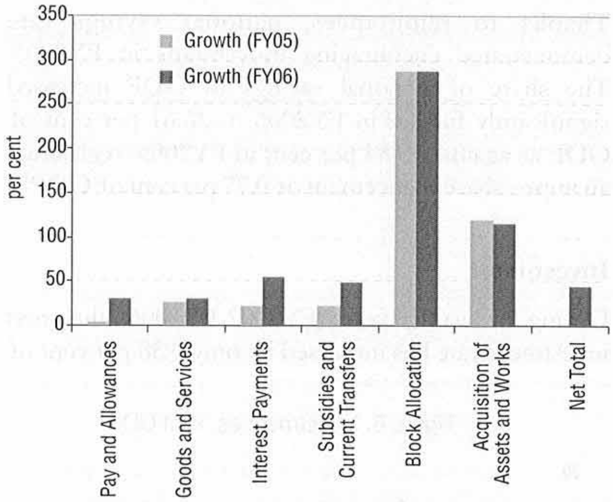
The overall growth in domestic resource mobilisation during FY2006 had been reasonable, given a 7 per cent inflation rate and 6.7 per cent real GDP growth. A target of 10.96 per cent revenue-GDP ratio was set for FY2006 (as per target figures mentioned in the Budget Summary). Based on the revenue earnings prediction of the Economic Review 2006, it appears that the achieved revenue-GDP ratio may surpass the target by 0.03 per cent as the preliminary estimation shows that the revenue-GDP ratio would be 10.99 per cent at the end of FY2006. However, according to the Monthly Fiscal Report of the Ministry of Finance, the actual revenue-GDP ratio for the first eleven months of FY2006 could not cross 10 per cent mark and stood at only 9.75 per cent.

Analysing revenue data for FY1980-FY2006, CPD's econometric analysis reveals that revenue collection in Bangladesh is largely dependent on the GDP of the country. It also shows that the introduction of VAT in 1991 played a significant role in increasing the total revenue collection by the government. Notwithstanding the fact that import related duties constitute a significant portion of the total revenue, the study, however, showed no effect of tariff rate on total revenue mobilisation. Consequently, the inference is that reduction in tariff rate will primarily lead to higher import without hampering government revenue collection.

Revenue Expenditure

The targeted revenue expenditure for FY2006 was 16.0 per cent higher than the targeted figure of FY2005. However, latest available figure shows that the actual revenue expenditure during the first eleven months of FY2006 was 19.9 per cent higher than the corresponding figure of the previous year (FY2005). Actual spending during this period was 75.9 per cent of the total FY2006 target, which was 74.9 per cent during the same period in FY2005. Actual expenditure on account of major three heads, "salary and allowances", "subsidies and transfers" and "interest payments" which accounted for 83.4 per cent in the total actual revenue expenditure, registered high growth during the first eleven months of FY2006, accounting for 24.4 per cent, 21.4 per cent and 27.3 per cent growth respectively. In the backdrop of a higher benchmark for FY2005, expenditure of block allocation decreased marginally by 0.5 per cent during the first July-May period of FY2006.

Figure 7: Growth of Revenue Expenditure by Economic Classification, FY2005-06



Note: Data for July-May period. *Source: CPD-IRBD Database, 2006.*

Annual Development Programme (ADP)

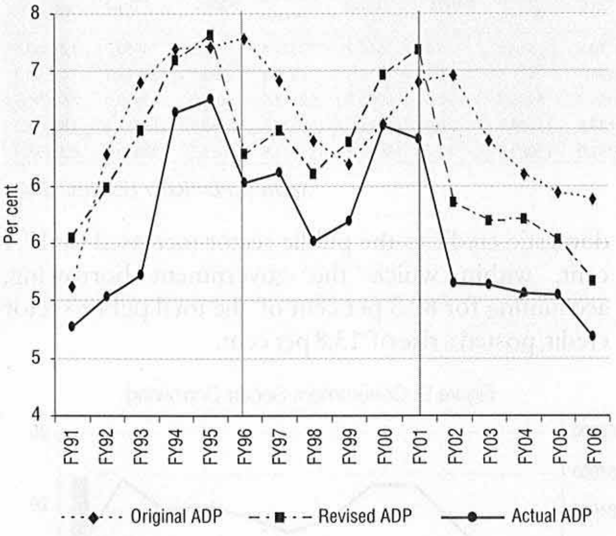
Expenditure record of ADP indicates that only 79.5 per cent of the original fiscal allocation was spent during FY2006, while 85.32 per cent of the original allocation was utilised in FY2005. Although the amount spent during FY2006 is 3.7 per cent higher than the amount spent during FY2005, this year's expenditure as percentage of original allocation is one of the lowest in the recent past. In the first reading of IRBD 2006, CPD projected that the ADP of FY2006 will be revised downward to about Tk 22,000-22,500 crore. CPD also projected that the actual implementation will be even lower than this, between Tk 19,500 crore and Tk 20,000 crore, which will be about 83 per cent of the original target. At the end, government revised the ADP to Tk 21,500 crore, which is 12.2 per cent lower than the original ADP and the implemented ADP amounted to Tk 19,472.1 crore which is 79.5 per cent of the original ADP.

Among the five Ministries/Divisions which received the highest allocation in the revised ADP, the Ministry of Post & Telecommunication and Ministry of Health and Family Welfare were the least spending ministries,

1. Augmented revenue expenditure including requisition of assets and works, and recoveries which is less than 2 per cent is not deducted here. Excluding the requisition of assets and works, revenue expenditure targets for FY2005 and FY2006 were Tk 30,518 crore and Tk 35,523 crore. Deduction of recoveries was not accounted for in the available information on actual revenue expenditure during July-May period collected from finance division (Finance Division, 2006).

with the expenditure of only 72.6 per cent and 87.1 per cent of respective allocations during FY2006. Lower implementation record of Ministry of Health and Family Welfare is of particular concern because of its implication for poverty alleviation. Though the Power Division spent 93.0 per cent of its allocation, the outcome of this expenditure was not visible. On the other hand, Ministry of Primary and Mass Education spent 96.9 per cent, a large part of which was spent on account of scholarships. Interestingly, the Local Government Division which holds the largest share of soft money, spent as high as 92.6 per cent of its allocation in a pre-election year. Among the four ministries which have developed their own budget under the Medium Term Budgetary Framework (MTBF), Ministry of Social Welfare (92 per cent) and Ministry of Agriculture (95 per cent) managed to perform above the national average while Ministry of Education (89 per cent) and Ministry of Women and Children Affairs (90 per cent) spent less than the average.

Figure 8: Annual Development Programme (FY1991-FY2006) as % of GDP



Source: CPD-IRBD Database, 2006.

While the implementation value of the ADP for FY2006 is close to the actual implemented value of FY2005 (Tk 18,726 crore), in terms of share of GDP it is lower (4.7 per cent for the first time below 5 per cent of GDP since 1991). This is absolutely not in line with the projection of the PRSP which set a target of 5.9 per cent of GDP. It will perhaps be pertinent to recall here that Bangladesh's public investment-GDP ratio does not compare favourably with that of India (7.2 per cent) and Pakistan (8.7 per cent). As of now, the prospect of having a respectable implementation level of ADP in FY2006 seems to be a remote possibility.

It is not possible to distinguish accurately the development and non-development allocations of the budget from the existing reporting system of the budget as several development related expenditures (e.g. allocations for safety net programmes) are also included in the revenue budget. As a result, a separate balance sheet on poverty related financing is now essential to measure the pro-poor impact of the PRSP budgets.

The government has set the new ADP target for FY2007 at Tk 26,000 crore, which is respectively 6.1 per cent and 21 per cent higher than the original and revised ADP of FY2006. Though education and religion witnessed the highest increase (34.8 per cent) in the new ADP allocation, both annual increase and sectoral share of education would be much lower if expenditure on account of religion is excluded from the total allocation for education and religion. Interestingly, despite the present power crisis, allocation for the power (electricity) sector shows a negative growth of 6.5 per cent in the new ADP for FY2007. A significant increase in the block allocation of 30 per cent is observed in the FY2007 over the original budget of FY2006.

An econometric analysis of the determinant factors of ADP implementation for the period FY1991-FY2005, carried out at the CPD, indicated that the actual implementation of ADP is mostly determined by revenue collection of the government. Revenue expenditure or even disbursement of project aid by the donors does not necessarily change the implementation level. The study carried out at CPD also reconfirmed the conjecture that higher allocation in the election year does not necessarily lead to higher implementation.

Budget Deficit and Financing

At the end of the financial year, overall deficit was 22.67 per cent higher in FY2006 than the comparable period of FY2005. Net foreign financing during this period showed a growth of 1.6 per cent due to low disbursement and high repayment. As a result, share of domestic financing increased from 54.8 per cent in FY2005 to 62.5 per cent in FY2006. As net foreign financing had declined, the government had to heavily lean on the domestic sources for financing deficit. During the fiscal year, borrowing from the banking sector stood at Tk. 5,667.8 crore in FY2006, whereas in the pervious fiscal year it was Tk 3,106.6 crore. Initially, the government borrowed heavily from the banking sector and as it reached the IMF-allowed limit, the government started to draw on the non-banking sector. Such expensive borrowing usually creates a vicious circle of borrowing and revenue expenditure which needs to be monitored carefully as this may turn out to be a major concern for the Caretaker government. Hence, for the FY2007, one needs to consider not so much the level, but the modes of financing of the fiscal deficit.

CPD's econometric analysis of the determinants of budget deficit for the period FY1991-FY2005 suggests that domestic financing crowds in foreign financing of the budget deficit. It also suggests that more domestic financing encourages donors to increase their development financing because an increase in domestic financing reflects government's ability to increase the earnings from the domestic sources. Moreover, it also echoes the efficiency and commitment of the government to support its development process. On the other hand, foreign aid had a significant positive impact on the budget deficit. An increasing flow of foreign aid encourages the government to incur larger volume of budget expenditure during the subsequent year.

4.3 Monetary Sector

Money Supply, Reserve Money and Liquidity

Money supply (in terms of M3) grew by 18.0 per cent at the end of FY2006. Reserve money posted a rise of 28.1 per cent at the end of June of FY2006 over June 2005. The excess liquidity of the scheduled banks stood significantly lower at Tk 9,591.05 crore at the end of June 2006 compared to Tk10,941.61 crore at the end of June 2005. The fall of liquidity in the banks may have originated from the over-financing of the investment demand and/or mopped up by the government to fill in foreign aid shortfall. This issue also needs to be looked at from the perspective of (seasonal) volatility of call money rates.

CPD carried out an econometric analysis to find out the determinants of money supply. Analysing the data for the period FY1980 to FY2005, it was revealed that the money supply has a positive relationship with the nominal GDP and the credit to private sector, while it shows a negative relationship with the balance of payment deficit. So the growth in GDP will increase the money supply but the credit to private sector can be a useful tool for monetary policy.

Government Sector Borrowing

FY2006 is characterised by a high and unsustainable rate of domestic credit growth which stood at Tk 223,155.5 crore, registering a 18.1 per cent growth over the corresponding figure of FY2005 (Tk 189,032.2 crore) on a point to point basis. On a point to point basis, at the end of June 2006, total outstanding domestic credit to the public sector increased by 17.1 cent, within which the government borrowing, accounting for 82.5 per cent of the total public sector credit, posted a rise of 13.8 per cent.

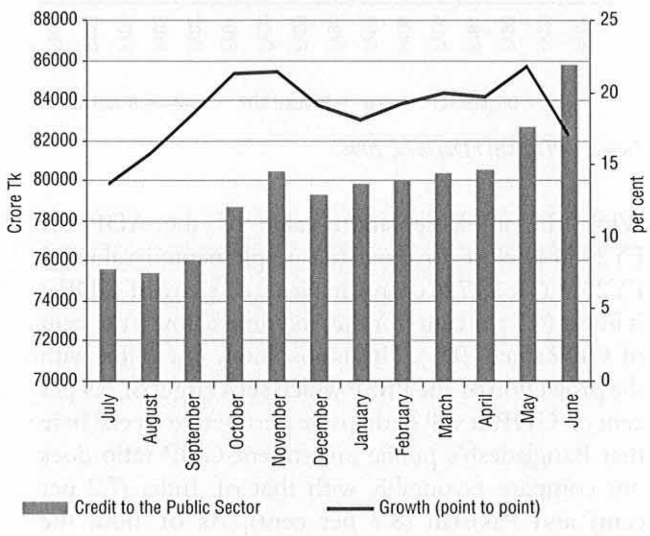
Table 3: Government Sector Borrowing

(in crore Tk)

End of Period	Domestic Credit (M3)										
	Government (Net)				Other Public Sector			Private Sector			Total Domestic Credit
	Banking Sector	NBDC	NSD	Total	Banking Sector	NBDC	Total	Banking Sector	NBDC	Total	
FY02	19977.0	0.7	25793.0	45770.7	7540.3	3.0	7543.3	72039.4	2911.3	74950.7	128264.7
FY03	19008.7	0.0	30096.0	49104.7	7471.5	1.0	7472.5	81270.2	3705.9	84976.1	141553.3
FY04	21912.1	16.0	34001.6	55429.7	8906.7	0.0	8906.7	92458.9	5400.0	97858.9	162695.3
FY05	25602.8	35.4	36497.7	62135.9	11124.9	0.0	11124.9	108235.7	7535.7	115771.4	189032.2
FY06	31231.8	35.9	39464.3	70731.9	15009.8	13.4	15023.2	127773.8	9626.5	137400.3	223155.5

Source: CPD-IRBD Database, 2006.

Figure 9: Government Sector Borrowing



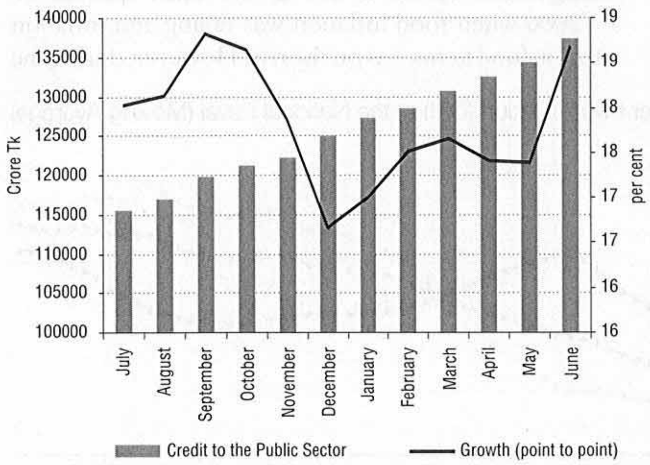
Source: CPD-IRBD Database, 2006.

Credit to other public sector, on the other hand, rose by a whopping 35.0 per cent during the period under consideration. Sale of NSD certificates during this period registered a 35.6 per cent growth. While the repayment of the principal amount increased by 41.0 per cent, the growth of net sale of NSD stood at 18.9 per cent. Data for credit to government sector from NBDC at the end of FY2006 shows a minimal growth of 1.4 per cent on a point to point basis.

Private Sector Borrowing

At the end of FY2006, total outstanding domestic credit to the private sector stood at Tk 137,400.3 crore, posting a moderate 18.7 per cent growth on a point to point basis. Within the total credit to the private sector, 93 per cent came from the banking sector, while the rest 7 per cent came from the non-bank depository corporations (NBDCs).

Figure 10: Private Sector Borrowing



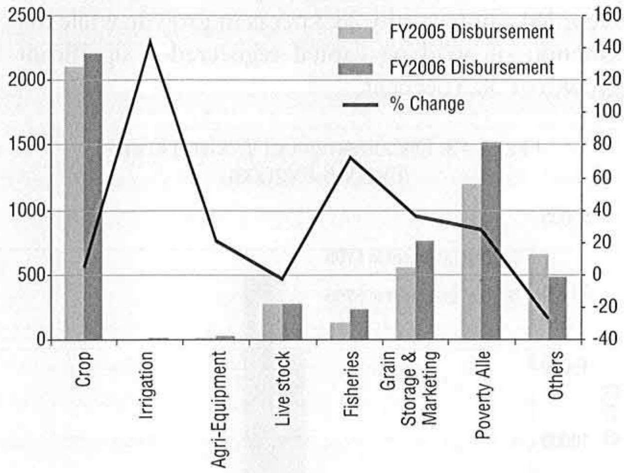
Source: CPD-IRBD Database, 2006.

It is logical to suggest that domestic credit growth should be put on the leash by controlling public borrowing, and not by curtailing credit flow to the private sector.

Agricultural Credit

In the backdrop of a higher benchmark during the flood year (FY2005), total credit disbursement to the agricultural sector posted a 10.9 per cent growth in FY2006. When recovery, which registered a high growth of 31.3 per cent, is excluded, net disbursement of agricultural credit experienced a negative 25.4 per cent growth during FY2006. Crop loan followed by "Poverty Alleviation" received the highest amount of credit with respective disbursement of Tk 2,203.90 crore and Tk 1,518.76 crore.

Figure 11: Agricultural Credit Position (FY2005 & FY2006)

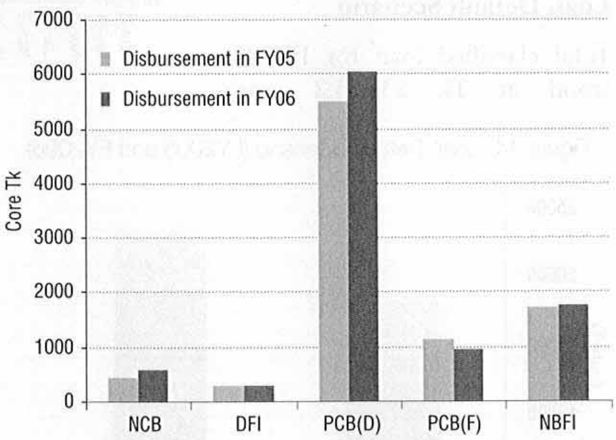


Source: CPD-IRBD Database, 2006.

Industrial Credit

Against the large benchmark growth of disbursement of term loan during FY2005 (36.5 per cent), FY2006 registered an insignificant growth of 5.9 per cent. However, net disbursement during this fiscal year is 409.0 per cent more than the equivalent figure of FY2005, mainly because of low recovery that shows a negative growth of 20.9 per cent on a point to point basis. While term loan disbursed by the specialised banks (DFIs) and the private commercial banks (PCBs) (foreign) declined by 0.3 per cent and 17.3 per cent respectively, their respective shares in the total credit disbursed went down from 3.3 per cent and 12.5 per cent to 3.1 per cent and 9.8 per cent.

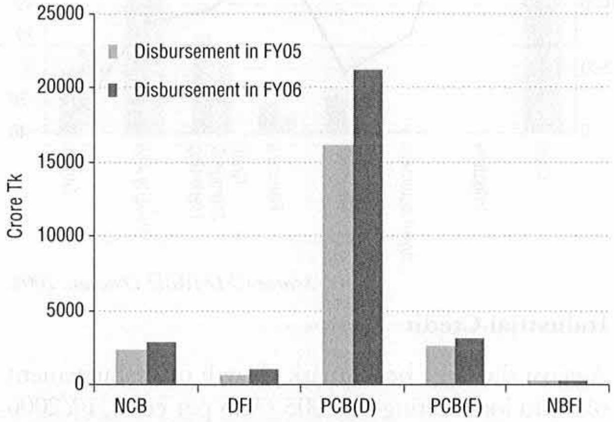
Figure 12: Disbursement of Term Loan (FY2005-FY2006)



Source: CPD-IRBD Database, 2006.

On the other hand, term loan disbursed by NCBs increased significantly by 29.9 per cent and their share increased from 5.0 per cent to 6.1 per cent. Disbursement by the PCBs (domestic) and NBFIs increased by 10.4 per cent and 1.7 per cent respectively. Disbursement of working capital during FY2006 recorded a noteworthy 28.3 per cent growth, while the sanction of working capital registered a significant growth of 30.5 per cent.

Figure 13: Disbursement of Working Capital (FY2005-FY2006)



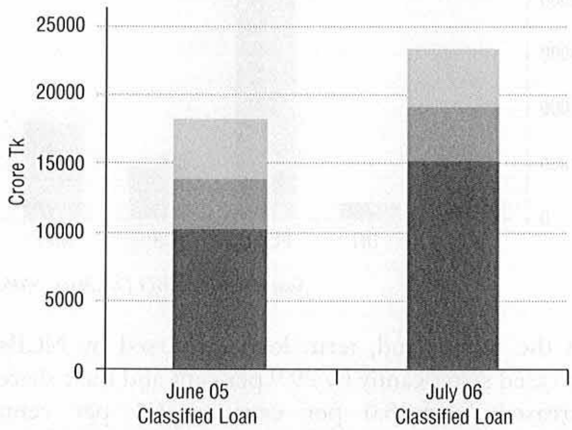
Source: CPD-IRBD Database, 2006.

During FY2006 an amount of Tk 28,448.53 crore was disbursed against the sanctioned amount of Tk 24,691.92 crore. In terms of disbursement, PCBs (Domestic) accounted for three-fourth of the total disbursement of working capital, while the highest growth (56.1 per cent) was registered by the specialised banks (DFIs).

Loan Default Scenario

Total classified loan for FY2006 stood at Tk 23,465.2 crore,

Figure 14: Loan Default Scenario (FY2005 and FY2006)



Source: CPD-IRBD Database, 2006.

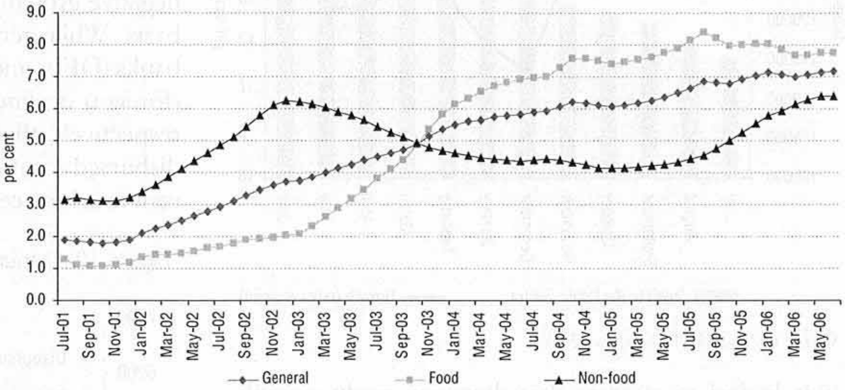
registering a significant increase of 27.3 per cent over the corresponding figure of FY2005. DFIs made impressive progress in reducing the increase in the total classified loan, recording a negative growth rate of 49.6 per cent over the corresponding period of FY2005. Foreign Banks (FBs) also recorded a negative growth of 1.5 per cent. However, total classified loan of NCBs increased significantly by 48.9 per cent during FY2006, while classified loan of PCBs increased by 4.2 per cent.

Consumer Price Inflation

On the basis of moving average, consumer price inflation increased from 6.49 per cent in June 2005 to 7.16 per cent in June 2006. Consumer price inflation stood at 7.54 per cent in June 2006, on a point to point basis, which was 7.35 per cent in June 2005.

In the recent past, food inflation had tended to be higher than the non-food inflation. A compositional change was observed during the third quarter of FY2006 when food inflation was falling and inflation of non-food items was on the rise. However, during the

Figure 15: Consumer Price Inflation (CPI) at the National Level (Moving Average)



Source: CPD-IRBD Database, 2006.

last quarter, inflation trend reversed back with an alarmingly high food price increase and falling non-food inflation. In June 2006, food inflation reached as high as 8.81 per cent and non-food inflation rate came down to 5.73 per cent on a point to point basis while the respective figures were 6.67 per cent and 6.70 per cent in march 2006 (8.73 per cent and 5.32 per cent respectively in June 2005).

General inflation in the rural areas (7.67 per cent in June 2006) remains higher than that in the urban areas (7.20 per cent in June 2006).

It has been well documented that the rise in inflation rate in FY2006 was induced by cost push factors manifested largely through higher global price of energy, fertiliser, steel and food. Thus, one may question the rationale of subsequent government decisions of pursuing a contractionary policy. Such an approach would only subdue the investment demand (and consequently economic growth), while the major source of inflation would remain beyond the reach of domestic policymaking, being spurred by global factors.

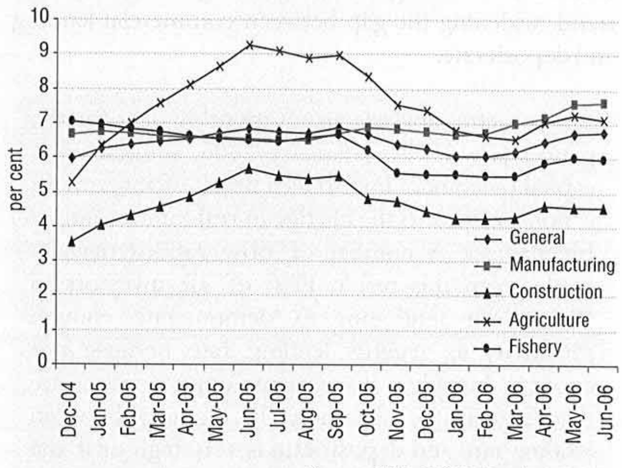
A regression analysis carried out at the CPD suggests that the real exchange rate, M2 and real interest rate are significant explanatory factors of monthly inflation (period July 1999-February 2006), and the coefficient of real exchange rate and real interest rate are significant in explaining yearly inflation (period 1981-2005) in the context of Bangladesh. As real interest rate is found to be significant with correct sign using only monthly data, rise in interest rate for controlling inflation can only be a short-term measure, not a long-term one. Depreciation of currency creates inflation in the importing country due to higher input prices for goods, both tradables and non-tradables, as well as higher prices of the final import product. However, there is a consensus that currency depreciation has a positive impact on export competitiveness which, in turn, has a positive impact on nominal income of exporters. But the real income of the exporters declines with an increase in the price level. As most of the essential commodities such as rice, wheat, edible oil, onions, etc. are imported by Bangladesh, depreciation of the local currency leads to a rise in the price of these products in the domestic market. Thus, a safe level of foreign currency reserve may solve the problem of high price of foreign currency which will ultimately be reflected in the lower level of general prices in the economy. However, control of money supply is a good measure to cure inflation in the context of Bangladesh, as is evidenced by both historical and recent data.

Wage Inflation

At the end of June 2006, general wage inflation stood at 6.73 per cent. Since January 2005, the wage inflation has continued to remain above 6 per cent and ultimately caught up with the consumer price inflation, at 6.17 per cent, which was declining at that period.

However, notwithstanding such increase, real wage rate had experienced steady erosion in the recent past. In April 2006, consumer price inflation (7.09 per cent) stood higher than wage inflation (6.47 per cent) on the basis of moving average and since then continued to remain above the wage inflation. This trend is particularly true for the manufacturing sector (where labour market is quite rigid and responds with a time lag) and the construction sector (which has a flexible supply of labour).

Figure 16: Wage Inflation

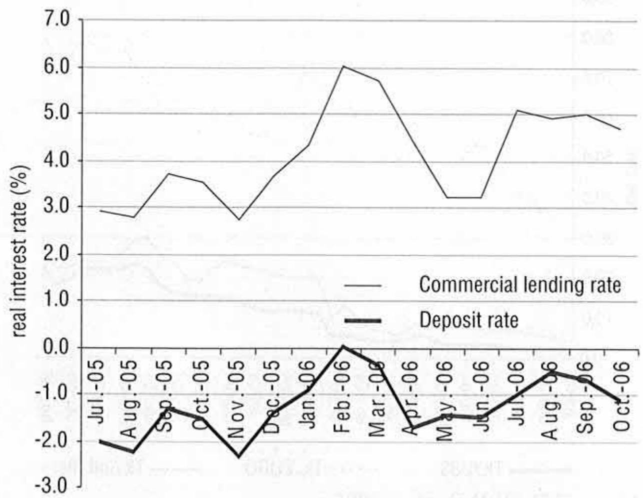


Source: CPD-IRBD Database, 2006.

Interest Rate

Real interest rate on commercial lending is increasing from August 2005 onward from 2.76 per cent in November 2005 to 6.03 per cent in February 2006. Real lending rate declined after that until it fell down to 3.21 per cent at the end of the fiscal year 2006. This fiscal year is marked with the increase in the commercial lending rate. The commercial lending rate in October 2006 stands at 4.69 per cent. Deposit rate (3 to 6 months), however, could not protect its real value and remained negative in real terms. Real deposit rate

Figure 17: Real Interest Rate

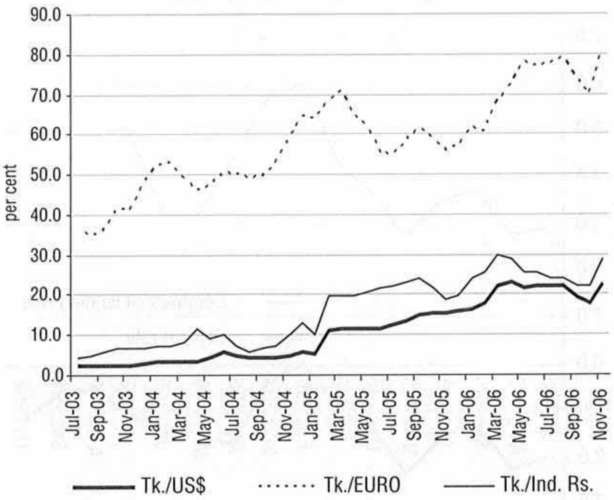


Source: CPD-IRBD Database, 2006.

showed a minor correction from (-) 2.03 per cent in July 2005 to (-) 1.15 per cent in October 2006. Taming inflation through increase of interest rate has been used over some period now and CPD finds it to be an inadequate policy proposition since it facilitates rise of lending interest rate but not the deposit interest rate. Consequently, though the inflation rate is declining, commercial lending is still showing a high upward trend, widening the gap between commercial lending and deposit rate.

Econometric analysis, using monthly data for the period July 1999 to January 2006, suggests that capital machinery import as a proxy of investment is not sensitive to the change in real interest rate in Bangladesh. A number of observations may be made from this result. First of all, investors in Bangladesh tend not to demonstrate enough sensitivity as regards lending rate because not enough lucrative investment opportunities are readily available. Secondly, if the gap between lending rate and deposit rate is very high or if the expected rate of return from investment is much higher than the bank deposit rate, investors tend to be less concerned about higher lending rate. Thirdly, developing countries are always facing problems of credit rationing for investment. The situation has worsened in Bangladesh at present, as foreign investors are also borrowing from the banking system which reduces credit availability for the domestic investors. All these might have contributed to the insignificant relationship between lending rate and investment level in the context of Bangladesh.

Figure 18: Exchange Rates



Source: CPD-IRBD Database, 2006.

Exchange Rate Situation

BBetween June 2006 and November 2006 Taka depreciated against the US dollar by 0.34 per cent, the EURO by 1.93 per cent and the Indian Rupee by 2.56 per cent. In nominal terms, the weighted average exchange rate of Taka against the US$ increased to Taka 69.91/$ from Taka 69.67/$, against the Euro increased to Taka 89.96/Euro from Taka 88.22/Euro, and against the India Rs increased to Taka 1.56/Rs. from Taka 1.52/Rs. during this period.

Taka continued to remain marginally overvalued against all the abovementioned currencies following the adoption of floating exchange rate. For example, Taka was overvalued by 12.23 per cent against the EURO, 5.19 per cent against US dollar, and 6.57 per cent against the Indian Rupee in November 2006. Depreciation trend of Taka against US dollar, EURO and Indian Rupee suggests that Taka is depreciated more against the EURO compared to the US dollar. It may be inferred from this that it is desirable to have an orderly depreciation of Taka instead of a sharp decline..

4.4 Real Economy

Agricultural Production

According to the final estimates of the Bangladesh Bureau of Statistics (BBS), total foodgrain production (rice and wheat) in FY2006 was 27.27 million metric tonnes (mmt) which is 4.33 per cent higher than that of the flood affected previous year (FY2005). However, it is 13.3 per cent less than the targeted foodgrain production (31.45 mmt) in FY2006. It may be recalled that highest food production in Bangladesh was 27.44 mmt in FY2004. Total rice production in FY2006 was 26.53 mmt (Aus: 1.75 mmt; Aman: 10.81 mmt; Boro: 13.98 mmt). It is pertinent to mention that production of Aus rice (1.75 mmt) in FY2006 was 15.0 per cent less than the target but 16.3 per cent higher than what was in flood affected FY2005. On the other hand, total production of Aman rice (10.81 mmt) in FY2006 was 17.0 per cent less than the target but 10.1 per cent higher than flood-affected FY2005. Boro production in FY2006 was 13.98 mmt, which is 7.1 per cent less than the target but 1.0 per cent higher than what was in FY2005. Wheat production in FY2006 was 0.74 mmt, which is 24.6 per cent less than actual production (0.98 mmt) in FY2005. It may be mentioned here that wheat production has been gradually decreasing since 1999/00.

Livestock production situation was also good.

According to the provisional estimates of the Directorate of Livestock Services (DLS), milk production in FY2006 was 2.24 million mmt, which is 4.7 per cent higher than that of FY2005. Estimated production of eggs in FY2006 was 6,070 million which is 7.9 per cent higher than in FY2005. On the other hand, meat production in FY2006 was estimated to be 1.16 mmt, indicating a 9.4 per cent increase against previous year's (FY2005) meat production.

In FY2006, fish production registered a significant progress. According to the provisional estimates of the Directorate of Fisheries (DoF), total fish production in FY2006 was 2.40 million metric tones, which was 1.8 per cent higher than in FY2005. Inland fish production in FY2006 (1.87 mmt) was 7.6 per cent higher than in FY2005. Contribution of cultured fisheries to the inland fish production is increasing over time. Production of cultured fish in FY2006 (1.0 mmt) was 13.3 per cent higher than that of FY2005. On the other hand, marine fish production in FY2006 was 0.53 mmt, which was 11.0 per cent higher than in FY2005.

Food Import

In FY2006, total rice import (rice aid and commercial imports) was 532 thousand mt, out of which 34 thousand mt was food aid and 498 thousand mt came through private sector import. Private sector import in FY2006 was 58.4 per cent less than that in FY2005. Wheat import by the private sector in FY2006 was 1.1 per cent less than that in FY2005. Altogether, total import of foodgrains in FY2006 was 24.0 per cent less than that in FY2005. It may be pointed out that import data (L/C opening and settlement) also indicate that import payment on account of foodgrains in FY2006 has declined compared to that in FY2005.

Rice Price

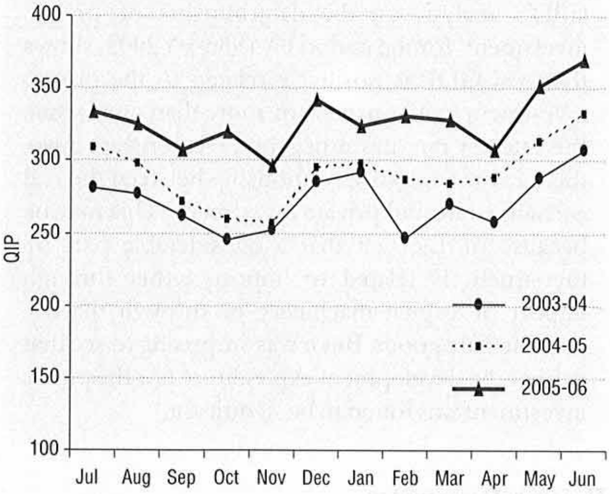
At the beginning of FY2006 (i.e. July 2005) the price of rice was much higher compared to the previous year. Though the wholesale price of coarse rice declined marginally during the first half of FY2006, the price remained at Tk 16,000 per mt until December 2005 (harvest of Aman). It then started to increase and had gone up to TK 18,000 per mt in April 2006. After the harvest of Boro rice, price declined marginally in May and June 2006. A comparison of wholesale prices of miniket rice and coarse rice in Bangladesh with import parity price of rice in Delhi and Bangkok reveals that price of coarse rice is lower in Dhaka, but the price of fine rice is higher than the import parity price. This possibly explains why the Bangladesh private sector is importing rice by a lesser quantity than was the case in the previous year.

CPD's regression analysis, covering the period FY1981-FY2005, reveals that the main determinants of food price in Bangladesh are world food price, prices of inputs used in agriculture, expected rate of food price inflation and agricultural production. Implications of this finding for policy are that domestic consumers may be supplied with food at a lower price through reducing tariff on food import and providing subsidy for imports of inputs such as fertiliser, diesel and electricity used by the agriculture sector.

Industrial Production

Production in large and medium manufacturing industries registered a respectable 12.97 per cent growth in FY2006, according to the QIP.

Figure 19: Quantum Index of Industrial Production During FY2004-06

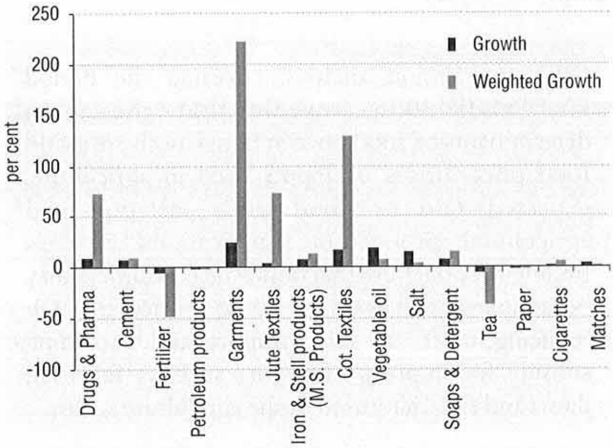


Source: CPD-IRBD Database, 2006.

During FY2006, most of the major industries achieved positive growth, for example, RMG (24.3 per cent), cotton textiles (16.5 per cent), drugs & pharma (10.3 per cent) and cement (8.2 per cent), whereas tea (-4.7 per cent), fertiliser (-4.3 per cent), paper (-0.8 per cent) and petroleum products (-0.6 per cent) suffered a decline in production.

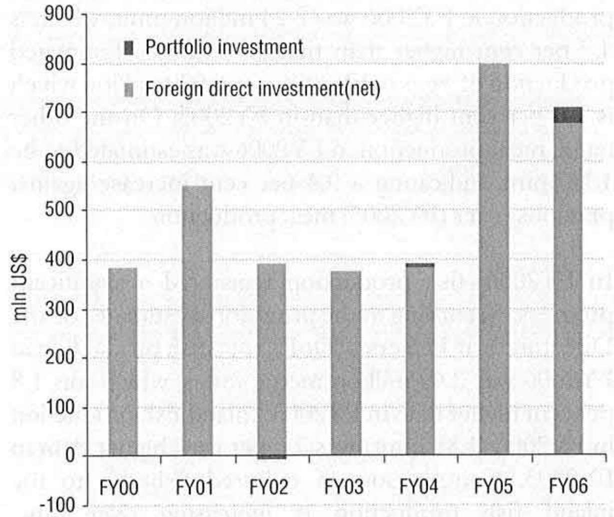
Interestingly, changes in production at individual industry level do not match with the QIP index of large and medium industries for the same period. This once again reemphasises the need for revising the 17 year old QIP weights. Comparing the sources of growth of

Figure 20: Growth in Industrial Production



Source: CPD-IRBD Database, 2006.

Figure 21: Foreign Investment during FY2000-FY2006



Source: CPD-IRBD Database, 2006.

small-scale industries with that of large ones, it was observed that growth of the former is more domestic market oriented, while growth of the latter depends on industries, such as textile, leather, apparel and wood products which are linked with international market.

CPD's analysis on the determinants of private investment, for the period FY1983-FY2003, shows that real GDP is positively related to the private investment (with elasticity of more than one), while the interest rate has a negative relationship. Also, there exists a negative relationship between the real exchange rate and private investment. This may be because of the fact that a considerable part of investment is related to import, either through import of capital machinery or through that of intermediate goods. But it was surprising to see that neither the development expenditure nor the public investment was found to be significant.

Foreign Investment

During FY2006 Bangladesh received a net amount of US$707 million as foreign investment, of which US$675 million came as foreign direct investment and the rest came as portfolio investment. Notwithstanding the recent announcement of Board of Investment (BOI) about approaching the one billion dollar mark in foreign investment, Bangladesh Bank's statistics recorded an 11.6 per cent decline in foreign investment during FY2006 over the corresponding period of the preceding fiscal year.

However, a considerable amount of FDI came in recent times primarily due to investment by some telecommunication companies, for example new investment by SingTel, reinvestment by Orascom, registration fee of Warid Telecome, etc. However, it seems that Tata's proposed investment (about US$2.5 billion) will not come on-stream before the newly elected government takes oath at the end of FY2007.

Table 4: Financial Account of Foreign Investment (FY05 & FY06)

(In million US$)

	FY2004-2005	FY2005-2006
Financial account	784	-24
i) Foreign direct investment(net)*	800	675
ii) Portfolio investment	0	32
iii) Other investment	-16	-731
MLT loans	940	921
MLT amortisation payments	-449	-489
Other long-term loans (net)	-46	-58
Other short-term loans (net)	241	-256
Other capital	-182	-245
Trade credit (net)	-320	-805
Commercial Bank	-200	201
Assets	-91	56
Liabilities	-109	145

Surprisingly, Bangladesh experienced a negative financial account of US$ (-) 24 million in FY2006, whereas the comparable figure stood at US$784 million in FY2005. A net amount of US$731 million was repatriated from the country during FY2006. As against an inflow of US$921 MLT loan, US$489 million was repatriated in FY2006. Net trade credit accounted the largest share of the total repatriation with an amount of US$805 million.

Capital Market

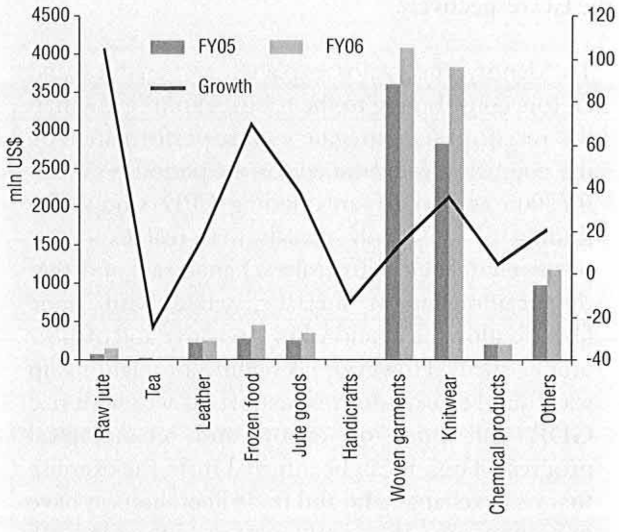
During FY2006 the Dhaka Stock Exchange (DSE) observed a decrease in all of its share price indices. All Share Price Index (DSI) declined by (-) 270 points from 1310.62 in June 2005 to 1040.47 in June 2006. The General Index AB also declined by -373.6 points from 1713.17 to 1339.5 during the same period. Surprisingly, the major shock originated from the performance of the top ranked companies--the DSE20 index lost 561.7 points, declining from 1872.6 to 1310.9 during the period under consideration. It seems that the present liquidity crisis in the money market is one of the key reasons for the continuing decline in share prices and indices. Under the current liquidity crisis in the banking sector, high deposit rate offered by banks and financial institutions may have encouraged small savers to deposit their money in banks instead of investing in capital market. Notwithstanding the deceleration of DSI, and the fact that most of the companies do not provide annual dividend to their shareholders, significant oversubscription of IPOs remained a reality. During FY2006, an amount of Tk 15.42 billion was oversubscribed. A total of 14 IPOs came to the market during FY2006 (13 companies and 1 mutual fund). Securities and Exchange Commission's (SECs) various initiatives, undertaken in the recent past, have no doubt contributed significantly to an increase in investors' confidence. However, it is also true that the large local and foreign companies (especially the telecom companies) have still not got themselves listed in the security market.

4.5 External Sector

Export

Export earnings stood at US$7,517.4 million at the end of FY2006, registering a growth of 24.7 per cent over the corresponding period of FY2005. Export earnings of all major items barring tea and handicrafts have posted positive growth rates. It is to be noted in this context that in spite of the obvious uncertainties following the phase out of the MFA as of January 2005, export earnings from woven-RMG sector increased significantly by 13.3 per cent, while knitwear-RMG posted a phenomenal growth of 35.2 per cent. This significant growth was achieved over and above the very high growth rates attained over the preceding two years, FY2005 (31.3 per cent) and FY2004 (29.9 per cent).

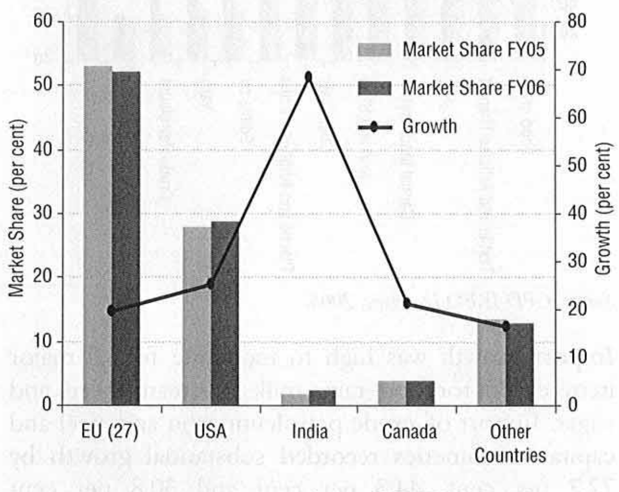
Figure 22: Export of Major Commodities (FY2005 and FY2006)



Source: CPD-IRBD Database, 2006.

Export of raw jute posted a monumental growth of 104.7 per cent and export of frozen foods registered an impressive 69.4 per cent growth over FY2005. As regards other export items, jute goods (37.7 per cent), leather (16.5 per cent) and chemical goods (4.8 per cent) experienced moderate to high growth rates. Tea and handicraft exports, however, suffered substantial export loss during fiscal year under review posting negative growth rates of (-) 25.3 per cent and (-) 13.5 per cent respectively compared to their respective exports during FY2005. In terms of export to different destinations, Bangladesh experienced highest growth in India (68.4 per cent) during FY2006. The EU and the USA has the highest market share of Bangladesh's total export which is 53.1 per cent and 27.9 per cent of the

Figure23: Market Share of Export and Growth



Source: CPD-IRBD Database, 2006.

CHAPTER 1

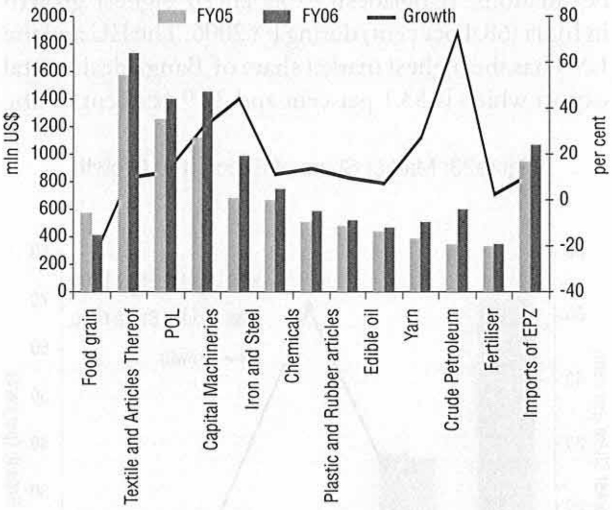
ASSESSMENT OF BANGLADESH ECONOMY IN FY2006 export in FY2006. The growth had been 25.3 per cent, 21.1 per cent and 19.6 per cent in the USA, Canada and the EU respectively.

To identify the major explanatory variables and factors contributing to the robust export growth in the recent past, aggregate export performance of the country was examined for the period FY1983-FY2005 as part of an ongoing CPD study. The finding of the study reveals that real export is positively related with real exchange rate and that the relationship is inelastic, while with trade liberalisation the relationship is positive and of near unit elasticity. However, no significant relationship was found to exist for real export growth with real GDP, unit price of export and technological progress. Thus, it can be inferred from the exercise that real exchange rate and trade liberalisation have impacted on the real export dynamics of Bangladesh.

Import

Total imports during FY2006 amounted to US$14,746.4 million, showing a growth rate of 12.2 per cent compared to the imports of the previous fiscal year. It needs to be noted in this context that this significant growth was registered over the high benchmark of 20.6 per cent posted during FY2005.

Figure 24: Import Growth in FY2005-FY2006



Source: CPD-IRBD Database, 2006.

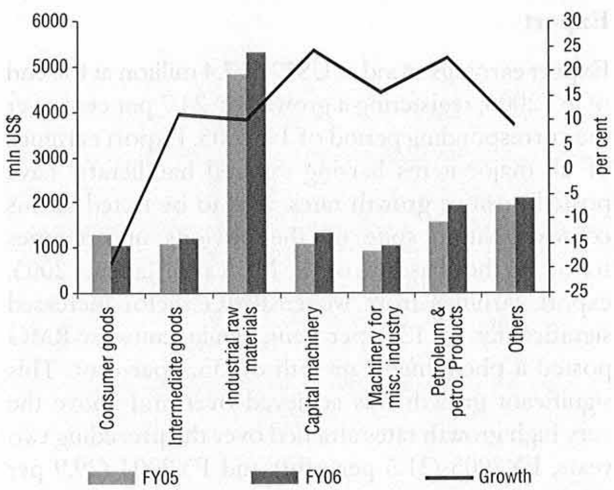
Import growth was high to moderate for all major items except for foodgrains, milk and cream, spices and sugar. Import of crude petroleum, iron and steel and capital machineries recorded substantial growth by 72.7 per cent, 44.3 per cent and 30.8 per cent respectively. Among the major increases in value terms, significant growth in imports was registered by yarn (27.4 per cent), clinker (23.7 per cent) and pharmaceutical products (21.1 per cent). Moderate growth was registered for chemicals (13.9 per cent), dying and tanning (12.0 per cent), POL (11.8 per cent) and raw cotton (11.5 per cent). During FY2006 imports by EPZ registered a growth of 11.6 per cent. Indeed, this high import growth is underpinned by either increase in investment demand or rise in global commodity prices. The rise in import payments is likely to continue for some time to come, which could put the BOP situation under significant pressure in the coming days.

An econometric analysis for the period FY1983-FY2005 shows that real import has positive elastic relationship with real GDP, negative inelastic relationship with real exchange rate and negative elastic relationship with unit price of import. It may be inferred from the exercise that real GDP, real exchange rate and unit price of import have impacts on real import.

Opening and Settlement of Import LCs

Letter of credits (LCs) worth about US$13,949.9 million was settled during July-June period of FY2006, registering a growth of 10.2 per cent over the corresponding period of the last year. Data on fresh openings of import LCs during the FY2006 amounted to US$15,245.4 million, registering a 8.4 per cent growth. During this period, settlement and opening of LCs for consumer goods decreased by (-) 19.2 per cent and (-) 26.3 per cent respectively. However, LC

Figure 25: Settlement of LC During FY2005-FY2006



Source: CPD-IRBD Database, 2006.

settlement of capital machineries, machinery for miscellaneous industries, and of petroleum and petroleum products registered significant growth rates of 24.0 per cent, 15.5 per cent and 22.5 per cent respectively.

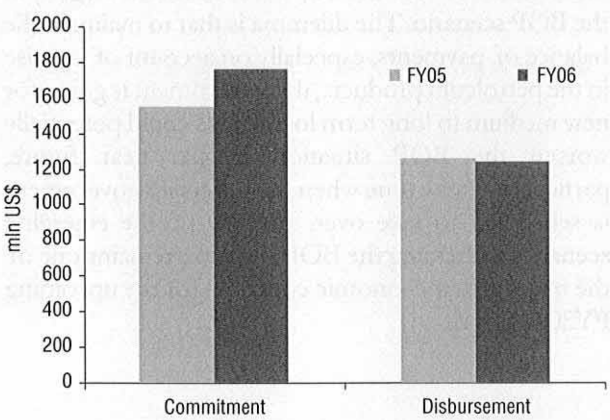
In the case of fresh opening of LCs, capital machineries, however, registered a negative 1.0 per cent growth, while petroleum and petroleum products registered a significantly high growth of 31.9 per cent during FY2006 over the last fiscal year (FY2005).

Foreign Aid

During FY2006, an amount of US$1241.21 million was disbursed as foreign aid which indicates a decline of 1.49 per cent compared to FY2005. After accounting for the payment of principal (US$489.0 million), net foreign aid during FY2006 stood at US$752.21 million, which is 7.3 per cent less than the corresponding figure of the preceding year. However, commitment of aid during FY2006 stood at US$1,759.03 million, which is 13.3 per cent higher than the commitment of FY2005.

Projections of foreign aid disbursement in FY2007 also indicate to a declining trend. Only US$756 million worth of new commitments have been made till February 2006 which is only half of the US$1,552.3 million committed during FY2005. In the revised budget for FY2006 the budgetary support of foreign aid has increased by 46.6 per cent while special support, commodity aid and policy loan decreased by 38.4 per cent, 75.0 per cent and 47.8 per cent respectively. Government projection for the FY2007 indicates a 22.8 per cent increase in project aid over the revised figure for FY2006. However, it ought to be kept in mind that no policy loan is projected for the next fiscal year.

Figure 26: Flow of Foreign Aid during FY2005-FY2006



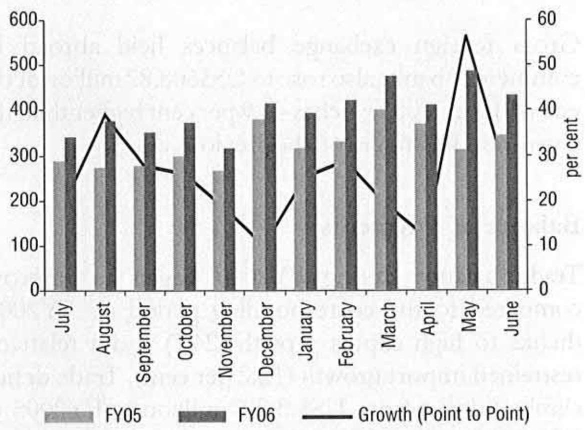
Source: CPD-IRBD Database, 2006.

Low off-take of foreign aid resulted in severe pressure on domestic sources of borrowing in the early part of FY2006. Under the circumstances, the government was likely to put more emphasis on quick disbursing budgetary support. However, the Development Support Credit (DSC) IV (around US$150 million) is still under consideration and likely to be disbursed only after a new government takes oath. The World Bank has already announced the conditionalities for the disbursement of DSC IV, which includes, among others, presenting the procurement law in the next session of the Parliament, adjusting the prices of petroleum products and natural gas, and selecting a strategic buyer for Rupali Bank.

Remittances

An impressive performance of the remittance flow helped to ease the pressure on the balance of payments during FY2006. Remittance posted a growth of 24.9 per cent during FY2006 when compared with the remittance earnings of the previous fiscal year. Total workers' remittance during FY2006 stood at US$4,806.3 million, which was US$3,848.3 million at the end of FY2005. Remittance inflow in a single month (US$487.2 million) was highest in May 2006.

Figure 27: Monthly Trend in the Flow of Remittance During FY2005-FY2006



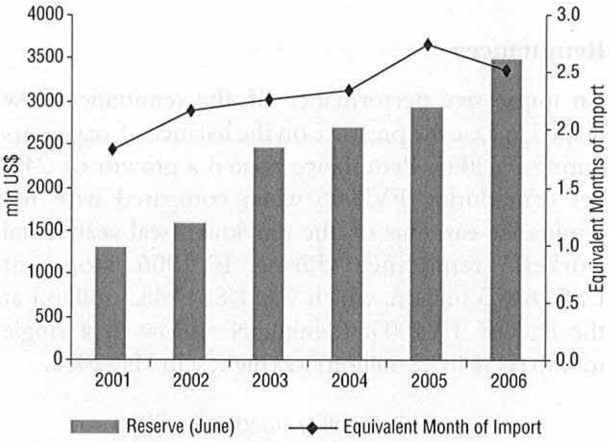
Source: CPD-IRBD Database, 2006.

This high inflow took place in the backdrop of the fact that during FY2006 the number of workers going abroad through formal channel for employment increased to 286,381 from the level of 251,699 recorded at the end of FY2005.

Foreign Exchange Reserves

Foreign exchange reserve was under considerable pressure during the first two quarters of FY2006, and came down from US$2829.34 million in July 2005 to US$2416.80 million by the end of November 2005. Following the release of the DSC III of the World Bank, and in the context of a controlled import and buoyant export-remittance earnings, foreign exchange reserves started to rise in recent months. At the end of June 2006, foreign exchange reserves stood at US$3483.78 million which is about 18.90 per cent higher than that of the corresponding month of the previous year. This amount is equivalent to 2.5 months' import of the country.

Figure 28: Foreign Exchange Reserves and Equivalent Month of Import



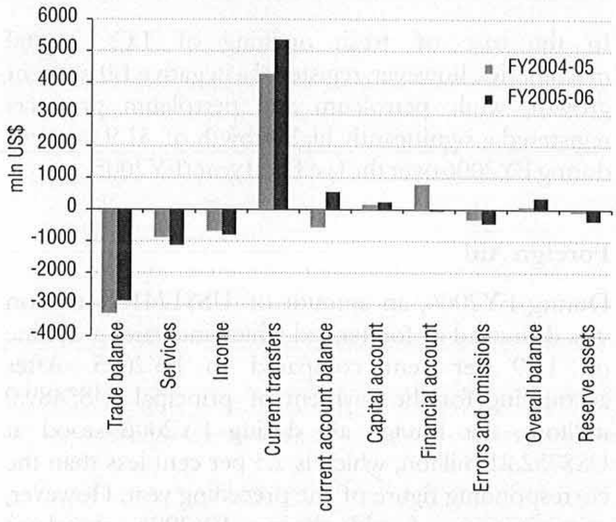
Source: CPD-IRBD Database, 2006.

Gross foreign exchange balances held abroad by commercial banks also rose to US$608.82 million at the end of June 2006, which is 46.9 per cent higher than the corresponding figure of the previous year.

Balance of Payments

Trade balance during FY2006 began to improve compared to the corresponding period of FY2005, thanks to high export growth (24.7) and a relatively restrained import growth (12.2 per cent). Trade deficit climbed down from US$ 3,297 million in FY2005 to US$ 2,879 million during FY2006. It may be mentioned here that the first reading of the IRBD 2005 predicted in January 2006 that the external balance may experience a favourable change in the upcoming months since the export was picking up and import was slowing down. Despite the larger service (-US$1,110 million) and income deficit (-US$786 million), the current account balance recorded a surplus of US$572 million during FY2006 against the deficit of US$557 million during FY2005, thanks to the higher levels of current transfers to the tune of US$ 5,347 million during the reporting period.

Figure 29: Balance of Payment Scenario during FY2005-06



Source: CPD-IRBD Database, 2006.

Outflow on account of the financial account is emerging as the villain in the country's balance of payment. On financial account, BOP experienced a net outflow of US$24 million during FY2006, as against the US$784 million inflow during FY2005. Major sources of financial outflow occurred from the *Other Investment* (-US$731 million), MLT amortisation payments (-US$489 million), other short-term loans (-US$256 million) and net trade credit transfer (-US$805 million). Despite a large net financial account outflow, due to the surplus in current account balance and a moderate deficit in trade balance, BoP experienced a surplus in the overall balance to the tune of US$365 million during FY2006 as against a surplus of US$69 million of FY2005.

It appears that rise of petroleum price in the world market has not been the major reason for the fragility in the BOP scenario. The dilemma is that to maintain the balance of payments, especially on account of the rise in the petroleum products, the government is going for new medium to long term loans. This could potentially worsen the BOP situation in the near future, particularly at the time when the Caretaker government is scheduled to take over. In view of the emerging scenario, addressing the BOP situation remains one of the major macroeconomic concerns for the upcoming FY2007 as well.

5. CHALLENGES AND OUTLOOK FOR FY2007

Control High Inflationary Pressure

Major economic challenge for the upcoming FY2007 is the control of high inflationary trend which is being observed in the economy at present. In view of the high prices of foodgrains in the international market, the prospect of restraining the rise in the price of imported food items does not appear to be a viable proposition. In case of agricultural commodities, the government will need to undertake special measures to increase the production of crops, particularly by way of ensuring availability of quality inputs (seed, fertiliser) to the farmers and by taking appropriate measures in order that the benefits from subsidies allocated to agriculture sector reach the farmers. Special budgetary measures will be required to face natural calamities, if any, such as flood and drought, through prompt rehabilitation programmes. In order to control the inflationary pressure, contractionary monetary policy, which appears to work, may have to be brought into play. Government should focus more on ensuring supply of commodities in the market by reducing various duties, tariffs, etc. Currently, some commodities such as sugar have high tariffs. If tariffs on sugar can be reduced, inflation may be curbed and competitiveness of agro-processing industries can be increased. A major part of the inflationary spiral is related to syndication in the marketing channel of various essential products. Under the prevailing market based economic system, one of the major challenges for the government is to control the oligopolistic behaviour, particularly in the markets for food items, through effective monitoring and appropriate supervision.

More Effort to Increase Tax Base

The government needs to expand the tax base in order to increase tax revenue. Immediate measures to achieve this target may include increasing the number of tax payers, reducing the gap of corporate tax between the listed and unlisted companies, extending the coverage of the highest corporate tax slab by including other high-profit industries, rationalising the duty structure of different products imported under the category of capital machinery, intermediate products and raw materials, rationalising the structure of existing investment incentives, and improving auditing system for augmenting revenue collection from the corporate sector.

Maintaining Safe Level of Foreign Currency Reserve: Maintaining a safe level of foreign currency reserve has become a challenge for the government, particularly in view of the growing imbalance in the current and capital accounts. Rise of import payments for petroleum products due to higher, and still rising, price in the international market will continue to put pressure on the exchequer. The large amount of foreign currency repatriated by foreign companies, against a much lower inflow of FDI, is likely to further aggravate the BOP situation. Growing pressure on the BOP account is likely to lead to more depreciation in the value of taka, with resultant increase in price of import.

Take Necessary Measures to Solve Power Crisis: Frequent power outages severely affect production, investment and overall domestic activity. As an immediate (but provisional measure), government should rent portable power plants (although the cost will perhaps be quite high). The government should keep in mind that high costs involved in setting up power plants would put considerable burden on the caretaker administration and the next government. But such a measure cannot perhaps be avoided and as a long term measure government should immediately take the necessary steps to establish medium-scale (500 MW) power plants under a targeted time schedule. In order to solve the crisis of fund, the government should raise the electricity tariffs to a reasonable level.

Take Measures to Increase Oil Price

In view of rapid rise of petroleum products in the global market, the government should raise domestic fuel price to reduce the pressure on the exchequer. This will reduce the amount of subsidy given to the consumers which is quite large at the moment. Considering the nature of use by various consumer groups, this upward rationalisation of oil prices ought to be made with due caution, taking into consideration its impact on the various consumer groups and the economy as a whole. Since diesel and kerosene are largely used for irrigation, transport and rural household purposes, their price should be fixed at a reasonable level. On the other hand, a higher rise in octane price should be tolerated by the consumers who happen to be from affluent urban households.

Ensure More Foreign Aid Disbursement

Low disbursement of foreign aid is a major concern for the government. Although importance of foreign aid in the overall budget has been on the decline in recent years, its role in the development of particular sectors including infrastructure and human resource development related ones should not be lost sight of. Instead of focusing on large number of unimportant and irrelevant road projects, often arising out of political consideration, the government should focus on strategic network development of the entire country.

Immediate Decision Regarding Large Scale FDI Projects

The present government will need to make appropriate decision, however difficult these may be, regarding large scale foreign investment proposals, particularly those of the Tata and Asian Energy. Government is yet to take a decision on Tata's recently submitted revised proposal with its new offers concerning price of gas, long term gas supply and other relevant aspects. If the present government hesitates to make its position clear now as regards the Tata investment, the decision would be inordinately delayed since the caretaker government will not take any decision on it and the momentum will be lost when a new government takes over. Besides, the controversial agreement between the government and the Asia Energy regarding coal mining at Phulbari may have to be renegotiated by the incumbent government. The draft coal policy has given rise to debate on various issues, including royalty payment, export limit, renovation and rehabilitation, pace of coal extraction, etc. This is so particularly in view of the fact that the present offered level of royalty payments is considered to be low (6 per cent), while this is substantially higher in other countries (13 per cent in Indonesia).

Provide Sufficient Fund for National Election 2007: The government should allocate adequate funds in view of the upcoming national election 2007. The Election Commission will need to undertake a number of critically important tasks in order for the next election to be free and fair. This includes updating the voter list based on the list of 2001, appointment of competent officers, extensive media campaign, etc. Considering the importance of the upcoming election, every effort should be made for raising the efficacy of the functioning of the Election Commission.

Safety Net and ADP Implementation

Safety net programmes should be adequate in terms of coverage, allocation and implementation. ADP projects need to be undertaken solely on the merit of their relevance and importance from the perspective of developmental impact. Allocation for critical sectors such as electricity should get priority in this respect.

6. CHALLENGES FOR THE CARETAKER GOVERNMENT

It is to be expected that the caretaker government will manage the economy by maintaining a low profile which would mean that only urgent decisions of immediate importance for the smooth functioning of the economy will be taken by this government. Most important economic challenges that the caretaker government is likely to face will emanate from budgetary measures proposed in key areas. Some of the critical issues will relate to pricing of fuel and other utilities, foreign exchange management, settlement of aid deals with IMF and other bilateral and multilateral development partners, settlement of pending decisions on important economic matters such as the Tata investment proposal and installation of new barge-mounted power plants, etc. The caretaker government may be forced to decide on foreign financing for fuel import. If it cannot obtain soft loan for fuel import from sources such as the IDB, it may be put under tremendous pressure. It will be good for the caretaker government if the outgoing government settles all the pending issues mentioned in the previous section. The caretaker government may face the following six major challenges related to economic policymaking and administration:

(i) Decide on implementation priorities of the over-ambitious budget for FY2006-07 without the backing of a realistic revenue flow and foreign aid disbursement, and in view of the possibly very high release of development funds during the first quarter of the fiscal year;

(ii) Face the challenge in the areas of balance of payments and exchange rates, and serious fund shortages if fuel prices are not increased and aid deals are not settled by the outgoing government;

(iii) Manage inflation at a reasonable level and ensure food security of poor communities during the lean season when employment opportunities are generally low but there is likely to be high spending for election-oriented activities by certain quarters;

(iv) Bear the additional cost to maintain law and order situation if there is increased violence and conflicts in the country;

(v) Ensure power supply in a situation which might be constrained by inadequate supply and low price; and

(vi) Effective participation in the WTO negotiations as the Doha Round comes to a close.

7. CONCLUDING OBSERVATIONS

Fiscal year 2005-06 kicked off with a stressed fiscal balance (arising from the revenue expenditures outpacing the revenue receipt) and stretched balance of payment (due to imports outpacing exports). The macroeconomic fundamentals were further strained as the economy was struck by the double whammy: low net flow of foreign assistance as well as FDI. The shocks generated in the external balance led to high public borrowing to meet the shortfall in financing the overall budget deficit. In the mean time, a cost-push inflationary pressure in conjunction with high levels of government's borrowings was further fuelled by global price hike of commodities (particularly of petroleum and food items). However, robust growth of exports and remittances proved to be the saving graces for Bangladesh in FY2006.

In this backdrop, CPD in its First Reading of IRBD 2006 in January 2006 (based on information for first four months of the fiscal year) noted that the government will have to weigh between two options in terms of monetary and fiscal stances. Under the first option the government may have to consider a moderate growth rate (say 5 per cent plus) predicated by lower monetary expansion and managed public investment. Alternatively, the government may opt to ride over the situation with a high spending-high growth approach.

Now with data available for nine months, it seems that the government pursued the first option, partly by commission (in the case of monetary policy) and partly by default (in the case of public investment management). As the BOP came under severe pressure during August-October 2006, coupled with peaking of the rate of inflation in October-November 2006, the central bank changed its monetary stance. Towards the end of 2005, the Bangladesh Bank started to bring down the aggregate credit expansion rate by moderating credit flow to the private sector as it could not control borrowing by the government (which needed to underwrite liabilities of the BPC). The central bank, through the secondary market operation of government's bills and bonds and increasing the SLR and CRR as well as through "moral suasion," pushed up the real rate of interest by February 2007.

The anticipated conflict between the contractionary monetary stance and expansionary fiscal stance was largely resolved when the government failed to implement the ADP even at its average low level. Regrettably, the fiscal space created by the non-implementation of ADP was greatly filled up by the monetary expansion in the quasi-government sector. However, by January-March 2006, one observes a certain degree of stabilisation as the import growth slowed down and growth of inflation rate decelerated.

Notwithstanding the above, the economic growth rate did not suffer in FY2006, as it benefited from the private investment momentum which built-up during the earlier year and thanks to the intrinsic resilience which the economy has acquired in the recent past. Thus, one observes the robust growth of agriculture, manufacturing, exports and remittances in spite of the severe breakdown of the policy and institutional support mechanism of the government (e.g. acute shortage of electricity and widespread allegation of corruption in the sector from tendering projects to bill collection). Such a situation has only worked against the interest of the poor making the income distribution further skewed.

However, the economic growth outlook for FY2007 seems to be somewhat sober. The stagnation in industrial credit and decline in agricultural credit disbursement are going to have lagged effect on the GDP growth. Recent L/C opening information also corroborates this apprehension. The economy, which is poised to be managed by three governments, cannot expect any spectacular improvement in the delivery of public investment programme during the coming year to pick up this slack left behind by the private sector. Thus, FY2007 will be a year of economic hiatus underpinned by slowdown in economic growth.

Concurrently, the PRSP process will effectively go into a hibernation. It is possibly from FY2008 that we may expect to have a full blooded (and recast) national poverty alleviation plan, whichever party wins the next elections. This is, however, not to say that the ongoing foreign aided projects will come to a standstill during the interim period.

This is not so exciting a prospect for FY2007, and the challenges awaiting the next caretaker government may ease a bit if the outgoing government can demonstrate a degree of responsibility and sagacity in formulating the next year's budget and in its implementation during its remaining period (July-October 2006). Although the Finance Minister has repeatedly emphasised that he was not inclined to make the economic tasks of the caretaker government more difficult, the fact of the matter is that he is not a free agent in terms of policymaking. First, policymaking in Bangladesh remains captive to the conditionalities agreed upon while accessing loans from the IFIs. It may be recalled that within less than two months of adoption of the national budget for FY2006, the government had to undertake major reduction of tariff, in violation of fiscal discipline, to satisfy the IFIs. Second, the policymaking process in Bangladesh remains beholden to powerful and entrenched private interest groups. This observation is best evidenced by the continuation of the tax amnesty accorded to the black money holders in the budget for FY2006, though the Finance Minister had openly admitted that this was an unethical and discriminatory measure. Third, policymaking in Bangladesh is greatly influenced by myopic political considerations, rather than by persuasive economic rationale. The inability of the Finance Minister to undertake a much needed fuel price revision in the face of opposition from within the ruling party is a case in point. He failed to do so even when the professionals expressed their open support for this unpopular measure while the opposition remained silent about the issue.

Early indications suggest that the budget for FY2007 will bring no major surprises and is expected to journey through the trodden track. However, we choose to refrain from pre-judging the budget for FY2007, and will remain prepared to be pleasantly surprised.

Annex 1: BALANCE SHEET OF BANGLADESH ECONOMY IN FY2006

Indicator	FY2005	FY2006	FY2007 (PRSP)
Revenue Receipts	The revenue-GDP ratio remained at 10.7 per cent. However, growth of total receipt was 13.3 per cent over FY2004. NBR and non-NBR components rose by 12.7 per cent and 15.33 per cent respectively.	The government set a target for FY2006 at 11.0 per cent of GDP. Growth of revenue receipts (Jul-May) was 16.19 per cent over the corresponding period of FY2005.; 81.4 per cent of the target for FY2006 was actually realised during this period. Growth of NBR (July-June) and non-NBR (July-June) tax revenue was 13.65 per cent and 7.37 per cent respectively.	A new target was set for FY2007 at 11.3 per cent of GDP.
Public Expenditure	For the first time in the recent past, the total revenue earnings rose by only 13.3 per cent as against 18.0 per cent growth in total public expenditure.	The government has set the growth of public expenditure at 15.7 per cent.	The PRSP target for public expenditure for FY2007 was set at 15.5 per cent of GDP.
a. Revenue Expenditure b. ADP	Revenue expenditure registered a significant 22.17 per cent growth against a 11.1 per cent ADP growth.	Actual revenue expenditure (July-May) was higher than that of FY2005; it was only 75.9 per cent of the target. Only 79.5 per cent of the original ADP allocation has been spent during FY2006.	The government has set a new target for ADP at 6.2 per cent of GDP.
Fiscal Deficit	The actual budget deficit was 3.0 per cent which was lower than the PRSP target (4.7 per cent). The share of domestic financing was 54.8 per cent of total deficit financing.	The government has set a target at 4.5 per cent of GDP. The overall fiscal deficit was 22.67 per cent higher than the matching period of FY2005. While net foreign financing showed a growth of 1.55 per cent, the share of domestic financing increased by 7.79 per cent at the end of FY2006.	The government has set a new target at 4.4 per cent of GDP, of which 2.5 per cent was expected to come from foreign financing and 1.9 per cent from domestic sources.
Domestic Credit Expansion	Total domestic credit (M3) registered a substantial 16.19 per cent growth over FY2004. The share of private sector was 61.24 per cent and private sector credit experienced a stable growth of 18.3 per cent.	Total domestic credit (M3) registered a growth of 18.05 per cent over the corresponding period of FY2005. Private sector borrowing (18.68 per cent growth) surpassed public sector borrowing (17.05 per cent growth) by a big margin.	The government has set a target for private sector credit at 13.0 per cent of GDP.
Industrial Credit	Disbursement of term loan registered a 36.5 per cent growth, while disbursement of working capital registered a 18.6 per cent growth.	Net disbursement of term loan was 409 per cent more than the equivalent figure of FY2005, while the recovery showed a negative growth of 20.9 per cent on point to point basis. On the other hand, disbursement of working capital recorded a noteworthy growth of 28.3 per cent, while the sanction of working capital registered a growth	

Indicator	FY2005	FY2006	FY2007 (PRSP)
		of 30.5 per cent over the same period of FY2005.	
Agriculture Credit	Credit disbursement was 22.4 per cent higher than FY2004.	Credit disbursement was 10.88 per cent higher than the corresponding period of FY2005.	
Loan Classification	Total classified loan registered a 14.7 per cent growth over FY2004.	Classified loan registered a 27.3 per cent growth over the corresponding period of FY2005.	
Price Inflation	The national inflation on point to point basis was 7.35 per cent, whereas the 12-month moving average inflation rate was 6.49 per cent.	Inflation rate was set at 6.5 per cent in the PRSP on the basis of moving average for FY2006. During the fiscal year, inflation rates on point on point basis and on the basis of moving average were 7.54 per cent and 7.16 per cent respectively.	The new target was set at 6.8 per cent on the basis of moving average.
Agriculture Output	Total rice production was 3.9 per cent lower and total foodgrain production was 4.8 per cent lower compared to that of FY2004.	The operational target was set at 20.36 per cent growth over FY2005. Although both Aman and Aus production in FY2006 were higher than the previous year's production, they missed the target production for the current fiscal year. Total import of foodgrains during FY2006 was about 24 per cent less than that of comparable months in FY2005.	
Industrial Production	QIP indicated a 6.9 per cent growth of industrial production.	During FY2006, QIP increased by 13.0 per cent over the corresponding period of FY2005.	
Foreign Investment	Bangladesh received US$800 million as FDI in FY2005. Total flow of foreign investment was 104.6 per cent higher than FY2004.	During FY2006, Bangladesh received an amount of US$707 million as foreign investment which recorded a (-) 11.6 per cent decline over the equivalent period of FY2005.	
Capital Market	Both DSE and CSE observed an increase in share price index. The issuance of IPO increased as 20 new IPOs entered into the capital market.	During FY2006, DSE observed a slow decrease in all of its share price indices. Total 14 IPOs came to market during the fiscal year (13 companies and 1 mutual fund).	
Export	Export earnings showed a highly encouraging growth of 13.83 per cent over FY2004. It has attained the strategic export target.	During FY2006, export registered a robust growth of 24.7 per cent over FY2005 which attained the strategic export target.	The new target was set at US$10,946 million which is 12 per cent higher than the target for FY2006.

Indicator	FY2005	FY2006	FY2007 (PRSP)
Import	Imports registered a significant growth of about 21 per cent compared to FY2004. Fresh opening and settlements of LCs registered a growth of 17.2 per cent and 13.5 per cent respectively over FY2004.	Growth rate of imports was 22.9 per cent compared to the corresponding period of FY2005. Fresh opening and settlements of LCs during the fiscal year registered a growth of 8.4 per cent and 10.2 per cent respectively over the corresponding period of FY2005.	The new target was set at US$15,493 million which is 13.5 per cent higher than the target for FY2006.
Remittances	Remittance earnings have registered an impressive 14.13 per cent growth over FY2004.	Remittance earnings registered a 24.9 per cent growth during FY2006.	The new target was set at 12.0 per cent over the target for FY2006.
Foreign Aid	Disbursement of foreign aid stood at US$1,258.05 million, registering a 32.1 per cent growth over FY2004.	Flow of foreign aid in terms of disbursement decreased by 1.3 per cent in FY2006 compared to FY2005.	
Foreign Exchange Reserve	Foreign exchange reserves stood at US$2,930 million at the end of June 2005, which was about 8.3 per cent higher than FY2004.	At the end of 2006, foreign exchange reserves stood at US$3,484 million (which was 18.9 per cent higher than that of the corresponding month of FY2006), thanks primarily to the release of the World Bank Development Support Credit III.	The target was set at US$3,655 million.
Balance of Payments	The overall balance stood at US$67 million during FY2005, hinting at a deterioration in the BoP situation. Higher import growth offset the benefits of the robust export growth and high levels of remittance flow, resulting in a deficit of (-) US$557 million in current account balance during FY2005.	The current account balance recorded a surplus of US$572 million during FY2006 against a deficit of US$557 million during FY2005. The balance of payments (BoP) experienced a net outflow of (-) US$24 million in contrast to the US$784 million inflow registered for FY2005.	

Participants at the Experts Group Meeting

As has been the tradition in recent years, CPD organised two Expert Group Consultation Meetings on 02 January 2006 and 30 May 2006 to discuss the working documents of respectively the First and Second Reading of the *State of the Bangladesh Economy FY2006*. Held in the CPD Dialogue Room, this in-house meeting was attended by a distinguished group of high level policymakers and professionals.

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

IRBD 2006 (First Reading)

Dr Fakhruddin Ahmed	Managing Director, PKSF and Former Governor, Bangladesh Bank
Dr A M M Shawkat Ali	Former Secretary, Government of Bangladesh and Chairman, Shawkat & Associates Ltd.
Mr Siddiqur Rahman Choudhury	Secretary, Finance Division, Ministry of Finance Government of Bangladesh
Dr Mohammed Farashuddin	Former Governor, Bangladesh Bank President, Board of Directors and Vice Chancellor, East West University
Dr Saadat Husain	Former Cabinet Secretary, Government of Bangladesh and Chairman, Bangladesh NGO Foundation
Dr Mirza Azizul Islam	Chairman, Security Exchange Commission and former Director, UN-ESCAP, Bangkok
Mr Khondkar Ibrahim Khaled	Managing Director, Pubali Bank and former Deputy Governor, Bangladesh Bank
Professor Wahiduddin Mahmud	Department of Economics, University of Dhaka and former Finance Advisor to the Caretaker Government
Dr. Masihur Rahman	Former Secretary, Government of Bangladesh and Managing Director, Credit Rating Agency of Bangladesh (CRAB)
Mr. M. Syeduzzaman	Member, CPD Board of Trustees former Finance Minister and Chairman, Bank Asia
Dr Sajjad Zohir	Senior Research Fellow, BIDS and Executive Director, Economic Research Group (ERG)
Professor Rehman Sobhan	Chairman, CPD chaired the session.

IRBD 2006 (Second Reading)

Dr Fakhruddin Ahmed	Managing Director, PKSF and Former Governor, Bangladesh Bank
Dr Quazi Mesbahuddin Ahmed	Member (GED), Planning Commission
Professor Syed Moinul Ahsan	WBI Resident Advisor, Bangladesh Bank
Dr Mohammed Farashuddin	President, Board of Directors, East West University and Former Governor, Bangladesh Bank
Dr Saadat Husain	Former Secretary, Cabinet Division and Chairman, Bangladesh NGO Foundation
Dr Mirza Azizul Islam	Chairman, Sonali Bank and Former Chairman, Securities and Exchange Commission
Dr Akbar Ali Khan	Director, Centre for Governance Studies BRAC University
Dr Kaniz Siddique	Consultant, Ministry of Finance
Mr M Syeduzzaman	Member, CPD Board of Trustees and Chairman, Bank Asia

The CPD-IRBD Research Team sincerely acknowledges their contribution in terms of sharing views and providing comments on the draft reports placed for discussion at these meetings. However, the IRBD Team 2006 alone remains responsible for the analysis and opinion expressed in the report.