Analytical Review of Bangladesh's Macroeconomic Performance in Fiscal Year 2014

(Second Reading)

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Contents

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The CPD IRBD 2014 Team would like to register its sincere gratitude to *Professor Rehman Sobhan*, Chairman, CPD for his advice and guidance in preparing this report.

As part of the CPD-IRBD tradition, CPD organised an Expert Group Consultation on 22 January 2014 at the CPD Dialogue Room. The working document of the *Analytical Review of Bangladesh's Macroeconomic Performance in Fiscal Year 2014 (Second Reading)* prepared by the CPD IRBD 2014 team was shared at this in-house meeting with a distinguished group of policymakers, academics and professionals. The CPD team is grateful to all of those present at the consultation for sharing their views, insights and comments on the draft report. A list of the participants of the meeting is provided below (in alphabetical order):

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The team gratefully acknowledges the valuable support provided by *Ms Anisatul Fatema Yousuf*, Head and Director, Dialogue and Communication Division, CPD and her colleagues at the Division in preparing this report. Contribution of the CPD Administration and Finance Division is also highly appreciated. Assistance of *Mr A H M Ashrafuzzaman*, Deputy Director (System Analyst) and *Mr Hamidul Hoque Mondal*, Senior Administrative Associate is particularly appreciated.

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The CPD IRBD 2014 Team alone remains responsible for the analyses, interpretations and conclusions presented in this report.

1. INTRODUCTION

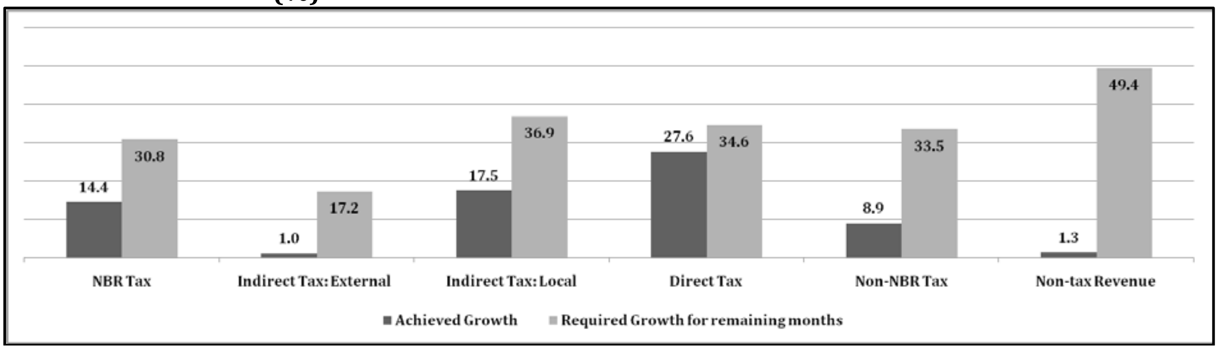
The present document has been prepared under flagship programme of the Centre for Policy Dialogue (CPD) titled *Independent Review of Bangladesh's Development (IRBD)*. The IRBD is geared towards assessing the performance of the country's economy and key related variables on a continuing basis. The present document is the second instalment of FY2014 prepared under the abovementioned programme focusing on the first six months and also looking ahead. The document seeks to address three areas - (i) an assessment of macroeconomic developments during the first half of FY2014, from the particular perspective of capturing the impact and implications of the protracted political turmoil of the recent past; (ii) consequences of the impacts for macroeconomic management and the required adjustments in policies; and (iii) taking cue from the above, to undertake projections on growth prospects and identify required policy measures in view of the emerging challenges. Following this introduction, the next section reviews the macroeconomic performance during the first half of FY2014. The next four sections undertake a more detailed analysis of performances of four critical sectors of the economy – agriculture, banking, export and manufacturing. The paper intends to close with a set of policy suggestions originating from the review undertaken in this report.

2. MACROECONOMIC MANAGEMENT IN FY2014

2.1 Fiscal Sector

Revenue Earnings Scenario. During July-November period of FY2014, National Board of Revenue's (NBR) achievement was to the tune of a 14.4 per cent growth compared to the corresponding periods of FY2013. During the first half of FY2014, NBR fell short of about Tk. 8,500 crore from its strategic target.[1] Only revenue collection from income tax approximated the target,[2] while mobilisation from other sources, as also collection from non-NBR tax and non-tax-revenue heads, were found to fall behind the targets (Figure 2.1). Revenue collection from non-tax revenue sources registered a growth rate of 1.3 per cent against the budget target of 22.8 per cent and is unlikely to attain the annual target.[3]

FIGURE 2.1: GROWTH (%) OF DIFFERENT SOURCES OF REVENUE



Source: Based on National Board of Revenue (NBR) and Ministry of Finance (MoF) data.

[1] http://newagebd.com/detail.php?date=2014-01-14&nid=80285#.Ut0hLtLxLIU

[2] 28.3 per cent achieved in first 5 months against a target of 32.1 per cent over the actual collection in FY2013.

[3] Bangladesh Telecommunication Regulatory Commission (BTRC) has collected the first instalment of 3G spectrum fees (Tk. 2,500 crore) from the mobile telecom operators in October 2013. The second instalment, due on the second half of FY2014, will expect to generate another Tk. 1,600 crore. However, these payments may not be enough to reach the targets of other non-tax revenue sources.

The slack in the performance as regards revenue collection could be explained by the following factors. *First*, the government, while designing fiscal measures for FY2014, had come up with a number of fiscal incentives including increase in the threshold for non-taxable income limits for individuals; reduction and exemption of a number of tax rates; raising the limit for investment for tax rebate and also enhancing the related tax exemption margin. These fiscal measures had some impact in terms of lower revenue collection. *Second*, domestic demand experienced a significant decline due to recent political impasse. The slowdown in economic activities had a direct impact on revenue mobilisation. NBR extended the deadline for submission of income tax return by three months, an unprecedented move, however, tax returns filed in FY2014 was one lakh lower than that of FY2013. *Third,* during the first five months of FY2014, growth in import payments did not correspond to import related tax collection. Indeed, a significant part of the import growth was attributed to duty exempted goods (i.e. foodgrains, readymade garments (RMG) export related imports and capital machineries). Global commodity prices were stable and exchange rate of BDT experienced some appreciation (4.3 per cent in July-December 2013 compared to the corresponding periods of 2012) against USD. These also had a lowering impact on tax collection at import stage. *Fourth*, initiatives concerning expansion of tax net were seriously impeded during the first half of FY2014.

The recently announced incentives to business may also result in somewhat lower tax collection. The government has decided to provide a number of fiscal incentives to exporters in view of helping them recover losses arising from the prolonged political turmoil at a time when minimum wages had seen significant increase. A CPD estimate found that the revenue foregone from reduction of advanced income tax (AIT) on apparel exports alone could be worth more than Tk. 500 crore.[4]

Public Expenditure. The public expenditure growth for FY2014 will be to a higher tune of 27.7 per cent over the actual expenditure in FY2013. It may be noted here that, actual expenditure in FY2013 was only 14.3 per cent higher compared to the same of FY2012. During July-November period total public expenditure registered a growth rate of 13.1 per cent.

Non-development revenue expenditure was projected to grow by 13.7 per cent in FY2014. During the first five months of FY2014, the expenditure head registered only 8.0 per cent growth. According to BFY2014, government's sector-wise emphasis showed increased expenditure on public services, domestic interest payments and on non-development capital expenditures in FY2014. CPD, in its earlier review (in October 2013) briefly examined the initiatives taken by the government with regard to these expenditures and anticipated a significant rise on account of these heads in FY2014. Actual expenditure on non-development capital expenditure (includes investments in share capital, equity investment and investment for recapitalisation) may fall short of the target due to shortage of funds from revenue mobilisation. One significant feature of FY2014 could be lower demand on account of subsidy payments.[5]

Development expenditure registered a growth rate of 22.6 per cent during July-November of FY2014 against the budget target of 38.1 per cent. In the first five months of FY2014, only 20.0 per cent of the ADP was implemented whereas the same was 24.7 per cent in FY2013. One observes three major features of ADP implementation during the first five months of FY2014: (i) low utilisation of both project aid (PA) and GoB (Taka) allocation; (ii) continuing levels of low

[4] The incentive for apparel sector came into effect from January 1, 2014. Assuming 15.0 per cent export growth for FY2014, the revenue foregone was measured for last 6 months of FY2014 at a rate of 0.5 per cent (AIT has reduced from 0.8 per cent to 0.3 per cent).

[5] The continued political violence kept the fuel requirement in check. Bangladesh Petroleum Corporation (BPC) indicated that they will require lower subsidy payments during this fiscal year. Fertiliser prices in the international market also declined.

implementation for all months; (iii) depressing performance of top (in terms of highest allocation) 10 ministries. Expenditure of GoB and PA components were 21.8 per cent and 17.0 per cent of the original allocations respectively. Utilisation rate of GoB part was the lowest during the tenure of the grand alliance government.[6] Expenditure on PA allocation was also less than the average utilisation for the last 4 years (18.0 per cent). On the other hand, during the reported period, utlisation rate in a single month never exceeded five per cent of the total allocation (equivalent to Tk. 3,293.6 crore). This was never experienced since FY2008. One may recall that, only 69.6 per cent of the original ADP was utilised during FY2008. Regrettably, the top 10 ministries as a group also performed below par.

It may, however, be noted that ADP implementation performance is largely influenced by expenditure against Padma Multipurpose Bridge Project (PMBP). One needs to consider that, about 10.4 per cent of the total ADP allocation (55.6 per cent of incremental allocation) for FY2014 was earmarked for PMBP. If one takes out the allocation for the PMBP from the original allocation, the utilisation rate improves to 22.3 per cent (Table 2.1). This implies the ADP expenditure rate is indeed close to the average implementation rate (22.0 per cent) for the last four fiscal years (FY2010-FY2013).[7] It appears that a major part of the allocation for PMBP will remain unutilised during FY2014, which will have an adverse affect on ADP utilisation record in FY2014.

TABLE 2.1: COMPARISON OF EXPENDITURES CONTROLLING PMBP (July-November FY2014)

Particulars	**Total expenditure**			**Top 10 Ministries**
	GoB	PA	**Total**	Total expenditure
	(as % share of allocation)			
ADP for FY2014	21.7	17.0	**20.0**	19.0
ADP for FY2014 *(without PMBP Allocation)*[1]	24.9	18.2	**22.3**	21.7

Note: 1/ Bridges Division is one of the Top 10 ministries which included PMBP. Project wise expenditure is not publicly available for the period. Hence, the analysis assumed no expenditure on PMBP during the period. As was noted, the Bridges Division spent only Tk. 166 crore (or 2.4 per cent) against its allocation of Tk. 6,888 crore during July-November 2013.
Source: Based on IMED Data.

As it appears, turbulent political situation perhaps have affected the implementation process of ADP to some extent. Fictional allocations will also influence the performance of ADP for FY2014. Better implementation record of the ADP will depend on the following factors: (i) realistic revision of the allocations; (ii) the implementation of the large-aided projects to ensure utilisation of foreign aid component; (iii) prioritisation of projects which are to be completed in FY2014 project; (iv) monitoring the quality of the implemented projects with accountability and transparency; (v) enabling and conducive environment for smooth implementation of the projects which in its turn will depend on the evolving political scenario.

Financing of Budget Deficit. Traditionally, during the first half of the fiscal year, budget deficit remains within the safe zone and FY2014 is not an exception. Fiscal deficit (excluding grants) in the first five months of FY2014 was limited to only Tk. 6,340 crore (only 13.1 per cent of planned budget). As a result, low off-take of foreign grants (4.7 per cent of planned budget) and the negative net foreign borrowing[8] (to the tune of (-) Tk. 694 crore) did not put any serious

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[6] In FY2009 (during July-November), before the accession of the grand alliance government, 19.8 per cent GoB part was spent.

[7] Among these four years, ADP implementation in FY2013 was particularly remarkable when 91 per cent of the original allocation was spent.

[8] This implies that the amortisation payment by the government was higher than inflow of foreign aid in July-November FY2014.

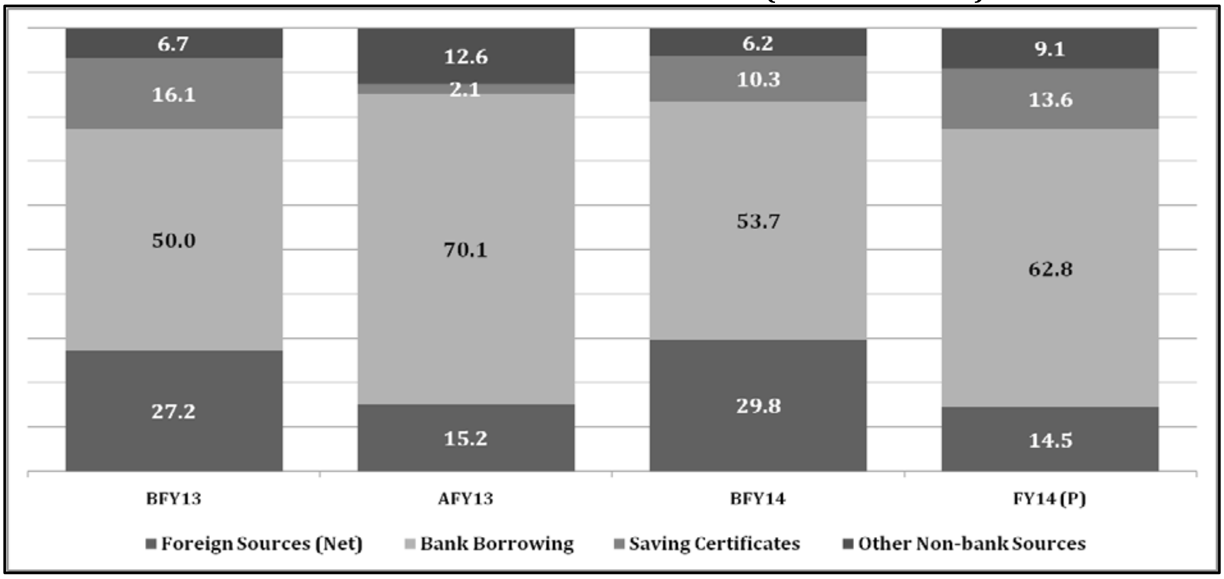
pressure on the budget deficit financing during the mentioned periods of FY2014. The net sales of National Savings Directorate (NSD) certificates was encouraging due to the lower deposit rates offered by the commercial banks on fixed deposits. Net sales of NSD certificates was Tk. 3,414 crore during July-November period of FY2014. This large borrowing from the sales of NSD certificates was in fact used to repay government borrowing from non-bank sources (sources outside borrowing from sale of NSD certificates). Borrowing from the banking system was only Tk. 5,914 crore (22.8 per cent of planned budget) during the first five months of FY2014; which was Tk. 8,800 crore during the corresponding period of previous fiscal year.

As is known, this scenario is misleading since public sector expenditure generally tends to be back-loaded. The trends in government income and expenditure suggest that FY2014 will experience a lower mobilisation of resources and lower expenditure (both development and non-development), alluding to a low level equilibrium. NBR has already requested to slash the revenue target by Tk. 16,000 crore. Even chasing a target of Tk. 120,000 crore by NBR could be somewhat challenging. The other revenue heads may also face some shortfall – to the tune of Tk. 2,000-3,000 crore. On the other hand, ADP expenditures will need some restructure as well. The major portion of allocation for PBMP will not be spent. The actual ADP may be about Tk. 12,000 crore less than the original size of which about Tk. 8,000 crore could be on account of project aid. Downsizing other expenditures by any significant margin will be difficult for the government. Indeed, in face of increased salary expenditures for the government employees may require an additional allocation. However, the government may consider downsizing the allocation for investments in shares and equities (Tk. 15,359 crore). One may recall that, about Tk. 4,100 crore was disbursed in December 2013 in favour of state-owned commercial banks (SCBs). However, the government may restrain itself from spending the major portion of rest of the allocation. Overall budget deficit is expected to remain within the planned target.

One of the challenges facing the government will entail the options as regards sources of financing the deficit[9]. With lower utilisation of project aid and soaring amortisation payments, the foreign financing is expected to remain lower than the budget target. It appears that rising trend of net NSD sales and lower than the envisaged budget deficit will contain the bank borrowing within the planned limit. However, CPD projections suggest that due to lower utilisation of foreign resources, as a share of total budget deficit financing, bank borrowing may reach about 62.8 per cent of total financing and exceed the planned target of 53.7 per cent (Figure 2.2). At the margin, these predicted developments will depend on (i) the political situation in the second half of FY2014; (ii) revision of plans as regards revenue mobilisation; and (iii) patterns of expenditure cut in preparing revised budget.

[9] In FY2013, government sourced 70.3 per cent of its financing from the banking sources; the planned target was 50.0 per cent.

FIGURE 2.2: SOURCES OF FINANCING THE DEFICIT AND SHARE (IN PERCENTAGE)



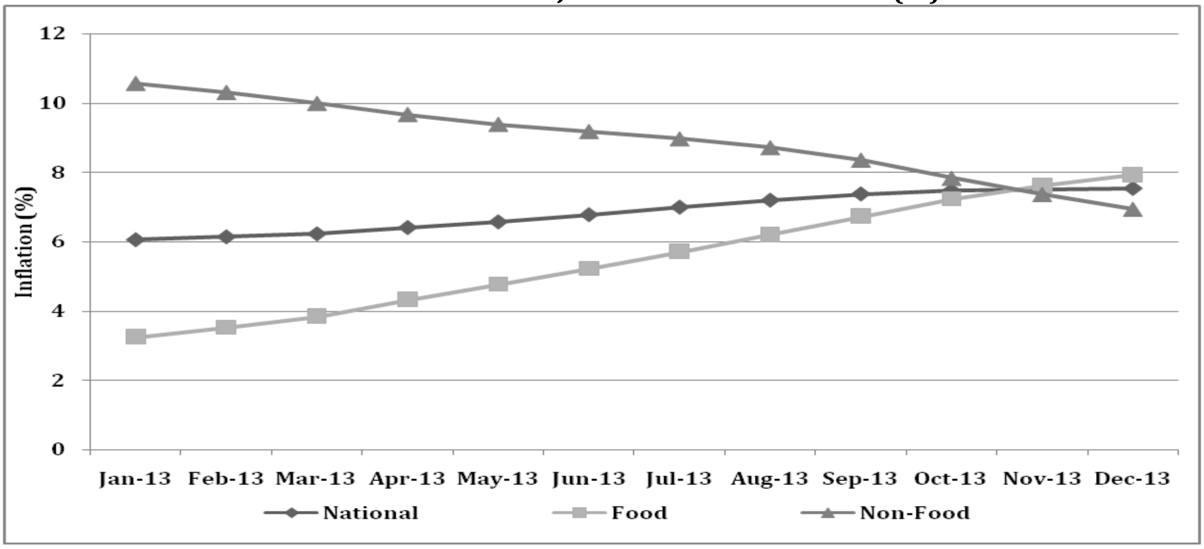
Note: B denotes Budget, A denotes Actual and (P) denotes Projections.
Source: Analysis based on Budget Documents and MoF Data.

2.2 Inflation and Monetary Policy

During the first six months of FY2014, national inflation trends experienced a consistently upward trend. In December 2013, the average annual inflation reached 7.5 per cent. One may recall that, in the monetary policy statement (MPS) for July-December 2013 period, Bangladesh Bank (BB) aimed to keep annual average inflation target for FY2014 at 6.0-6.5 per cent which was 6.8 per cent in FY2013. One can identify a number of distinguishing features of the present inflationary phenomenon. *First*, one can observe that the present steady rise in inflationary trend is driven by food inflation. Food inflation in December 2013 was 7.9 per cent, which was 5.2 per cent in June 2013. In contrast, non-food inflation has come down to 6.9 per cent in December 2013 from 9.2 per cent in June 2013. *Second*, indeed one can discern that there is a pattern in all these which is visible since January 2013 (Figure 2.3). *Third*, inflation in urban areas was higher than rural inflation.[10] Concurrently, the upward trend of food inflation and downward trend in non-food inflation are also observed in both areas. *Fourth*, in October 2013, CPD observed that the rising food inflation was driven by higher price of rice at retail level. The harvest of Aman rice did not change the scenario mainly because of the continuing supply disruption due to political violence. At present, the coarse rice price in Dhaka city was about 17.1 per cent higher than that of last year according to the Trading Corporation of Bangladesh (TCB) data.[11] Indeed, with exception of a few commodities (such as milk and spices), prices of most other food items were lower compared to the last year. Fifth, this rising inflationary scenario is being experienced at a time when international commodity prices have experienced some decline and real exchange rate has come down. One can thus argue that supply disruption was the major cause behind the rising prices in the domestic market. The decline in non-food inflation may be attributed to lower domestic demand at a time of relatively slack economic activities. Growth of money supply at the end of November 2013 (16.7 per cent) remained below the target of 17.2 per cent (for end of December, 2013). Indeed, much of this growth is explained by the high growth of net foreign assets which was 34.3 per cent as of November 2013.[12] In contrast, growth rates of domestic credit and credit to private sector, which were 10.8 per cent and 11.1 per cent respectively as of November 2013, remained at subdued levels. Targets for December 2013 were 19.3 per cent and 15.5 per cent respectively.

[10] In December 2013, urban and rural inflation was 8.4 per cent and 7.1 per cent respectively.
[11] A detailed analysis of rising rice price is given in Section 3.
[12] The target for net foreign assets as of December 2013 is only 19.3 per cent.

FIGURE 2.3: ANNUAL AVERAGE INFLATION IN JANUARY-DECEMBER 2013 (%)



Source: Estimated from BBS data

It appears that the relative stagnation in economic activities observed during the first half of FY2014 may improve to in the second half if the political environment becomes favourable for undertaking economic activities. If this be the case, one may then expect rise in aggregate demand over the rest of the fiscal year. However, ensuring a functioning supply chain and enhancing market management capacity will be the keys in the context of inflation management. Nonetheless, reining in average annual inflation rate to between 6.0-6.5 per cent in FY2014 could prove to be an unattainable target. However, the central bank should not be too preoccupied with containing inflation through demand side management.

2.3 External Sector

Against all odds, export earnings registered an impressive growth rate of 16.6 per cent during the first half of FY2014. One can identify a number of features in this regard.[13] *First*, the RMG exports (20.0 per cent) has continued to post high growth. *Second*, RMG export to the non-traditional markets rose at faster pace (31.8 per cent) than the traditional market (18.1 per cent) in July-December FY2014. *Third*, impressive growth of RMG export in the non-traditional markets was mainly driven by a select set of markets that included Turkey (106.6 per cent), Russian Federation (72.9 per cent), China (84.7 per cent), Japan (37.0 per cent), and Malaysia (29.6 per cent). *Fourth*, the growth rate of non-RMG export was only 3.8 per cent. Within the non-RMG basket, there are winners (such as frozen food, pharmaceuticals, footwear and leather) and losers (raw jute and home textile). *Fifth*, although during the first half of FY2014, the export growth of non-RMG goods achieved a significant growth in the EU market (22.0 per cent), in the non-traditional market, which constitutes about 60 per cent of the product group's market share, the growth was negative ((-) 3.2 per cent). No doubt, the resilience of export-oriented sectors helped significantly in generating domestic economic activities and income at a time of low growth in domestic demand.

Import related activities did not pick up in a significant manner during the first five months of FY2014 as it increased by only 4.4 per cent.[14] The growth in import was driven by higher payments against imports of foodgrains, chemicals and RMG related intermediate goods. Import of capital machineries during July-November period of FY2014 was almost similar to that of the

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[13] A detail analysis of Bangladesh's export performance in FY2014 is discussed in Section 5.

[14] The import payments data mentioned here is collected from Bangladesh Bank website. The website mentions that this data is recorded by customs. Curiously, according to Bangladesh Bank website, the import of data reported by the Statistics Department, Bangladesh Bank shows that import payments increased by 11.4 per cent.

corresponding periods of FY2013. Lower level of international prices also helped to keep the import payments in check.

Remittances experienced negative growth of (-) 8.4 per cent during the first half of FY2014. Decline in overall remittance inflow ((-) 9.0 per cent for the Jul-Nov FY2014 period) was underwritten a fall in remittances coming from major sources including Kingdom of Saudi Arabia (KSA) ((-) 27.6 per cent), United Arab Emirates (UAE) ((-) 12.4 per cent), the United Kingdom (UK) ((-) 17.1 per cent) and Kuwait ((-) 8.9 per cent), except for USA (24.4 per cent). Indeed, remittance inflow from major Middle East countries[15] decreased by 17.0 per cent compared to the previous year. Number of outgoing expatriate workers declined by (-) 13.8 per cent in the first half of FY2014 compared to the corresponding figures for FY2013. As a matter of fact, manpower exports to major Middle East markets decreased by 30.8 per cent for the same period compared to the previous year. One may recall that outflow of migrant workers from Bangladesh in FY2013 declined by (-) 36.2 per cent. Indeed, since August 2012 the (month-on-month) growth rate is on the declining trend (the only exception is September 2013).

BOX 2.1: REMITTANCES: THE SAGA OF DECLINING FORTUNES

Remittance sector which has recorded such a stellar growth over the past several years, has suffered a jolt during the first half of FY2014 both in terms of earnings, as well as the number of workers going abroad. Possible reasons behind this sudden fall in remittance inflow are several: lower growth of manpower export; a higher number of returnee migrant workers with adverse implications for stock of migrant workers; appreciation of BDT creating incentives for transfer of remittance through informal channels; Government to Government (G2G) system not giving the expected results; limited market opportunity (major traditional destinations such as KSA and UAE having virtually stopped recruiting from Bangladesh); and difficulties faced in transferring remittances through banks or Money Transfer Operators (MTOs) from a number of transferring countries including UK.

Although the G2G agreement with Malaysia was considered to be a landmark initiative for safe labour migration from Bangladesh, at a fraction of usual cost, only two thousand workers actually went under the scheme till now. Significant strengthening of the institutional capacity was needed; perhaps an appropriate public private partnership (PPP) arrangement could be explored. There is a need to accelerate the pace of issuing machine readable passports (MRP) for migrant workers as the deadline of March, 2015 is approaching fast. Migrant workers are experiencing difficulties in renewing work permits without MRPs. A mechanism should be developed to keep track of returnee migrants. In view of the large number of migrant workers returning to Bangladesh, a comprehensive plan should be developed to take advantage of their skills and the investable resources that they bring. The expatriate Bank could play an important role in this. GoB has signed a MoU with Iraq for sending 30 thousand workers. Saudi Arabia, biggest source of remittance earnings for Bangladesh (26.48 per cent of total earnings in FY2013), has initiated the practice of signing *Standard Employment Contract* with sending countries. Already India, Philippines and Sri Lanka have signed such contracts with Saudi Arabia to ensure safety and rights of migrant workers. Bangladesh should also pursue proactive diplomatic initialise in this regard. Such contracts will ensure workers to get proper wages and to work only the stipulated hours, and will also provide for an appropriate forum for dispute settlement. Government should also provide adequate support to the migrant workers in the KSA where the window for being legalised under the *Iqama* system has been extended by another two months (till March 2, 2014). There is a growing demand for construction workers in Qatar in view of the World Cup Football that 2022 it will host. A serious market specific demand side study should be undertaken to assess future needs and a comprehensive skills development programme should be put in place in view of this. Ongoing programmes have to be calibrated in view of the newly emerging opportunities in a fast changing global labour market. Bangladesh should also take an active part in the negotiations in the WTO in the context of operationalisation of the service waiver, as was agreed in Bali during Ministerial Confernce-9 (MC-9).

[15] The major Middle East market for Bangladeshi workers include KSA, UAE, Kuwait, Qatar, Oman and Bahrain

The balance of payment (BoP) of the country, in July-November FY2014, observed a favourable situation because of robust export performance and lower import payments. The decline in trade deficit during the abovementioned period was about USD 1,248 million compared to the corresponding period of previous fiscal year. This has also helped to offset the decline in remittance inflow to help towards attainment of higher current account balance. Current account balance increased to USD 1,384 million during July-November of FY2014 compared to that of USD 433 million for the corresponding months of FY2013. Another contributing element of the higher BoP surplus emanated from the commercial borrowing of private sector from foreign sources.[16] These were permitted on grounds of higher lending rate in the domestic financial market. Indeed, this could be considered as policy towards enforcing more competition in the domestic financial market. However, at a time when private sector credit disbursement is low, with about Tk. 86 thousand crore excess liquidity prevailing in the banking system (at the end of October 2013), and favourable BoP situation, the rationale of such a policy may be revisited. It is recommended that at present private sector's commercial lending from abroad facilities may be granted at a limited scale to foreign exchange earning industries only. In connection to this, it is critical to assess the possible risk of twin mismatches in terms of currency and maturity.

Overall, BoP enjoyed a surplus balance of USD 2,040 million in July-November FY2014, for the corresponding periods of FY2013 this was USD 1,752 million. The large surplus in BoP pushed the foreign exchange reserve to a new height. Foreign exchange reserve on 13 January 2013 was USD 17.6 billion which was USD 15.3 billion at the end of FY2013.[17] The central bank rightly maintained the stability of exchange rate of BDT against USD by augmenting foreign exchange reserves. The outlook of external balance suggests that export was likely to remain robust while import payments may pick up to some extent. The present trend in remittance inflow, foreign aid disbursement and FDI is likely to be maintained. Under such a scenario, the central bank should continue its current policy stance of keeping exchange rate stable and allow foreign exchange reserve to adjust accordingly.

2.4 Concluding Observations

The preceding analysis of Bangladesh's recent macroeconomic developments bears out that the macroeconomic scenario of the early months of FY2014 transmits a mixed signal. It was observed that some of the strong areas including export earnings and BoP has maintained the trend, while some of the correlates including import payments demonstrated signs of recovery. Concurrently, economic performance of a number of indicators continued to deteriorate in the first half of FY2014 including inflation, ADP implementation, remittance inflow and foreign aid utilisation. Any major breakthrough in the area of private investment is yet to be seen. The proposed fiscal framework for FY2014, as was anticipated at the time of CPD's budget analysis[18], is in need of a revisit.

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[16] Foreign loans to private companies were approved to the tune of USD 1.0 billion in FY2012 and USD 1.8 billion in FY2013. Foreign loans equivalent to USD 57.9 million in July, USD 238.6 million in September and USD 85.5 million in December were approved. The interest rates on these loans are generally charged at the rate of LIBOR plus 4.5 per cent. (Source: <http://www.newagebd.com/detail.php?date=2013-12-25&nid=78000> and <http://www.dhakatribune.com/money/2013/nov/17/demand-foreign-loans-rises>)

[17] On 19 December 2013, the foreign exchange reserve crossed the USD 18.0 billion mark and since then has remained above the threshold. Bangladesh Bank made a routine payment of USD 760 million to the Asian Clearing Union (ACU) on 9 Jan 2014 against imports during the November-December period of 2013. After the payment, the country's foreign exchange reserve came down to USD 17.5 billion. The previous installment paid to ACU was to the tune of USD 890 million.

[18] See http://cpd.org.bd/index.php/fiscal-framework-the-weakest-link-in-budget-for-fy2014/ for details.

CPD's earlier analysis revealed that in FY2013 Bangladesh economy moved towards stability with arrested growth.[19] The analysis presented here for the first half of FY2014 confirms that, the economy in FY2014 did not manage to make any significant shift from this towards a higher growth trajectory. The early projections of Bangladesh's GDP growth in FY2014, carried out by various international organisations vary between 5.5-5.8 per cent (Table 2.2). The central bank in its first quarterly report also anticipated GDP growth to be between 5.7-6.0 per cent. In view of available information on various sectors and assuming that there will be no major supply-side disruption and uncertainty (arising out of political turmoil) over the rest of FY2014, it is likely that GDP growth rate in FY2014 will be between 5.6-5.8 per cent for FY2014 (base year 2005-06).[20] It is disquieting to see that the GDP growth acceleration, so critical to realising Bangladesh's ambition of becoming a middle income country and graduating from LDC status, appears to be lost in recent years. At the same time, one also needs to keep in mind that GDP growth estimate may not fully reflect the losses incurred due to the observed violent political situation during the first half of the fiscal year.[21] Employment and livelihood of a significant section of the people in Bangladesh depends on the informal sector, performance of which is not fully captured in the official GDP estimates.

TABLE 2.2: GDP GROWTH PROJECTION FOR FY2014

Agency	Growth Projection FY14
World Bank	5.7
IMF	5.5
ADB	5.8
BB	5.7-6.0

Source: World Bank's Bangladesh Development Update (October 2013), IMF Country Report No. 13/357 (December 2013), Asian Development Outlook 2013 update (December 2013), and Bangladesh Bank Quarterly (July-September 2013).

BOX 2.2: POLITICAL CRISIS IN FY2014: ESTIMATE OF ECONOMIC LOSS

While there is a lot of casual discussion about the economic loss incurred by the country due to political violence, there is hardly any rigorous and reliable estimate of such losses. CPD in one of its earlier studies estimated that 1 per cent loss of the country's capital stock leads to 0.9 per cent loss of GDP. With a view to generate an assessment about the magnitude of the political violence- related economic loss, a meticulous scan of the print media was undertaken to collate the reported numbers. The focus of the media scan was on four major sectors, namely export-oriented clothing and textiles, agriculture and agro-based industries (vegetables, agro processors, poultry, frozen food, agro machineries, jute etc.), land transport (rail and road), and tourism. The reported losses included loss of assets (stock), operational and income person-days of work (flow). However, one needs to be mindful that this loss does not represent the loss of value addition. The present exercise attempted to estimate the monetary value of the foregone capital and income for these four sectors.

The estimate shows that due to 55 hartal/blockades days (from July 2013 to January 2014), among the four sectors reviewed, the land transport (rail and road) sub-sector incurred the highest amount of loss (Tk. 16,688.65 crore), followed by the agriculture and agro-based industries (Tk. 15,829 crore), export-oriented clothing and textiles (Tk. 13,750 crore) and tourism (Tk. 2,750 crore) sector. The total amount of loss is estimated to be Tk. 49,017.92 crore which is equivalent to 4.7 per cent of the GDP (FY2012-13). One important sector which was hit hard is the small production and businesses. Regrettably, we could not acquire sufficient data to capture losses encountered by these sectors.

While it is acknowledged that the estimated figure was *partial* and *uncorroborated*. Moreover, we need to be mindful that the estimated loss does not indicate *net* loss as some of the losses are recouped through various adjustment measures overtime. However they do provide some insights about the magnitude and sectoral concentration of the incurred losses during the recent spate of political violence.

[19] See http://cpd.org.bd/wp-content/uploads/2013/10/Bangladesh-Economy-in-FY2014.pdf.
[20] According to the new national accounting estimate, GDP growth rate in FY2013 was 6.2 per cent. The corresponding GDP growth rate, estimated on the basis of previous base year (1995-96), was 6.0 per cent.
[21] Box 2.2 informs about a partial loss originating from political violence.

The possible slowdown in GDP growth rate was accompanied by rising concern in terms of macroeconomic stability. This related to the rising inflation which is emerging as a concern. While in terms of fiscal deficit the economy is expected to remain within the programmed level, CPD projection is that budget deficit financing mix will continue to rely on domestic sources. The government's challenge will be to putting back the economy on its track at the same time maintaining macroeconomic stability.

3. AGRICULTURE

3.1 Crop Production: Disrupted Boro Cultivation could Hamper Achieving Overall Target
Aus and *aman* rice to be produced in FY2014 have already been harvested. The production target for *aus* was 2.41 million metric tons (mmt); for *aman* this was 13.28 mmt (Table 3.1). According to unofficial estimates of DAE, *aus* production was higher than last year (2.16 mmt) but somewhat lower than the target. In contrast, *aman* had a bumper harvest and production target may be crossed. Wheat and maize area target was 4.20 lakh and 3.17 lakh hectares in FY2014 and been achieved, according to the primary estimates of the DAE. However, political instability during the peak season of *boro* plantation has adversely affected cultivation. Until mid-January, about 20 per cent *boro* cultivation has been made (which is slightly higher than the plantation achieved in last year). However, particular regions are lagging behind. For example, until mid-January, production target has been achieved by only 0.67 per cent in Rangpur region and 5.60 per cent in Rajshahi region. These two regions account for about 20 per cent of total *boro* rice production in the country. Lack of supply of inputs, such as fertiliser, due to the political situation and shortage in the availability of diesel have negatively affected plantation in the northern and northwestern regions of the country. Shortage of seedlings has also hampered production in some regions. Due to the interrupted input delivery during October-November and dense fog in late December and early January, *boro* seedlings target could not be achieved.[22] In this backdrop, CPD projects a lower production of *boro* rice this year, if further measures are not taken. CPD estimates indicate crop (rice, wheat and maize) production in FY2014 to be in the range of 37.5-37.8 mmt, which is 0.5-1.4 per cent higher than the production of last year but 0.8-1.8 per cent lower than the target of this year. CPD estimates indicate, in FY2014 *aus* and *aman* production is likely to rise by about 1.5-1.9 per cent and 2-3 per cent respectively and *boro* production is likely to change in the range of (-) 1- (+) 0.1 per cent when compared with production figure of the previous year. In order to ensure a positive growth in *boro,* government needs to ensure (i) continuous electricity supply during peak season of irrigation (i.e., February to April); (ii) adequate diesel and fertiliser supply in a timely manner; and (iii) proper monitoring of the crop to protect the produce from any pest attack. In addition, the procurement plan should be announced at the very beginning of the harvest period.

[22] The target was 3-lakh hector of which 2.9 lakh hector was achieved (96 per cent).

TABLE 3.1: CROP PRODUCTION IN BANGLADESH

(area in lakh hectare, production in million metric tons, and growth in %)

Sl.	Crops	FY2012		FY2013		FY2014 (Target)	
		Area	**Prod.**	**Area**	**Prod.**	**Area**	**Prod**
1	Aus	11.38	2.33	10.53	2.16	11.55	2.41
2	Aman	55.80	12.80	56.10	12.90	56.30	13.28
3	Boro	48.10	18.76	47.60	18.78	47.80	18.92
4	*Total Rice (1+2+3)*	*115.28*	*33.89*	*114.23*	*33.83*	*115.65*	*34.60*
5	Wheat	3.58	1.00	4.17	1.25	4.20	1.28
6	Maize	2.83	1.95	3.12	2.18	3.17	2.24
7	Potato	4.30	8.21	4.44	8.60	4.40	8.65
8	*Total Crop (4+5+6)*	*121.69*	*36.84*	*121.52*	*37.27*	*123.02*	*38.12*
	Total Crop Growth (%)	**0.84**	**3.68**	**-0.14**	**1.16**	**1.24**	**2.28**

Source: DAE and BBS.

3.2 Ensuring Adequate Food Stocks: A Challenge for the Rest of the Fiscal Year

In December 2013, public food stocks were to the tune of 0.951 mmt, which was 31 per cent lower than that of December 2012 and 38 per cent lower than that of December 2011. Lower level of domestic procurement in both *boro* and *aman* season is the main reason underwriting this uncomfortable stocks position. The government had planned to procure one million MT of *boro* rice (900 thousand MT rice and 150 thousand MT of paddy) from the domestic market during May to November in 2013. However, about 831.17 thousand MT were actually procured which was 83 per cent of the target and 18 per cent lower than the procurement of 2012 (1,015 thousand (MT)). The government has started procurement of 200 thousand MT of *aman* rice from 1 December 2013. However, this target was 33.33 per cent lower than the target of last year. Due to political turmoil throughout December, *aman* procurement was severely disrupted. As of 26 December 2013, only 36 per cent of the procurement target was achieved. In order to raise the stock level, government is importing rice and wheat from the international market. However, the pace of rice import is slower than that of wheat. During July to December of FY2014, 1,180.4 MT of wheat was imported, which was 26 per cent higher than that of FY2013. On the other hand, rice import during July-December of FY2014 was only 1.33 thousand MT, while it was 15.80 thousand MT during the same period of FY2013 and 486 thousand MT in FY2012 (Table 3.2).

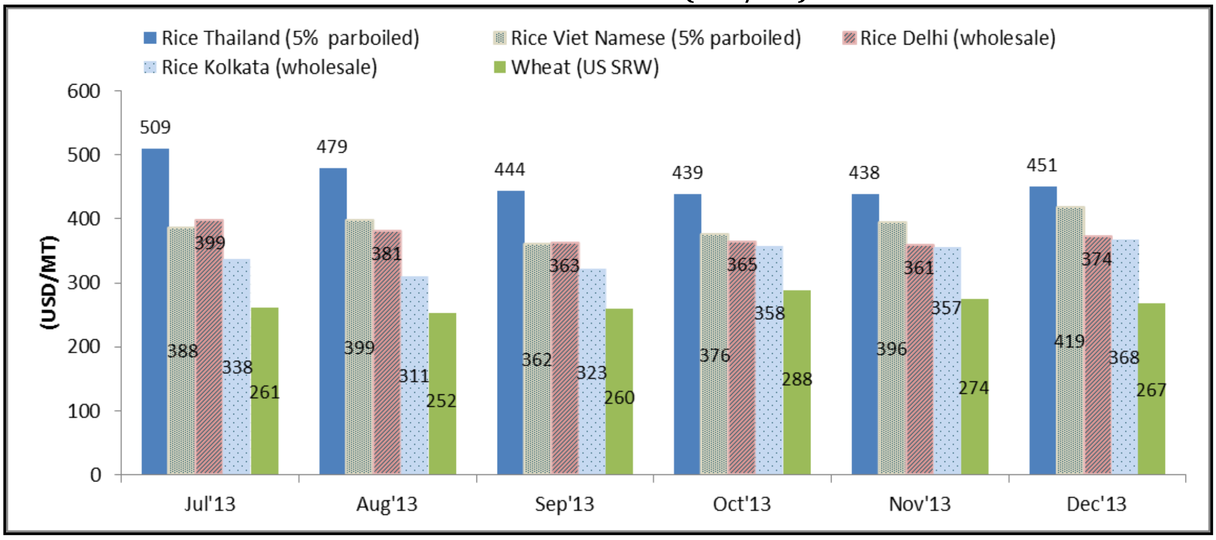
TABLE 3.2: FOODGRAINS IMPORT AND PUBLIC FOOD STOCK ('000 MT)

Source	FY2010 (Jul-Dec)	FY2011 (Jul-Dec)	FY2012 (Jul-Dec)	FY2013 (Jul-Dec)	FY2014 (Jul-Dec)
Rice					
GoB Com.	0.00	370.00	437.70	2.20	0.35
Food Aid	3.60	1.10	1.90	1.40	
Private	0.00	196.40	46.00	12.20	0.99
Total Rice	*3.60*	*567.50*	*486.10*	*15.80*	*1.33*
Wheat					
GoB Com.	104.82	157.60	326.00	199.20	437.70
Food Aid	16.12	132.50	33.00	71.40	
Private	1820.00	1471.00	575.50	665.50	742.70
Total Wheat	*1940.94*	*1795.30*	*934.50*	*936.10*	*1180.40*
Total Foodgrain Import	**1945**	**2363**	**1420**	**952**	**1182**
Public Stocks as of December	**1170**	**851**	**1542**	**1368**	**951**
Rice	...	...	*1166*	*1128*	*676*
Wheat	...	...	*333*	*240*	*275*

Source: Prepared on the basis of data from MISM and DG Food.

Since current food stocks are less than the standard level of 1.0 million MT as set by the Ministry of Food, it is important that the government takes necessary steps on an urgent basis to raise the level of stocks. In this backdrop, the government has three options: either to strengthen current *aman* procurement drive, increase import from the international market or a combination of both. Since rice price in the local market has been on the rise, going for higher procurement from the local market could further deteriorate the already critical food inflation situation. In view of this, higher import from the international market could be a better option. Both rice and wheat prices in the international market are on the decline (Figure 3.1). Between December 2012 and 2013, the price of Thai parboiled rice (5 % broken) declined by 19 per cent, Delhi wholesale rice fell by 4 per cent, and wheat price decreased by 18 per cent.[23] This declining trend is expected to be continued in the coming months.[24] Bangladesh could prefer importing rice from the Indian market at present since this would be cheaper than Thailand and Vietnam. CPD estimation shows that, if the prices of December 2013 prevails, imports from Kolkata would cost Tk. 30.98/Kg, from Delhi Tk. 31.30/Kg whilst this will be Tk. 35.72/Kg from Vietnam and Tk. 38/Kg from Thailand.[25] Currently appreciated BDT against USD and Indian Rupee could also be an advantage to Bangladesh in this context.

FIGURE 3.1: INTERNATIONAL RICE AND WHEAT PRICES (USD/MT)



Source: World Bank Commodity Market Review and Department of Consumer Affairs, the Government of India.

3.3 Economic Implications of Disrupted Market Supply Chain due to Political Unrest

Significant Gap between Growers Level and Retail Prices of Vegetables. Vegetables sector has experienced significant adverse impact due to the recent political turmoil. Analysis of the Department of Agricultural Marketing (DAM) data for selected vegetables shows that the farmers from north and northwestern districts such as Rangpur, Dinajpur, Lalmonirhat, Rajshahi, Bogra, and from Jessore, Jhinedah, and Pabna were severely affected because they were not able to market their product due to transport disruption and the blockade. From the

[23] In December 2013, Thai parboiled rice (5 % broken) was USD 451/MT, which had been USD 543.5/MT in December 2012, Delhi wholesale rice was 374/MT, which had been USD 390/MT in December 2012, and wheat was USD 325/MT, which had been USD 267/MT in December 2012.

[24] USDA has forecasted a higher level of crop production for FY2014. Their estimates show that global rice production in FY2014 is likely to be 471 mmt, which is 0.3 per cent higher than that of FY2013. Similarly, global wheat production is forecasted to be 711 mmt, which is 8.4 per cent higher than that of FY2013.

[25] Assuming transportation cost of USD 40/MT from Vietnam and Thailand and USD 30/MT from Delhi and Kolkata.

DAM data, it is observed that the price of ripe tomato at growers' level in Zikargacha upazila of Jessore district was Tk. 17.5/Kg in December 2013, while the retail price in Dhaka was Tk. 59/Kg. Similarly, the price of cabbages at growers' level in Pirgonj upazila of Thakurgaon district was Tk. 6.7/Kg in December 2013, whilst it was Tk. 30/Kg in Dhaka. Average retail price of ripe tomato in Dhaka was 3.52 times higher than at growers' level in selected districts in December 2013, which was 1.79 times higher in December 2012 (Table 3.3). The average retail price of cabbages in Dhaka was also significantly higher than at growers' level in selected districts in December 2013 (5.56 times). Similar pattern is also observed for cauliflower and Brinjal (Table 3.3). Due to losses, vegetables farmers are facing difficulty in repaying the small loans they have taken from government institutions and/or local Mahajans. To restore the interest of vegetables farmers, for the next season, government needs to provide agricultural credit on easy terms on an urgent basis.

TABLE 3.3: GAP BETWEEN RETAIL AND GROWERS LEVEL PRICE FOR SELECTED VEGETABLES IN SELECTED REGIONS

	December, 2013	December, 2012
Tomato (ripe)		
Retail price in Dhaka	59.0	40.0
Growers level price	16.8	22.3
Faridpur (Boalmari)	*16.8*	*20.0*
Jessore (Zikargacha)	*17.5*	*25.0*
Lalmonirhat (Sadar)	*16.0*	*22.0*
Price in Dhaka as Percentage of growers level price	**352**	**179**
Cauliflower		
Retail price in Dhaka	25.0	30.0
Growers level price	9.0	14.3
Jhinedah (Kaligonj)	*9.5*	*12.5*
Thakurgaon (sadar)	*11.5*	*18.5*
Pabna (Sathia)	*6*	*12*
Price in Dhaka as Percentage of growers level price	**278**	**209**
Cabbage		
Retail price in Dhaka	30	25
Growers level price	5.4	11.3
Thakurgaon (Pirgonj)	*6.7*	*14.5*
Jhinedah (Kaligonj)	*5*	*9.5*
Pabna (Sathia)	*4.5*	*10*
Price in Dhaka as Percentage of growers level price	**556**	**221**
Brinjal		
Retail price in Dhaka	19	26.5
Growers level price	5.6	12.2
Jhinedah (Kaligonj)	5.5	12
Thakurgaon (Pirgonj)	6.25	13
Pabna (Sathia)	5	11.5
Price in Dhaka as Percentage of growers level price	**340**	**218**

Source: CPD estimation based on data from DAM.

Poultry Sector: An Incentive Package is Required on an Urgent Basis. Poultry sector has suffered significant losses due to recent political turmoil. Bangladesh Poultry Industries Co-ordination Committee estimates that the sector has incurred a loss of around Tk. 4,000 crore during October-December 2013. In addition, around 36 thousand poultry farms have been closed due to lack of capital and feed. Estimates carried out by the Committee show the losses of poultry feed manufacturing industry to be around Tk. 1,000 crore, loss of the Breeders of day-old chicks to be about Tk. 382 crore, loss of the egg producers to be about Tk. 630 crore, loss of commercial poultry or chicken producer to be about Tk. 975 crore and loss of medicine producers and their suppliers to be about Tk. 158 crore. Besides this, higher feed and transportation cost, torching of vehicle, higher duties related to delay in ports, and other logistic losses amounted to approximately around TK. 900 crore according to their estimates. CPD has carried out a number of consultations with poultry farmers from Narsingdi, Chandpur, Mymensingh, and Manikgonj districts, and poultry feed suppliers such as *BRAC Feed Mills,* and *Aftab Bahumukhi Farms Limited,* as well as the leaders of breeders association. These consultations indicate that the sector is in need of immediate attention from the government. It is also important to recall that the sector has emerged as the second highest employment provider in the private sector in rural and semi-rural areas. The government can carry out an assessment of the losses suffered by the poultry sector and came up with an incentive package. In order to revive the sector, steps which could be thought of are rescheduling Bank loans and waiving Bank Interests for a fixed period for layers and broilers farms, hatchery farms and breeders which produce day-old chicks, feed producers, medicine producers and marketers and other institutions which are associated with the poultry business. Special schemes may be considered for opening up firms, which have gone out of operation.

4. BANKING SECTOR

While the banking sector is still struggling to recover from the setbacks originating from a number of large financial scams concerning some state owned and private commercial banks, unearthed in the recent past, political impasse has made the situation worse leading to unsatisfactory performances of the sectors in major areas.[26] Many of the related targets are off-track with indiscipline featuring in several banks. The following review presents some selected issues in the banking sector that are currently considered to be of major concern.

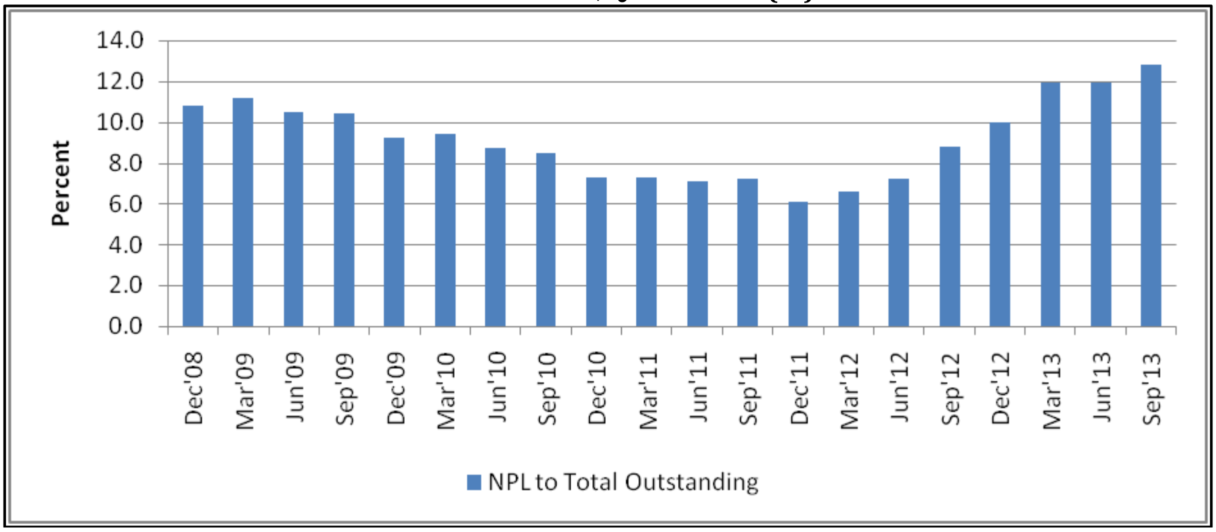
4.1 Non-performing Loan Soaring Rapidly

An increasing trend in Non- performing loan (NPL) has been observed since FY2012 when NPL's share of rose to 10.03 per cent in total outstanding loans. This has further escalated to 12.8 per cent at the end of third quarter of 2013 (September 2013), the highest since FY2009[27]. At a disaggregated level, share NPLs in both state owned commercial banks (SCBs) and development financial instates (DFIs) have gone up to as high as 28.76 per cent and 29.39 per cent respectively, as of September 2013. High NPL in banks could be attributed to large scale financial frauds and subdued economic activities due to political violence and agitation. Financial fraudulences that have been brought to light in recent years are not only due to lack of supervision and lack of governance in the banking sector itself, it is also due to exertion of political influence over loan disbursement. It has been reported that in all financial scams loans were given to fake companies with false identity of clients. The failure to practice due diligence to undertake proper investigation of the involved companies indicate severe lapse of responsibility on the part of loan providing banks. Those who were able to identify the fraudulent practices could not do the needful in this context due to political connection and pressure. Regrettably, the investigations carried out by the affected parties have been rather slow and have not seen much progress. Dull economic situation has also led to high NPL as several business people have failed to service their loans because of losses.

[26] A list of major banking sector scams is provided at Annex 1.

[27] Curiously at this moment an IMF-ECF programme is being implemented in the country. Box 4.1 presents a short commentary on the implementation of the aforementioned programme.

FIGURE 4.1: NPL TO TOTAL OUTSTANDING LOAN, QUARTERLY (%)



Source: Bangladesh Bank.

BOX 4.1: THE IMF-ECF CATCH-22

Bangladesh, in April 2012, was granted an Extended Credit Facility (ECF)[28] by the International Monetary Fund (IMF), to the tune of USD 987 million, which was to be disbursed over three years, in seven instalments. Having reached halfway through the ECF programme, and consequent to disbursements of four credit instalments, one wonders to what extent the programme had been successful, particularly in terms of attaining its stated objectives. Table 4.1 presents performance of selected Indicative Targets (IT) and Performance Criteria (PC) as set out by the IMF as part of the ECF requirements. It may be observed from the table that the government has been quite successful in meeting the targets set out as regards (i) net credit to the central government by the banking system, (ii) net domestic assets of Bangladesh Bank and (iii) net international reserves of Bangladesh Bank. Additionally, other indicators which have been met partially and non-continuously over the span include (i) reserve money and (ii) net supplier's credit and other short term financing for oil imports.

In contrast, indicators which have not been met in totality include (i) tax revenue of central government and (ii) social-related spending by the central government. *It may be observed that the government has been able to comply with indicators which correspond to the monetary policies and has not been able to pursue the fiscal priorities*.

The relatively better performance of monetary policy over fiscal policy in terms of meeting the targets could perhaps be explained by a number of reasons. *Firstly*, decisions regarding monetary policy are implemented by institutions (primarily the Bangladesh Bank) which are able to maintain some degree of autonomy and involve only a limited number of stakeholders (for example, board members of the Bangladesh Bank). Consequently, for the relevant players, it is easier to take politically or economically unpopular decisions. *Secondly,* objectives of monetary policy are more narrowly defined and there is a broad agreement on those (inflation control and price stability measures). *Thirdly*, fiscal policy calls for support of a large number of diverse stakeholders, who pursue their own agendas and have particular constituents to satisfy. *Fourthly,* fiscal policies are driven by the national budget, which sets out its own priorities and has to be calibrated according to evolving macroeconomic scenarios and demands.

With evidence supporting a decline in inflation and money supply growth and a steeper decline in private sector credit, questions may be raised as regards the health of the banking-financial sector at a time when the country was under IMF programme (banking scams, rising non-performing loans (NPL), resilient

[28] Earlier IMF programmes included the Compensatory Contingency Financing Facility (CFF) (1972), Stand-by Arrangement (1974), Oil Facility (1974), Stand-by (1975), Stand-by (1979), Extended Fund Facility (1979), CFF (1982), CFF (1983), Stand-by (1983), Stand-by (1985), Structural Adjustment Facility (1987) and Extended Structural Adjustment Facility (1990). The recent financial arrangements of Bangladesh with the IMF would include an ECF initiating in August, 1990 (SDR 345 million) and another ECF in June, 2003 (USD 567.28 million).

interest rate spread). The fact of the matter is that, the economy has lost its growth momentum over the corresponding period, though one can argue whether it was demand-driven, policy-driven, arising mainly from the disruption driven by political confrontation or a combination of all the above. A number of studies which have examined the impacts of IMF programmes in some of the implemented countries indicate that these have contributed to growth reduction (Dreher, 2004, Barro and Lee, 2003). A rising openness of the economies is seen, but with reduction in levels of investment in the domestic economy (Barro and Lee, 2003)[29]. It is to be seen how the growth-stabilisation nexus plays out in the current Bangladesh context. In view of this apparent trade-off, it remains to be seen how policymakers will decide on the optimum policy-mix in the near term future.

TABLE 4.1: PROGRESS OF SELECTED INDICATIVE TARGETS AND PERFORMANCE CRITERIA OF ECF

Reserve money											
March, 12		June, 12		September, 12		December, 12		March, 13		June, 13	
IT	Estd	IT	Estd	IT	Estd	IT	Estd	IT	Estd	IT	Estd
950	917*	1014	976*	1037	997*	1061	1067	1063	1079	1135	1122*
Tax revenue of central government											
March, 12		June, 12		September, 12		December, 12		March, 13		June, 13	
IT	Estd	IT	Estd	IT	Estd	IT	Estd	IT	Estd	IT	Estd
627	633*	924	916	232	228	489	456	757	723	1088	1033
Social-related spending by the central government											
March, 12		June, 12		September, 12		December, 12		March, 13		June, 13	
IT	Estd	IT	Estd	IT	Estd	IT	Estd	IT	Estd	IT	Estd
248	248	400	421*	81	73	161	174*	276	237	455	464*
Net suppliers credit and other short term financing for oil imports											
March, 12		June, 12		September, 12		December, 12		March, 13		June, 13	
IT	Estd	IT	Estd	IT	Estd	IT	Estd	IT	Estd	IT	Estd
15	-2*	0	-10*	0	-2*	0	11	0	6	0	-61*
Net international reserves of Bangladesh Bank											
March, 12		June, 12		September, 12		December, 12		March, 13		June, 13	
PC	Estd	PC	Estd	PC	Estd	PC	Estd	PC	Estd	PC	Estd
5977	6405*	6097	6984*	6193	7968*	6356	9435*	9404	10887*	10450	12357*
Net domestic assets of Bangladesh Bank											
March, 12		June, 12		September, 12		December, 12		March, 13		June, 13	
PC	Estd	PC	Estd	PC	Estd	PC	Estd	PC	Estd	PC	Estd
483	418*	538	435*	554	383*	566	338*	340	243*	340	190*
Net credit to the central government by the banking system											
March, 12		June, 12		September, 12		December, 12		March, 13		June, 13	
PC	Estd	PC	Estd	PC	Estd	PC	Estd	PC	Estd	PC	Estd
174	133*	240	139*	47	1*	92	41*	128	66*	204	145*

* Targets met are shaded

4.2 Capital Adequacy is on a Downward Trend

Another important indicator of the banking sector, the risk weighted capital asset ratio (CAR), has increased marginally from 9.12 in June 2013 to 9.14 in September 2013; this was still below the minimum threshold of 10 per cent as required under the Basel-III (Table 4.2). SCBs with only 1.38 per cent and DFIs, with a negative ((-) 10.2 per cent) CAR, are undermining the effort of the central bank to maintain the BASEL-III requirement which was achieved in FY 2012 (10.5 per cent). Low CAR of SCBs and DFIs also indicate their vulnerabilities to various shocks when in case there is a need for injecting financial resources of their own into the banking system, without relying on the government. Tk. 4,100 crore was disbursed in December 2013 in order to recapitalise the SCBs in a move to protect these banks. In order to ensure good health of the banking system and to bring SCBs and DFIs under strict monitoring and control mechanism, a number of remedial measures have been put in place by the central bank with a view to regaining the trust of customers. These include introduction of the Bank Company (Amended)

[29] On the other hand, studies supporting IMF credit programmes are also present in literature.

Act 2013, formation of risk management committee, implementation of credit and risk management training, spelling out the terms and references and responsibilities of the board of directors, and a number of reform measures at the administrative level. It is to be seen how this renewed instructions work towards improving the overall performance of the sector.

TABLE 4.2: CAPITAL ADEQUACY OF BANKS (%)

Indicator	Bank Type	2000	2009	2010	2011	2012	As of September 2013
Capital Risk Weighted Asset (%)	SCBs	4.4	9.02	8.9	11.68	8.13	1.32
	DFIs	3.2	0.36	-7.3	-4.49	-7.78	-10.18
	PCBs	10.9	12.12	10.1	11.49	11.38	11.56
	FCBs	18.4	28.13	15.6	20.97	20.56	20.25
	Total	6.7	11.67	9.3	11.35	10.46	9.14

Source*:* Bangladesh Bank.

4.3 High Excess Liquidity and Low Private Sector Credit Growth are Dual Challenges Affecting Profitability

Excess liquidity in the banks has risen by 73.8 per cent at the end of November 2013 over the corresponding period of November 2012; however, in case of DFIs a negative growth is observed for the same period as regards excess liquidity situation (Table 4.3). Low private sector demand for credit due to political uncertainties and also the ceiling imposed on banks' investment in the share market by Bangladesh Bank have contributed to high liquidity in the banking system. Though credit to the public sector has increased by 15.56 per cent in November 2013 compared to 8.9 per cent in FY 2012, credit to the private sector increased by 11 per cent as of November 2013 as opposed to the target of 16.5 per cent for FY2014 (Figure 4.2). Lower credit to the private sector is a reflection of low appetite on the part of the private sector which is the result of both recent political turmoil and long standing problems of weak infrastructure and other bottlenecks.

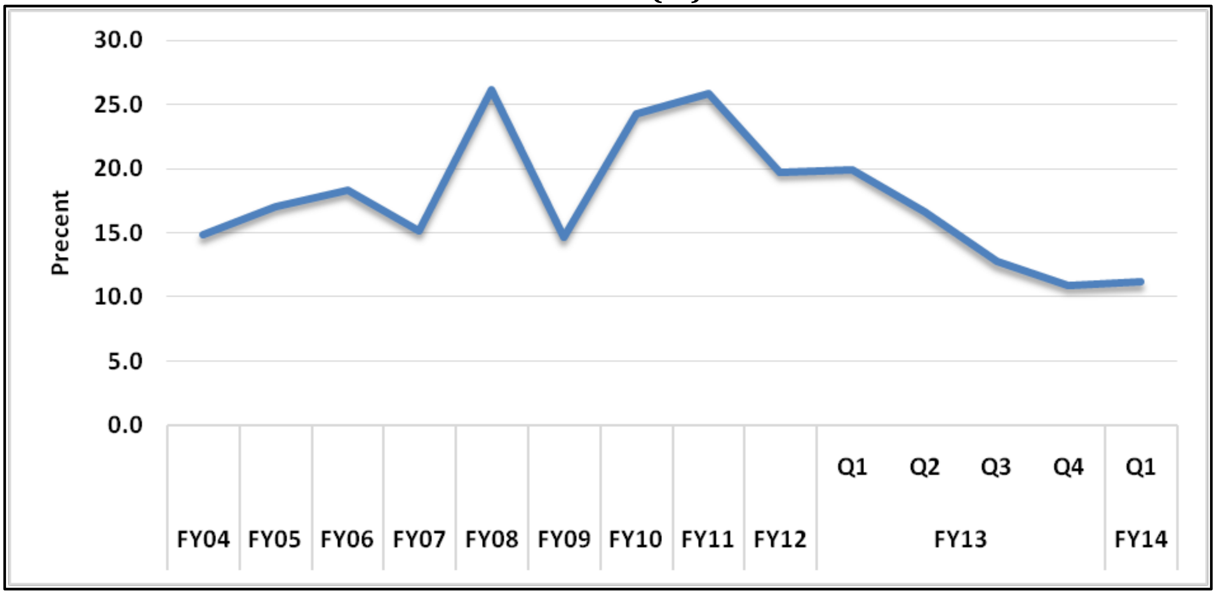
TABLE 4.3: EXCESS LIQUIDITY BY TYPES OF BANKS

(Tk. in crore)

Types of Bank	Nov 2012	Jun 2013	Sep 2013	Nov 2013	Growth over Nov 2012 to Nov 2013
SCBs	14947.84	27033.79	31240.75	34394.34	130.10
Specialised Banks	834.56	2011.73	811.9	612.86	-26.56
PCBs (other than Islamic)	25157.74	31977.39	35749.94	36732.17	46.01
Private Banks (Islamic)	5126.2	10539.24	7232.76	9004.32	75.65
FCBs	5802.36	7878.41	8909.24	9426.18	62.45
All	51868.7	79440.56	83944.59	90169.87	73.84

Source: Bangladesh Bank.

FIGURE 4.2: PRIVATE SECTOR CREDIT GROWTH (%)

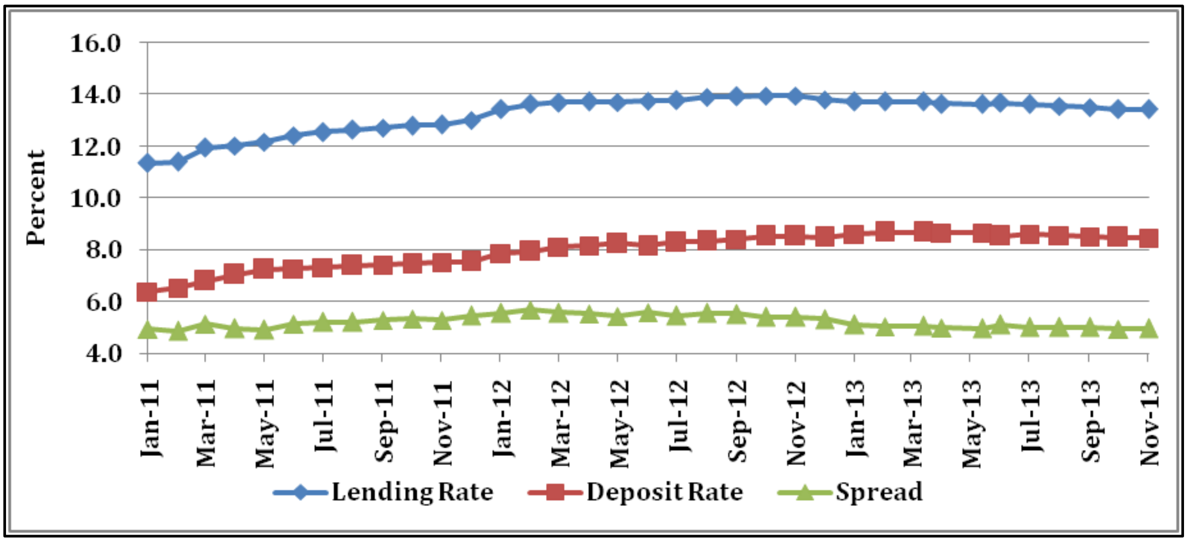


Source: Bangladesh Bank.

4.4 Lower Interest Rate Spread in New Banks

Some banks are trying to cope with low business activity by maintaining a somewhat lower level of interest rate spread (IRS). At the end of November 2013 IRS stood at 4.97 percentage points (5.4 percentage points in November 2012) for some banks this is unusually low, even negative (NRB Global Bank Limited's interest rate spread in November was (-) 6.45 percentage points). Keeping IRS low is a strategy for banks to navigate through difficult times since profitability has dampened due to the discouraging business scenario. The new banks have now entered into the race to get a share of government deposits as attracting customers and business has emerged as a real challenge. Also the new banks are having to operate in a relatively shallow market.

FIGURE 4.3: INTEREST RATE FOR LENDING AND DEPOSIT RATE AND SPREAD



Source: Bangladesh Bank

4.5 Earnings and Profitability Exhibit Mixed Results

Earning and profitability situation of banks is under stress for many of the banks, excepting the SCBs. Provisional figures of both return on asset ratio (ROA) and return on equity ratio (ROE) are positive for the SCBs in 2013 as opposed to the negative record of FY2012. This is yet to be understood as to what has been the contributing factors for this positive achievement; particularly, ROE is expected to be 94.81 in FY2013 compared to (-) 11.87 in FY2012. For DFIs both these indicators are negative for FY2013 indicating negative profitability status. Private commercial banks (PCBs) have also lost some ground in FY2013 which is revealed from the lower ROA and ROE in FY2013 compared to FY2012 (Table 4.4). The overall low performance of banks and losses are incurred by them have led to some erosion of confidence which will need to be restored through improved prudential management.

TABLE 4.4: PROFITABILITY RATIO BY TYPES OF BANK

Bank Type	2000	2009	2010	2011	2012	2013P
Return on Asset (%)						
SCBs	0.1	0.96	1.1	1.34	-0.56	0.6
DFIs	-3.7	-0.37	0.2	0.03	0.06	-0.53
PCBs	0.8	1.55	2.1	1.59	0.92	0.44
FCBs	2.7	3.18	2.9	3.24	3.27	3.44
Total	0	1.37	1.78	1.54	0.64	0.61
Return on Equity (%)						
SCBs	1.7	26.17	18.4	19.66	-11.87	94.81
DFIs	-68	-171.68	-3.2	-0.92	-1.06	-8.62
PCBs	17	20.95	20.9	15.69	10.17	5.03
FCBs	27.3	22.38	17	16.58	17.29	18.49
Total	0.3	21.72	20.97	17.02	8.2	9.7

P = provisional data
Source: Bangladesh Bank

4.6 Response to Political Unrest by the Bangladesh Bank

In view of the adverse impacts of the disruption of economic activities Bangladesh bank has extended the time for classification of bank loans by six months. This may be a temporary relief for some banks; however, banks will have to do the needful to improve their governance. The government has decided that the RMG sector will be provided with 3 per cent subsidy on export related loan. While this could be helpful for the industry in view of the losses suffered during the recent past, this will have adverse implications for the banks. And also, small and medium enterprises and the agriculture sector have been affected due to political unrest and these also need support. Support to these sectors should, however, come from dedicated funds instead of subsidy on loan since it may create pressure on banks' profitability.

5. EXPORT SECTOR PERFORMANCE

5.1 Trend Analysis: Impressive Growth

Bangladesh's export sector recorded a robust growth in the first six months of FY2014 in the backdrop of a number of important developments. Export sectors had to face the consequences of disruption due to political turmoil, address the fallouts from the Rana plaza tragedy, face the labor unrest in the RMG sector, and confront the threat to GSP. On the other hand, a stable exchange rate, adjustment capacity of export-oriented sector, particularly the RMG, and the recovery, albeit slow, in the developed economies, had a positive impact on the performance of the sector.

Export earnings stood at about USD 12.6 billion, registering an impressive growth of 16.56 per cent, during July-December in FY2014 over the corresponding period of FY2013. Growth of RMG export was 19.96 per cent in this period with woven export posting a rise of 20.37 per cent and knitwear recording a 19.55 per cent growth. Major exportable items including leather (43.61 per cent), shrimps (34.71 per cent), footwear (35.49 per cent), pharmaceuticals (34.76 per cent) also experienced impressive growth. On the contrary, export growth of home textile declined by (-) 6.3 per cent whereas export earnings from jute and jute goods declined drastically by (-) 17.10 per cent over the same period of FY2014 compared to the corresponding period of FY2013.[30]

Table 5.1 shows the growth for major items of export during July-December in FY2014.

TABLE 5.1: EXPORT GROWTH OF MAJOR PRODUCTS DURING JULY-DECEMBER, FY2014

Product	Growth Target FY2013	Actual Growth FY2013	Growth Target FY2014	Actual Growth Jul-Dec FY2014	Required Growth Jan-Jun FY2014
RMG	**12.8**	**12.7**	**12.2**	**20.0**	**5.6**
Knit	11.9	10.4	10.5	19.6	2.3
Woven	13.8	15.0	13.9	20.4	8.6
Non RMG	**24.3**	**5.6**	**15.5**	**3.8**	**26.3**
Raw Jute	13.4	-13.7	5.0	-49.8	62.6
Leather	21.2	21.1	15.0	43.6	-5.5
Home Textiles	26.9	-12.6	5.0	-6.3	15.1
Frozen Food	17.0	-9.1	6.4	30.3	-20.8
TOTAL EXPORT	**15.3**	**11.2**	**12.9**	**16.6**	**9.7**

Source: Export promotion Bureau, 2014

As can be seen from Table 5.1, the required growth rate for the RMG sector over the next few months (January-July, 2014) to attain the growth target is 5.6 per cent, which should be attainable.[31] The required growth rate of 9.7 per cent over the next six months appears to be a justified target inspite of the evident uncertainties.

Market decomposition analysis shows that export to the US market posted a significant growth of 17.6 per cent for the RMG during July-October of FY2014 as opposed to the same period of FY2013 (USITC, 2014). USITC data also showed that performance of Bangladesh either

[30] Export earnings both in terms of value and volume in the jute sector have declined mainly due to the price cuts of jute products, lower demand from the European countries and political stalemate in the Middle East.

[31] Jute goods are likely to fail in attaining the required growth rate during the next 6 months of the current fiscal. It can also be seen from the table that actual growth rate for total export (11.2 per cent) was lower than the growth target (15.3 per cent) for FY2013.

surpassed or matched the growth performance of major competing countries in the US market such as Cambodia (0.86 per cent), China (2.80 per cent), Indonesia (-0.58 per cent) and Turkey (7.58 per cent). However, Vietnam (12.86 per cent) and India (16.32 per cent) recorded high growth over the same period. Table 5.2 shows the export performance of Bangladesh in major destinations.

TABLE 5.2: EXPORT GROWTH OF BANGLADESH TO MAJOR DEVELOPED AND DEVELOPING COUNTRIES

Major Destinations	FY2013 (July-Dec)	FY2014 (July-Dec)	Growth (%)
	(USD million)		
EU 27	6,520.5	7,912.2	21.3
USA	2,483.0	2,790.9	12.4
Canada	530.6	543.9	2.5
Japan	340.1	445.4	31.0
Australia	216.0	230.8	6.9
Turkey	272.9	434.9	59.4
China	222.6	329.2	47.9
India	267.3	182.5	-31.7
Russian Federation	87.0	129.3	48.6
ROW	1,660.0	1,686.8	1.6
Total	**12,599.7**	**14,685.8**	**16.6**

Source: Export Promotion Bureau, 2014

Bangladesh experienced a commendable growth of 21.34 per cent despite the recent downturn in the EU market during July-December in FY2014 as opposed to the matched period of FY2013 (EPB, 2014). According to the Euro STAT data, RMG sector of Bangladesh achieved 17.58 per cent growth in the EU market during July-September period of FY2014 as over the comparable months of FY2013. Performance of the other competitors of Bangladesh in the EU market was found to be rather mixed. RMG export of Cambodia (36.76 per cent growth) was significantly better whereas Turkey (3.57 per cent), Vietnam (1.55 per cent) and India (5.08) experienced only a moderate growth during the corresponding period. However, RMG export from China (-0.49 per cent), Mexico (7.32 per cent), Indonesia (-7.17) posted negative growth from during the abovementioned period.

Export earnings of Bangladesh in the EU market from footwear (2.18 per cent) and shrimp (7.81 per cent) failed to post impressive growth in stark contrast to the high growth rate of RMG export (17.58 per cent) in the EU market during the first quarter of FY2014.[32] Performance of export sector has also been notable for other markets.[33] South-South trade has been on the rise in recent year and this trend has sustained – registering a growth rate of 10.11 per cent during July-December in FY2014. However, it is important to note that export to the Indian market has declined by 31.72 percent. Also major land ports with India came to a halt due to the strikes and haratals in the last few months in the backdrop of significant appreciation of the BD Taka against the Indian Rupee. There was significant disruption in the land ports with India through which 90 per cent of Bangladesh's export with India takes place. Apparently, Bangladesh will also need to do much more to fully realise the potential benefit of duty-free market access offered by India since January 2012.

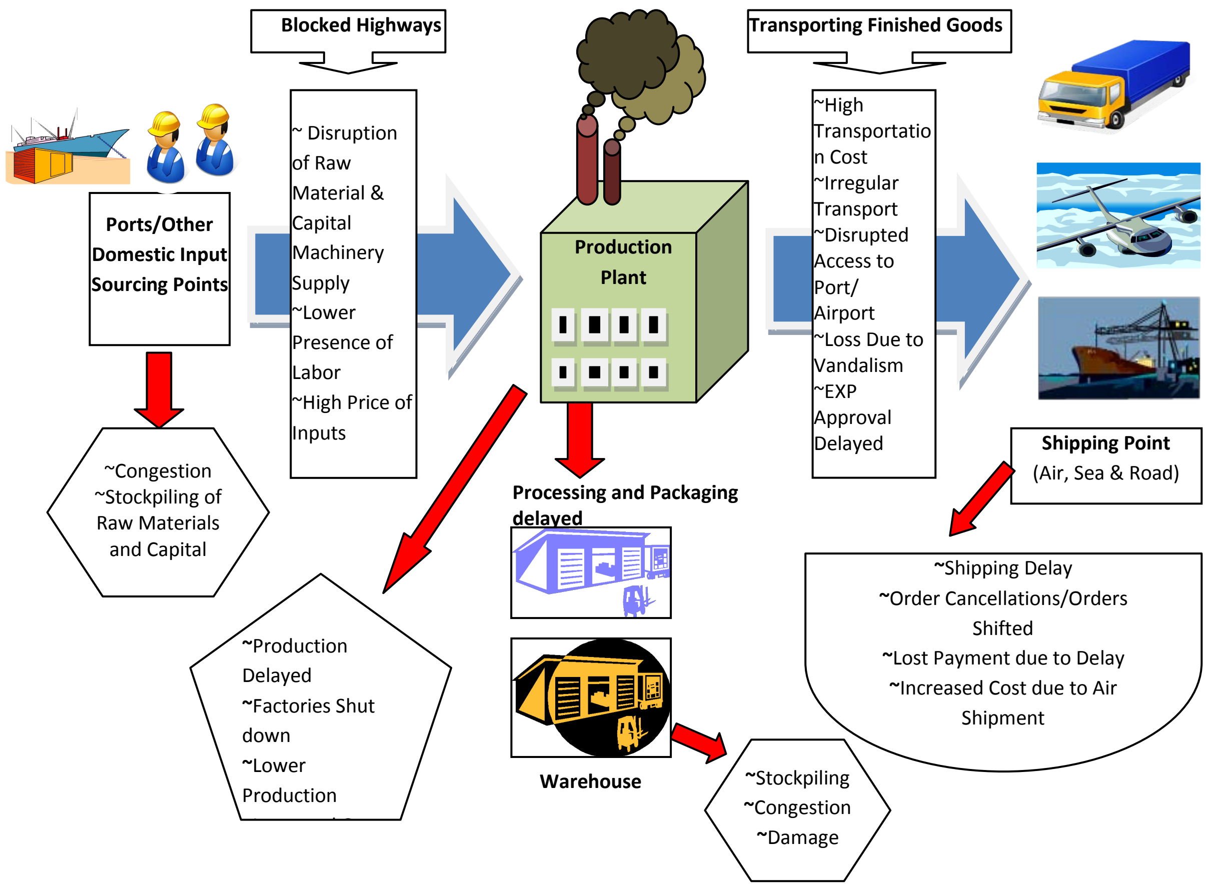
[32] It is of interest to note that, footwear exports of China and Indonesia declined by (-) 2.02 per cent and (-)6.41 per cent respectively in the EU market during July-September in FY2014 where as footwear export of Turkey (13.44 per cent) and Mexico (12.53 per cent) outperformed other countries.

[33] Bangladesh achieved 30.9 per cent growth in Japan, 50 per cent in Turkey, 47 per cent in China and 48 per cent in Russia during July-December period of FY2014 compared to the same months of FY2013.

5.2 Disruption and Its Implications for the Export Sector

Although export earnings evince a robust picture, this is not to say that recent disruptions did not have visible adverse implications for export-oriented sector of the country. Supply chains were disrupted, both for import of inputs and export of finished goods due to transport breakdown, raising the cost of doing business, delaying shipments and undercutting profits, at a time when the apparels sector is having to adjust to the rise in the minimum wage. Figure 5.1 graphically shows the impact of blockades and hartals in different stages of production and export of goods from Bangladesh.

FIGURE 5.1: IMPACT OF BLOCKADES /HARTALS ON DIFFERENT STAGES OF PRODUCTION AND EXPORT



As it can be seen from the figure, export oriented sectors had to face a host of problems over the past several months including lower production, order cancellation, shipment delay in the ports, higher transportation cost particularly when air shipment had to be made, high cost of doing business and losses due to vandalism.

Exporters reported that many enterprises had to reduce production to avoid congestion at warehouses for shortage of transports. Backward linkage industries (spinning, weaving, printing, dyeing and finishing) also faced problems due to disruption in supply of raw materials. Local spinning mills and fabric mills fell behind in terms of delivery schedule due to the transport shortage and attendant delays.[34] All these could have adverse near term

[34] It is important to note that the backward linkage industry makes many items for the apparels sector (addition to fabrics and yearn). These include button, carton, package, elastic, drawstring, embroidery, sewing thread, zipper and plastic items.

consequences for the RMG sector. The disruption of transport system due to the hortals and blockades also affected other export oriented sectors such as frozen food, leather industry.[35]

Higher Cost of Doing Business and Lower Profitability. Transportation cost experienced a significant rise during the blockade. The payment for a truck to transport goods which previously varied between Tk. 12 thousand and Tk. 15 thousand increased to between Tk 45 thousand to Tk. 60 thousand. Exporters were forced to choose expensive air shipments to meet the deadlines set by the buyers. As Table 5.3 indicates, air shipment (volume in tonnes) increased by 38.73 per cent during January-November in 2013 compared to the corresponding period of 2012.

TABLE 5.3: AIR SHIPMENT: DRY CARGO EXPORT STATISTICS

Carrier	**2012 (Jan-Nov)**	**2013 (Jan-Nov)**	**Growth** (in percent)
	(Volume in thousand Tonnes)		
Biman	15.6	17.4	9.1
Foreign Carrier (FC)	97.8	140.2	43.5
Total	113.6	157.6	38.7

Source: Biman Cargo Office

According to an Impact Assessment Survey carried out by the BGMEA from the response of 42 apparel enterprises, an average enterprise incurred a loss of USD 0.6 million due to the adverse impact of recent political programmes. Table 5.4 shows the impact of blockades and strikes for 42 RMG enterprises. Whilst no comprehensive damage assessment is available, either for apparels sector, or the entire export sector, it is highly conceivable that export-oriented sector has suffered significant cost escalation and profit erosion.

TABLE 5.4: HARTAL/BLOCKADE IMPACT ASSESSMENT SURVEY BY BGMEA (42 RMG ENTERPRISES)

Losses accruing from various reasons (42 RMG enterprises)	**Amount (Million USD)**
Order Cancelled	5.6
Discount	2.2
Air Freight	1.9
Shipment Delay	12.7
Loss Occurred by Vandalism	3.6
Excess Transport Cost	0.1
Total Losses for 42 RMG enterprises	26.1
Average losses (per enterprise)	**0.6**

Source: BGMEA (Reported up to first week of January, 2014)

Order Placement Scenario. In some instances business deals could not be stuck and orders got cancelled and shifted because of the uncertainties. Whilst mass consumption items suffered less, fashionable segment got hurt more. BGMEA had come up with some figures based on the aforesaid survey reported in the table. According to the BGMEA, the figure for air shipment related cost overrun was to the tune of Tk. 1,200 crore, whilst that for cancellation and other adverse impacts as to the tune of Tk. 2,000 crore, arising from the political unrest. However, in absence of any comprehensive assessment it is difficult to come to a reliable estimate of the losses.

[35] Supply of fish to processing plants for export and transportation of fish from Satkhira, Bagerhat, Khulna, Barguna, Barisal and Cox's Bazar, Chokoria, Chandpur was severely disrupted.

GSP Situation. As is known, US has suspended the Generalized System of Preferences (GSP) facility for Bangladesh on the ground of labor safety and workers rights following the Rana Plaza tragedy. Despite RMG not receiving duty-free under the existing GSP scheme, this has other implications – GSP for other products receiving duty-free market access, FDI from USA, adverse implications for EU-GSP, possibility of Bangladesh being excluded from any initiative in US Congress to grant duty-free market access for apparels. It is, thus, important that serious attention is paid by all concerned authorities to implement the tripartite action plans, and those by Accord and Alliance. The EU Head of Delegation in Dhaka has recently said that EU is not thinking of cancelling EU-EBA GSP facilities granted to Bangladesh. However, the debate in the UK and the EU Parliament, and the cautionary note that emerged from the debate should transmit the right signals to concerned Bangladesh authorities. Also, in the new EU GSP scheme, which has been put in place since January 2014, Part A (compliance with UN & ILO Conventions, human rights, pursuance of democratic norms and good governance) has now been made mandatory for GSP eligibility also for the EBA beneficiary LDC, such as Bangladesh. Bangladesh will also need to carefully monitor the impact of various multilateral and bilateral initiatives (EU's GSP plus facility for Pakistan, India-EU FTA, India-ASEAN FTA, Japan-India Economic Partnership Agreement and the Trans-Pacific Partnership Agreement which will give preferential market access to Vietnam, a competitor of Bangladesh, in the US and some of the other developed countries).

5.3 Demands Emanating from Various Export Oriented Sectors

In view of current difficulties, exporters from apparel, leather, textile and jute industries have put forward several demands to the government to enable them to compensate for the financial losses incurred during the recent blockades and strikes.

- Exporters asked for reduction of tax at source to 0.25 per cent instead of 0.8 per cent.
- Apparel and Textile sector also demanded that all term loans and forced loans in textiles, garments and backward linkage industries should be given a grace period of two years and transferred without any interest to a block account.
- To allow a five-year installment facility to repay the converted block loans with moratorium facility for two years.
- To provide bank loans equivalent to four months' wages of workers, starting from November 2013 which would be repaid over a period of two years.
- Not to categorise default loans as 'classified' within two years.
- Frozen food exporters urged commercial banks for allowing exporters to repay the existing term loans in installments without interest starting from January, 2014.
- Frozen food sector demanded 100 per cent waiver of interest on all types of loans taken from state-owned and private banks between October 2013 to March 2014.
- To allow 15 per cent cash incentive instead of 10 per cent for frozen shrimp and other fish from July 2013.[36]

5.4 Government Initiatives in Support of the Export Sector

Government has taken several initiatives to provide support to the export-oriented sectors which includes (a) cash subsidy, (b) loan rescheduling and (c) reduction of tax at source.

- Bangladesh bank has made the arrangement to provide loan up to USD 10 million from the Export Development Fund at an interest rate of 1.5 per cent in support of the export sector.
- The government has reduced tax at source to 0.30 per cent from the current rate of 0.80 per cent for the apparel and textile sector; this benefit is to be allowed till June 2015.

[36] In addition, exporters also called for keeping the Dhaka-Chittagong highway free from blockages as the highway have important consequences for both exports and imports; exporters also demanded police petrol to escort vehicles carry capital machineries, industrial raw materials and items related to export.

- To help recover the losses due to the ongoing political turmoil, the government has allowed apparel exporters to receive cash incentive against advance telegraphic transfer (TT). Under the facility, exporters of woven, knitwear and terry towels have been allowed to get cash incentive at the existing level of 5.0 per cent against advance TT before shipment of their goods.[37]
- Bangladesh Bank proposed to the government to give a 3 per cent subsidy on export loan interest.
- The government had decided to release a total of Tk 25.92 billion as cash incentive for several export-oriented sectors in the current fiscal year.
- Jute and jute products sector will receive Tk 945 million in the third installment while the total amount of cash incentive for the sector will be Tk 3.47 billion for the FY2014.
- Exporters of agro-based and agro processed products and potato will get 20 per cent cash incentive while leather products and bone dust exporters are getting 15 per cent.
- Cash incentive for export of jute goods, shrimp and other fishes, light engineering and pet bottle flakes is 10 per cent.
- Textile exporters who are looking for non conventional export market will receive 2.0 per cent cash incentive.
- Government was also considering a rise in the amount of cash incentive for export sector to 6 per cent from the existing 5 per cent rate for cash incentive.

Additional measures are also being considered by the policymakers in support of the export-oriented sectors.

Whilst the rationale for the proposed incentives cannot be denied, several factors should be taken into cognisance. The incentives will have fiscal implications. These should be implemented in a manner that takes into cognisance the interests of the SMEs. If not appropriately implemented the incentives could create market distortions and also lead to discretion and rent seeking – so a transparent policy based on good governance will be needed. Interest of the banking sector should not be undermined at a time when the share of NPL is on the rise. There should be a time bound exist policy.

6. STATE OF PRODUCTION AND INVESTMENT IN THE MANUFACTURING SECTOR DURING THE PERIOD OF POLITICAL VIOLENCE, INSTABILITY AND UNCERTAINTY

During the first half of FY2014 Bangladesh's manufacturing sector had experienced significant adverse impact arising from various economic and non-economic factors. In this context, application of the logic of simple endogenous growth model framework to interpret sectoral performance by using of economic, geographic, and institutional variables appears to provide only a partial explanation (Polachek and Sevastianova, 2010). A more robust explanation of the performance of the manufacturing sector during this period requires use of political instability and related factors in the relevant analysis (Metzgen, 1999; Bussiere and Mulder, 1999). Because of the lack of real time data on economic variables, let alone relating to non-economic variables, in this section relevant issues have been addressed more through a descriptive analysis. However, an econometric analysis has also been carried out, presented at the end of the section, by using time series data. The purpose was to understand the impact of political instability and volatility on private sector investment in Bangladesh. The section presents a

[37] Sectors will receive this incentive after fulfilling various conditions including names of beneficiary of export earnings, and inland back-to-back letter of credit (LC).

detailed analysis on production and investment in domestic market-oriented and export-oriented manufacturing industries primarily focusing on the first half of FY2014.

6.1 Performance of Production in the Manufacturing Sector

Overall Performance. Bangladesh's manufacturing sector has been passing through a volatile period, spanning over the past several months. The entire gamut of related activities – spanning from production, supply of raw materials, sales in domestic and export markets and the demand for products – has suffered significantly. The latest available data for the period of July-September, 2013 indicates that growth of production of large and medium industries was high at 11.7 per cent compared to first quarter of FY2013; however, growth of domestic market oriented industries has decelerated towards the end of quarter (Table 6.1). This trend was likely to continue till December (in view of political turmoil. The rise in intensity of political violence in the following months (October-December, 2013) is likely to affect this further. Growth in production of small scale enterprises remained at a much lower level compared to that of large and medium scale enterprises leading to further widening of the gap between the two categories. Production of domestic market-oriented industries has suffered more compared to export-oriented industries during July-September, 2013 as against the previous year.

TABLE 6.1: CHANGES IN QIP IN DOMESTIC AND EXPORT-ORIENTED MANUFACTURING SECTOR

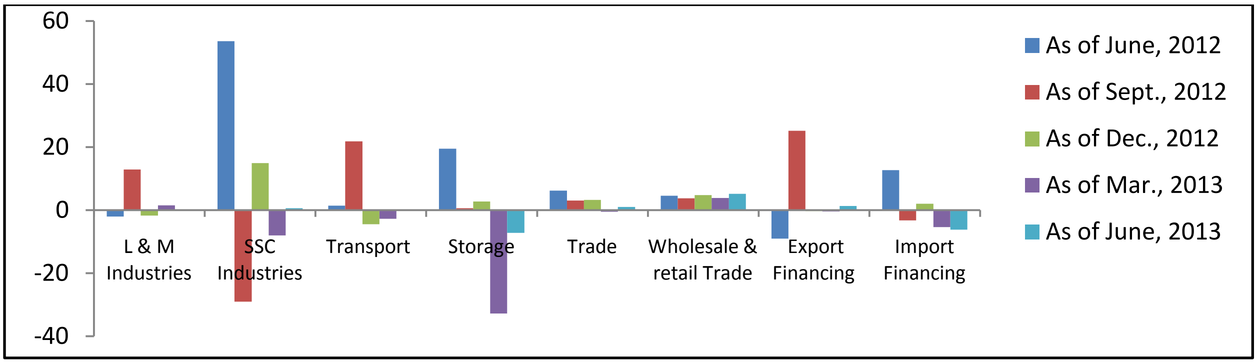
Major Industry Group	**% change of QIP over corresponding period of the previous year**			
	July, 2013	August, 2013	Sept., 2013	July-Sept., 2013
L &M enterprises				*11.7*
Largely domestic market-oriented				
Overall	10.0	5.6	6.7	7.6
Other than Food	4.1	-0.1	6.6	2.6
Largely export-oriented				
Overall	17.4	1.2	23.5	11.8
Other than RMG	2.2	-1.9	-0.8	0.02
Small scale enterprises				*5.4*
Food, beverage and tobacco				4.4
Jute, cotton, RMG and leather				18.1

Source: Based on BBS.

Of the L&M manufacturing enterprises, the difference in the level of growth between 'largely domestic market-oriented' and 'largely export market-oriented' industries during the same period is quite noticeable (7.6 per cent vs. 11.8 per cent). It was the domestic market oriented enterprises which were in a more adverse situation in this period. As is known, performance of these two categories are highly dependent on few key industries, food processing in case of domestic market-oriented industries, and RMG in case of export-oriented industries. If these industries are excluded, the performance of rest of the industries under both the categories was indeed rather bleak (2.6 per cent and 0.06 per cent respectively). Thus, both domestic and export market-oriented industries have experienced adverse consequences, albeit to varying extent, during the first half of FY2014.

The poor performance in industrial production is also reflected in terms of import of raw materials and intermediate products for manufacturing industries. According to the L/C opening data, during July-October, 2013 items such as chemical products, cotton yarn, scrap vessels, iron and steel, clinker and limestone etc. have experienced either negative or low levels of growth. The slowdown in production and the import of raw materials and intermediate products has reduced demand for working capital. As Figure 6.1 depicts, changes in advances for working capital during the immediate past quarters (e.g. June, 2013) in comparison to the earlier quarters was relatively low or experienced negative growth both for large and medium scale as well as in small scale industries. Similar trends in advances are also reflected in various linkage industries of the manufacturing sector such as transport, trade, export and import financing etc (Figure 6.1).

FIGURE 6.1: CHANGES IN ADVANCES IN WORKING CAPITAL FINANCING



Source: Based on BBS.

Performance of Different Sub-sectors. Anecdotal information reported in various media indicates that manufacturing production faced difficulties particularly relating to production, sales, work orders and capacity utilization, which also led to laying off of workers. For the purpose of this review, CPD has collected data from eight firms of four domestic and export-oriented industries including RMG, pharmaceuticals, light engineering, furniture and agro-processing industries. Given the limited number of sample under consideration, nature and extent of impact mentioned for different indicators in the table (Table 6.2) should only be considered as indicative instead of representative of the related sectors. It is found that, by and large, sample firms have experienced similar level of changes for most of the indicators as observed at the national level. Production of domestic market oriented firms such pharmaceuticals and light engineering have experienced negative growth during July-December, 2013 over the same period in the previous year. Firms also faced adverse situation as regards sales, particularly in case of light engineering and (to a lesser extent) agro-processing industries. Slow growth in production has led to reduced capacity utilization for the majority of the industries. As a result, firms had to lay off some of their workers to reduce the pressure on cost and to adjust with the changing scenario.

TABLE 6.2: PERFORMANCE OF SELECTED FIRMS OF DOMESTIC AND EXPORT-ORIENTED INDUSTRIES DURING JULY-DECEMBER, 2013

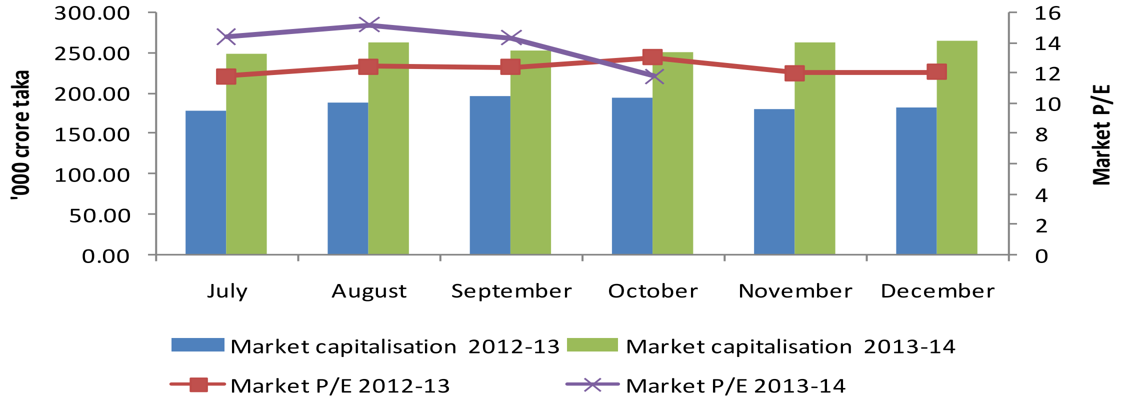
Issues	Change in July-December 2013 over Corresponding Period of the Previous Year				
	RMG (3)	Pharmaceuticals (1)	Light Engineering (2)	Furniture (1)	Agro-Processing (1)
Production (%)	na	Somewhat negative	Significantly negative	Moderately negative	Somewhat positive
Sales (%)				Somewhat negative	Somewhat positive
Domestic	na	Somewhat positive	Significantly negative	Somewhat negative	Somewhat positive
Foreign	Somewhat positive	Somewhat positive	na	Significantly negative	Somewhat negative
No. of Foreign Orders	Unchanged	Unchanged	na	Moderately negative	Somewhat positive
New Employment	Unchanged	Somewhat positive	Unchanged	Moderately negative	Significantly negative
Layoff (July-Dec., 2013)	Moderate	Somewhat	Significant	na	na
Capacity Utilisation (Jul.-Dec., 13)	na	Moderately negative	Significantly negative	Moderately negative	Significantly negative

Note: Somewhat negative: SN
Source: CPD rapid survey

The performance of the manufacturing sector during the first half of FY2014 could be explained both by economic and non-economic factors. In the domestic market, key indicators that were likely to have had implications for the manufacturing sector (both positive and negative) are: inflationary trends, reduced interest rate on advances from bank and appreciation of taka against US$. In case of the external market, these could be: rise in global demand for major export products particularly in USA and EU markets, appreciation of taka over Indian rupee vis-a-vis US$, withdrawal of GSP in US market and crisis in the image of RMG sector following the Rana Plaza tragedy. However, it is difficult to explain the trends in industrial sector performance based on this. For this, the adverse impact of the political conflict on the industrial sector has to be fully appreciated and considered. As is known, political conflict during the last several months has caused severe disruption in the supply chain of both domestic and export market-oriented enterprises which constrained supply of raw materials and intermediate products, sale of final goods and resulted in higher transport cost. All these had adverse implications for production, demand for credit and raw materials, and had also indirectly, reduced the demand for products arising from lower income.

Performance of Listed Companies in the Share Market. The share price index of listed manufacturing companies both in DSE and CSE was less responsive to the volatility in the performance of the manufacturing sector in the real economy. According to Figure 1, DSEX and DSE30 have both maintained a similar trend for a long period of time. Turnover at DSE during November and December, 2013 though not as high as this was in June-July, 2013 period, was nevertheless higher than that in January-May, 2013. Average daily trade value has increased by 22.1 per cent from Tk.428.1 crore during July-December, 2012 to Tk.522.6 crore for the year 2013. Market capitalisation increased from Tk. 183.5 thousand crore in December 2012 to Tk.264.7 thousand crore in December 2013 and P/E ratio was also found to be higher during July-September period of FY2014, however, went down in October, 2014 (Figure 6.2). Change in the turnover of manufacturing companies in the DSE during July-September, 2013 over the corresponding period of the previous year was quite significant; part of the reason was negative growth in the turnover of these shares in the corresponding period of the previous year. Overall, behaviour in the secondary market continues to be influenced by non-economic factors.

FIGURE 6.2: TREND OF MARKET CAPITALISATION AND MARKET P/E RATIO AT DSE



Source: Dhaka Stock Exchange (DSE)

6.2 Investment in the Manufacturing Sector

Public Sector Investment targeted in the Manufacturing Sector. Public sector investment towards the development of the manufacturing sector depends on investment made by different ministries and divisions in industry, power and energy, transport and communication etc. Traditionally, ADP implementation during first half of the fiscal year generally tends to be slack because of the time-consuming processes in completing tender related activities, acquisition of land (if necessary), disbursement of funds against work orders and procurement of construction materials etc. It was noted that till November, 2013, ADP projects have been implemented at a rather slow pace (Table 6.3). During July-November, 2013 expenditure as a percentage of total allocation for ministries of industry, energy and mineral and power division was below the average ADP expenditure. A number of ministries have crossed last year's respective performance – these include the ministries of industry, railway and labour and employment. Those which are well behind last year's respective performance include energy, mineral resource, power, and roads divisions. The slow progress in infrastructure related projects of different ministries/divisions was partly due to the disruption in completion of the tendering processes and the delay in the supply of construction materials caused by prolonged political violence.

TABLE 6.3: ADP EXPENDITURE OF SELECTED MINISTRIES/DIVISIONS

	July-Nov, 2012				July- November, 2013			
Ministry/ Division	Project No.	Allocation	Expenditure	% of allocation	Project No.	Allocation	Expenditure	% of allocation
M/o Industries	26	172227	9825	6%	26	210700	36262.24	17%
Energy & Mineral Res. Division	31	158097	40449.85	26%	54	450277	77807.21	17%
Power Division	52	784964	305694.5	39%	56	875614	115151.5	13%
Roads Division	145	253110	101185.2	40%	131	315412	64140	20%
M/o Railway	44	3295.46	42083.78	13%	51	366111	92418.04	25%
M/o Labour & Employment	4	12133	561.65	5%	5	12711	3016.6	24%
Grand Total	1037	5500000	1357475	25%	1283	7398442	1388164	19%

Source: IMED.

Private Investment in the Manufacturing Sector. The situation as regards private sector investment in the manufacturing sector is reflected in the performance of various indicators relating to debt and equity financing, including disbursement of industrial term loans for large, medium and small industries, advances other than working capital financing for the manufacturing sector, outstanding balance of SME loan, classified loan, import of capital goods, FDI, registration of manufacturing companies for investment at BOI and equity financing in the capital market. Disbursement of industrial term loan during July-September, 2013 has declined by 8.6 per cent compared to that of the previous year indicating a distressed investment situation. Borrowing by large scale industries which generally accounted for higher share in the term loan, was relatively low during July-September, 2013 (growth was only 3.0 per cent); the medium-scale industries have indeed borrowed less compared to that in the previous year (-44.8 per cent growth). Borrowing by small scale industries during this period was, however, exceptionally high (37.5 per cent). Higher amount of bank advances, particularly to small scale industries, was led by the private commercial banks (5.9 per cent growth during July-September, 2013) as most of the other categories of banks have experienced a negative growth in credit disbursement. Given the low level of growth in small scale industries' production during a volatile situation, such a rise in industrial credit by commercial banks, especially for small scale industries, calls for strong justification. Otherwise, the risks of default which has increased in recent times, may contaminate these new loans as well. One logic in favour of this high credit disbursement for small scale industries may be attributed to the low level of risks since most of these loans relate to trade financing particularly for financing wholesale and retail trade, where repayment period generally tends to be low. However, if these advances are pushed primarily by commercial banks' excess reserve, and economic justification for advancing credit to these projects are not sound, the risk of possible default would likely be high. If this be the case, banks may end up being burdened with loan defaults, which could well be higher than the cost of keeping excess reserve (Annex 2). However, depressed demand for both working capital and term loan in the manufacturing sector did not have any tangible impact in terms of pushing down the interest rate on bank advances (interest rate in July-September, 2013 was 13.9 per cent against that of 13.6 per cent in July-September, 2012). High rate of interest, as also the costs associated with risks arising from political uncertainties has pushed the cost of financing projects and discouraged investment by private sector.

TABLE6.4: DISBURSEMENT AND RECOVERY OF CREDIT: VALUE, SHARE AND GROWTH

	Disbursement (July-September)				Recovery (July-September)			
	LSI	MSI	SSCI	Total	LSI	MSI	SSCI	Total
Growth of disbursement of term loan (%)								
2010	37.0	35.2	71.6	38.3	60.4	37.4	48.2	54.3
2011	-6.2	12.7	18.2	-0.5	-12.7	99.3	72.9	15.2
2012	23.2	55.0	15.8	30.7	37.0	-4.7	16.6	20.3
2013	3.7	-44.8	37.5	-8.64	35.4	-3.0	45.4	24.9

Source: Estimated based on the Bangladesh Bank data.
Note: LSI: Large-scale industry; MSI: Medium-scale industry; SSI: Small-scale industry.

Private Investment in Various Sub-sectors. Private investment in different sub-sectors has been analysed using the data for bank advances available; however, this data is only in cumulative form (at the end of each quarter of a fiscal year). Use of this kind of data to explain investment has obvious limitations as investment in a particular period cannot be properly appreciated. According to Table 6.5, changes in advances in the industrial sector have registered a mixed trend over the period between June, 2012 and June, 2013. Growth in the advances of large scale industries has been rather low for last several quarters while that of small scale industries have maintained a mixed trend. The changes in advances for small scale industries was significantly high compared to that in large and medium scale industries at the end of June, 2013. If the growth of term loan for different sectors is expected to be reflected in the trend in advances, higher growth in advances over that of other categories would likely continue over the following quarters of 2013.

The trend in advances for large and medium scale industries and small scale industries, both in cases of export-oriented and domestic market oriented industries, followed the overall trend in advances during June, 2012 to June, 2013. The high growth in the advances of small scale industries, as of June, 2013, in all categories, was a notable exception in the backdrop of the uncertainties pointed out earlier.

According to BOI, investment proposals from both local and 100 per cent foreign owned declined during the calendar year 2013 by 27 per cent and 10 per cent respectively compared to that of the precious year. Registration of 1197 investment proposals from local sources in 2013 was Tk.424.9 billion while that of 181 investment proposals from foreign sources was about USD 2.62 billion.

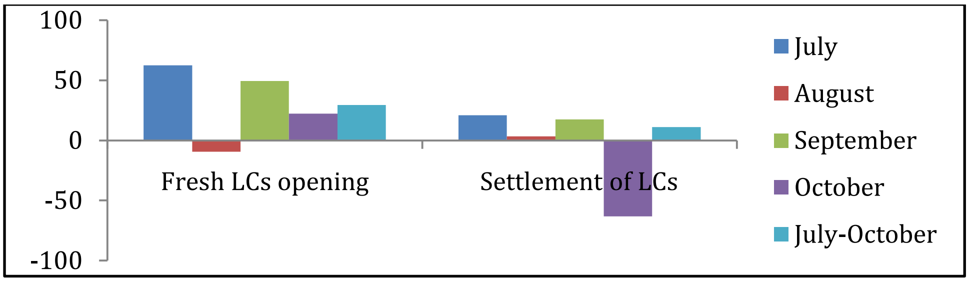
TABLE 6.5: CHANGES IN CUMULATIVE BANK ADVANCES FOR OTHER THAN WORKING CAPITAL FINANCING (TERM LOAN)

Economic Purposes	% change over the corresponding period of the previous year				
	As of June, 2012	As of Sept., 2012	As of Dec., 2012	As of Mar., 2013	As of June, 2013
Industry (Other than Working Capital Financing)	4.95	-2.69	8.23	-0.22	6.9
Large & Medium Scale Industries	3.4	-1.69	7.05	0.31	5.1
Small Scale & Cottage Industries	33.55	-10.36	4.45	-6.15	27.7
Export-oriented Industries					
Large & Medium	4.05	-7.46	0.25	2.6	3.6
Small Industries	99.3	-45.25	0.01	19.28	15.6
Domestic market oriented					
Large & Medium	5.02	6.01	10.39	-0.86	6.3
Small Industries	35.05	-1.86	-1.38	-1.81	18.5
Cottage Industries	73.93	18.88	-17.12	5.83	-0.1

Source: Based on Bangladesh Bank

Slowdown of investment in the manufacturing sector during the first few months of FY2014 is associated with low level of import of capital goods and machineries. Import of capital goods during July-November, 2013 has experienced growth of about 5.5 per cent over the same period of the previous year. During July-October, 2013 there was a gradual deceleration in the opening and settlement of LCs for import of capital goods, which was even negative in a few cases (Figure 6.3). Capital machineries, which constitute about 30 per cent of total capital goods, have experienced a negative growth during this period while other capital goods which comprise the remaining 70 per cent, have experienced a growth of 7.9 per cent over the same period. Import of capital machineries for most of the industries such as leather, jute, pharmaceuticals and packing have registered either low or negative growth both in the settlement and opening of LCs during July-October 2013; in contrast, import of machineries for the textile and garment industry has registered moderate growth in the same period. Although the Bangladeshi Taka has experienced some appreciation against US$ in the course of past one year (exchange rate of BDT, however, started to stabilise during July-September, 2013), leading to some reduction in import costs; this did not have any significant impact on the import of capital machineries.

FIGURE 6.3: OPENING AND SETTLEMENT OF LCS OF CAPITAL GOODS



Source: Bangladesh Bank.

Foreign Direct Investment (FDI). There was no significant breakthrough in the Inflow of FDI during the first half of FY2014. Although FDI flow has decelerated in later months (September and October), overall FDI flow during July-October period in 2013 (US$538 million) was 1.3 per cent higher compared to that of the previous year. In contrast to overall FDI trend in H1 of FY14, EPZs have registered a rise in investment (both local and foreign) by about 26.5 per cent during July-December, FY2014 compared to that of the previous year. A total of USD 190.2 million has been invested during H1 in FY2014 (vis-à-vis USD150 million in H1 in FY2013). Dhaka EPZ (USD64 million), Chittagong EPZ (USD45 million) and Adamjee EPZ (USD41 million) together was accounted for 79 per cent of total investment in EPZ this year. A significant part of this investment is likely to be reinvestment by existing companies indicating better working condition in EPZs even in the period of political conflict which particularly affected domestic tariff areas (DTAs).

Investment in IPOs in the Capital Market. Investment in the capital market was observed mainly in the form of equity investment in primary shares. A total of six companies have gone for initial public offering (IPO) during the first two quarters of FY2014; these had a face value of Tk.427 million (Table 6.5). This record compares well when compared to that of the previous year when there were only three IPOs with total face value of Tk.111.7 million. The companies that offloaded shares this year include two engineering, one textile, one pharmaceutical, one financial institute and one mutual fund. Unlike the poor debt financing record of the manufacturing sector in the first half of FY2014, performance of equity finance was better. As is known, the capital market is currently undergoing various restructuring and reform initiatives in terms of management and operation, legal, administrative issues. This has made some contribution to improving the market situation. However, monitoring and surveillance system needs further improvement to guard against illegal and unethical practices, and to take prompt action against violators. Building confidence of potential investors in the capital market as a viable long term investment destination remains a continuing challenge.

TABLE 6.5: OFFLOADED IPOS AT DSE DURING JULY-DECEMBER PERIOD OF FY2013 AND FY2014

		Sector	IPO price at face value (mill. Taka)	Post IPO paid up capital (mill. Taka)
July – Dec FY2014	Appollo Ispat Complex Limited	Engineering	220	250
	Paramount Textile Limited	Textiles	84	85.1
	Bangladesh Building Systems Limited	Engineering	14	64
	Fareast Finance & Investment Limited	Financial institution	45	160
	EXIM Bank 1st Mutual Fund	Mutual Fund	50	--
	Central Pharmaceuticals Limited	Pharmaceuticals	14	62
July – Dec FY2013	Envoy Textiles Limited	Textiles	30	130
	Generation Next Fashions Limited	Textiles	30	117.1
	Aamra Technologies Limited	IT	51.7	41.9

Source: Dhaka Stock Exchange (DSE)

6.3 Impact of Political Issues on Private Investment

Based on Bussiere and Mulder (1999), a simple econometric exercise was carried out to understand the impact of political uncertainty on private investment in Bangladesh. The model was developed in the context of Bangladesh using available panel data. The novelty of the model is that a number of variables related to 'politics' was included in addition to the standard economic variables. Four variables were considered to capture the essential structural features that play a role as regards politically driven uncertainty and indecision in the electoral system. The detailed methodology is presented in Annex 3. It is important to note that the model is still being developed. Accordingly, the results of the regression exercises should be interpreted carefully, with a view to understanding the nature of impact of the various investment related variables rather than the extent of the impact on investment.

The model is as follows –

PI/GDP = f (GDPGR, EXP/GDP, REM/GDP, CPRI/GDP, INTRAT, EXRATGR, NEFF, COAL, VOLAT, ELECD)

Table 6.6 presents the results of simple OLS regression of the model. It is found that other than economic variables, political variables improve the explanatory power of regression as R-squared was found to be high. Political polarization was found to be positively and significantly related to the dependent variable explaining that more concentration of power in the national parliament significantly erodes the potential for private investment. Political cohesion was also found to be strongly and negatively related to private investment, which indicates that as the parliament becomes more decentralized, investment environment was likely to be friendlier. The volatility (VOLAT) variable was also found to be negatively related to the dependent variable indicating that investors are concerned more when political indecision or volatility arises. However, election years are not a major concern for private investment as the dummy variable was found to be insignificant.

TABLE 6.6: OLS ESTIMATES

PI/GDP	Coefficient	Std. Err.	t stat	P>t
GDPGR	-0.00066	0.002670	-0.25	0.806
EXP/GDP***	0.63477	0.205050	3.10	0.005
REM/GDP	0.40052	0.283825	1.41	0.172
CPRI/GDP	-0.14411	0.088703	-1.62	0.118
INTRAT***	-0.00560	0.001832	-3.06	0.006
EXRATGR	-0.00013	0.000398	-0.34	0.738
NEFF**	185.30120	72.390760	2.56	0.018
COAL***	-0.02705	0.009029	-3.00	0.007
VOLAT***	-0.00055	0.000164	-3.34	0.003
ELECD	-0.00326	0.005738	-0.57	0.575
Constant	0.17164	0.027943	6.14	0.000
R-squared	0.95			
Adj R-squared	0.93			

Note: ***, ** and * represent 1%, 5% and 10% level of significance respectively
Source: Authors' estimation

Among the macroeconomic variables, export to GDP ratio (EXP/GDP) and average interest rate (INTRAT) are found to be significant with expected signs. Inward remittance earnings to GDP ratio (REM/GDP) and growth of exchange rate (EXTRATGR) over the years did not show the expected signs.[38] Weak relationship between credit to private (CPRI/GDP) with private investment can be explained as the data for the CPRI/GDP variable contain information on consumer credit that does not count as private investment.

6.4 Outlook

Results from the regression indicate that a democratic system with political competition is one of the pre-requisites to ensure higher levels of investment in Bangladesh. This has also been found in case of other developing countries. As is known, the confrontational politics in FY2013 and in the first half of FY2014 has severely affected the manufacturing sector of Bangladesh in terms of production, investment, sales and employment both relating to domestic as well as export market-oriented industries. Except for a few large sectors, the majority of the manufacturing sectors have been severely affected because of this. The impact was more acute for domestic market-oriented industries particularly for the small scale industries. Although various economic factors might contributed to the emergent scenario, it was the political factors which appeared to be the critically important determinant. A conducive political environment, underpinned by democratic governance, was needed for taking investment to a higher plane.

In order to improve the production environment, an assessment on the damages of different sectors is urgently needed in order to understand the needs of those sectors. This assessment should also include damages caused in the supply chain relating to various infrastructure

[38] However, in this model, growth rate of GDP (GDPGR) has failed (insignificant and negative sign) to influence private investment to GDP ratio which comes out as one major concern for the model.

including bridges, roads and rails related to domestic and export market-related supply chains. Government should come out with a comprehensive package with financial, technical and policy tools to restore investors' confidence. This package should ensure 'distributive justice' in terms of access by various categories of enterprises. Given the limited possibility towards accelerated large scale investment within short period of time, government should take targeted approach (at least for a year) to support selected sectors that have short turnout period and would contribute more in production and employment. Public investment through ADP may be revised by putting emphasis on building infrastructure and ensuring restoration of the supply chain.

Private investment will hinge on conducive political environment. Short term investment is likely to be continued because of the short gestation period and limited risks. A cautious approach is needed in case of disbursement of debt finance. Proper justification of projects should be ensured in this regard. A boost in long term investment will call for putting in place good and inclusive governance as well as supportive macro-economic environment.

7. CONCLUDING OBSERVATIONS

Most of the macroeconomic correlates showed either disquieting or stagnating trends as the economy suffered from political volatility during the first six months of FY2014. In this backdrop, the major emphasis of the second half of FY2014 should be on consolidation of the three correlates and kick-starting the growth dynamism through a package of policy measures. This perspective and based on our foregoing analyses, it is suggested that such a policy package needs to have the following four interrelated characteristics.

i. Restructuring the fiscal framework;
ii. Support to *Boro* harvest and rural economy;
iii. Compensatory measures for the affected sectors; and
iv. Ensuring policy predictability.

In the subsequent paragraphs we briefly outline each of these four components. In connection to this, one may highlight the fact at present economy is at more stabilised state. A number of favourable domestic conditions can help the government to undertake the countercyclical policies. Budget deficit as a percentage of GDP is quite comfortable. Exchange rate of BDT against USD is stable, underwritten by surpluses in both current account balance and overall balance. A number of external factors are also in favour of the government. International prices of food, fertiliser and fuel are either in a declining trend or stable while global outlook in 2014 anticipates stronger economic growth.

7.1 Restructuring the Fiscal Framework

In its budget analysis, CPD termed the fiscal framework for FY2014, as surreal. By the middle of the current fiscal year it has become obvious that the fiscal goalposts need substantive readjustment. This will entail significant downsizing of both resource and expenditure sides. Enhanced revenue collection and improved access to committed foreign project aid will be key in consolidating the resource side. The government borrowing from the non-bank sources has already increased; it will be important to keep bank borrowing within budgetary target. While the ADP size has to be reduced, it needs to be seen that it does not experience disproportionate cut vis-à-vis the revenue expenditure. Though the declared emphasis on large infrastructure projects are well taken, one needs to be mindful that they may not yield immediate growth impulse.[39] Thankfully the size of the budget deficit is quite reasonable, so the government will be able to afford a slightly expansionary stance. In the face of depressed private investment

[39] One was surprised to note that the declared list of priority projects did not include Dhaka-Chittagong four lane highway as well as the proposed new airport.

demands, this aspect becomes particularly important. Needless to say, the issue of ensuring quality of public investment will remain paramount.

7.2 Support to *Boro* Harvest and Rural Economy

Boosting aggregate demand through energising rural economy will be particularly critical. Agro-production and agro-based industries experienced major loss during the recent period. Smooth supply of inputs including electricity for *Boro* cultivation needs to be ensured. Policy support to sectors such as poultry and livestock has to be devised. Flow of agricultural credit needs to be maintained at high level. While revisiting public expenditure outlay, expansion of social safety net programmes should be considered. Indeed, the government may assess the possibility of increasing allowances under these programmes as there had been no significant upward adjustment of these allowances.

7.3 Compensatory Measures for the Affected Sectors

The government has already declared a number of supportive policy measures for private sector in view of its losses due to recent political violence. Regrettably, these measures (e.g. banking and taxation) are skewed towards the RMG[40]. As our study shows many other sectors were equally affected, if not more (e.g. agro-based industries, transport, small entrepreneurs and business). From the perspective of allocative efficiency as well as distributive justice, some measures may also be considered on an immediate basis. Such compensatory economic policies may be of two types, viz. the economy-wide and sector-specific measures. Among the economy-wide measures the most critical will be the focus on banking sector. Facilities providing flexibility in loan repayment rescheduling as well as interest rate rebates may be considered (as has been provided to other sectors). The exchange rate needs to stay stable. The monetary policy should not emphasise contraction of aggregate demand due to its preoccupation to contain inflation. Among the sector-specific measures, the most affected sectors such as transport and agro-production and agro-based industries may receive some targeted incentives, particularly in terms of fiscal measures. For example, the government may consider a time bound reduction of turnover tax on the SMEs.

BOX 7.1: POLICY DECISIONS TAKEN DURING THE ELECTION TIME GOVERNMENT

A wide range of public policy decisions were taken during the tenure of election time government (25 November, 2013 - 5 January, 2014) in different sectors. A number of these decisions has important financial and economic consequences. Some of these decisions have direct implications in shaping the environment for the national parliament elections. For example, the government increased the allowances for Border Guard Bangladesh (BGB) personnel and officers and staff engaged in development projects. The government also took a decision to increase the salary of primary school teachers during their period. Many of these people were in election duty later.

The poll-time government also took several important decisions which have farreaching implications for the country. For example, it signed Trade and Investment Cooperation Forum Agreement (TICFA) with the USA. The Cabinet Committee on Purchase allowed 15 proposals to go ahead and the Cabinet Committee on Economic Affairs approved another 4 proposals. Among them extension of two power projects for five years, import of wheat and fertiliser are notable. The government decided to procure 0.2 million tonnes of *Aman* from local farmers at a price of Taka 30 per kg. In addition, the poll-time government gave license to five insurance companies.

The poll-time government also initiated several support measures for the RMG sector. For example, it lowered the cost of funds for exporters by lowering the interest rates on Export Development Fund (EDF) loans. Moreover, the government brought down the export tax and increased the amount of cash incentive for garment export. In addition, the central bank relaxed the loan rescheduling policy for the SMEs and businesses.

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[40] A number of supportive measures were also taken during the election-time government. Box 7.1 addresses the issues as regards major decisions taken by the election-time government.

Government has also taken several important decisions at the fag-end of its tenure i.e. prior to the assumption of the poll-time government. For example, ECNEC gave nod to 15 projects worth of Taka 4,796 crore on November 5, 2013 and 17 projects worth of Taka 4,579 crore on November 12, 2013. The Prime Minister inaugurated a total of 193 projects and laid foundation of 121 projects at different locations of the country during October-November 2013. In addition, the government passed the Grameen Bank Act 2013, the Anti Corruption Commission (Amendment) Bill 2013 (incorporated a provision that the ACC has to take prior government approval to initiate case against a public servant), announced formulation of interim Pay Commission and approved license for 13 more TV channels.

7.4 Ensuring Policy Predictability

The effectiveness of above policies will critically hinge on a policy environment (both economic and non-economic) which can instill confidence, and ensure predictability to the investors and entrepreneurs. The currently practiced "seize fire" or "peace clause" approach by the contending political camps is useful and may restore the operational efficiency of economic capacities, but will not be enough to induce expansion of capacities to attain a higher economic growth and more gainful employment. Without greater predictability in the political front, one may not expect any significant upturn of private investment – both local and foreign – in the country. While the prospect of participatory and credible national election is being debated, it would be important for the present government to be transparent and inclusive in its policymaking and its implementation process. In that sense, reaching out to the local community, policy-oriented civil society, private sector and political opposition may facilitate smoother implementation of the development programmes. Creation of more democratic space for the non-state actors may have positive influence on energising the economic activities.

ANNEX 1: A SNAPSHOT ON RECENT SCAMS IN THE BANKING SECTOR (as of December 2013)

Bank/Institution Involved	Types of Scam	Amount of Credit	Measures
BASIC Bank	loans to nonexistent e.g., AB Trade Link, Ma Tex, EFS Enterprise, SPN Enterprise companies Auto define, ARSS, Brothers Enterprise, S Suhii Shipping Line and S Resources Shipping Lines are mainly involved in this term.	Credit scam Tk. 4500 crore;	BB signed a memorandum of understanding with BASIC Bank underscored by 15 conditionalities.
Janata Bank, Prime Bank, Jamuna Bank, Shahjalal Islami Bank Ltd and Premier Bank	Bismillah Group and its fake sister concerns Shaharish Composite Factory Ltd, Alpha Composite Towel Ltd, Shaharish KT Ltd, Hindul Wali Ltd and Bismillah Towel Ltd	Tk 1,174.46 crore.	The Anti-Corruption Commission has filed 12 cases against 53 top officials of five banks and Bismillah group on November 3, 2013
Sonali, Jnatata, NCC, Mercantile and Dhaka Bank	Fahim Attire Limited manage bank loan with forged land documents	Tk. 5.89 crore (Tk 2.3crore of Sonali Bank's Gulshan Branch, Tk 1.6 crore of Janata Bank, Tk 0.33 crore of NCC Bank, Tk 1.51 crore of Mercantile Bank and Tk 0.15 crore from Dhaka Bank)	ACC has filed case against Sonali Bank, Fahim Attire Limited and some individuals
Sonali Bank	Hall Mark and some other businesses	Tk.3547 crore	The ACC has filed 11 cases against 27 people, including Sonali Bank's 20 former and present officials and seven officials of the Hall-Mark Group.

Source: Various Newspapers and Bangladesh Bank Website

ANNEX 2: PERCENTAGE OF CLASSIFIED LOAN

	June, 2012	Sep, 2012	June, 2013	September,2013
	% of classified loan	% of classified loan	% of classified loan	% of classified loan
NCBs	13.5	17.7	26.4	28.8
PCBs	3.8	4.9	6.6	7.3
FBs	3.2	3.2	4.7	6.0
DFIs	23.8	24.1	26.2	29.4
Total	7.2	8.8	11.9	12.8

Source: Bangladesh Bank.

ANNEX 3: METHODOLOGY FOR REGRESSION ANALYSIS

Four variables have been used to capture the essential structural features that inform politically driven uncertainties and indecision. Description of these variables is given below.

Political Polarisation: The Effective Number of Parties (NEFF)

The effective number of parties is defined as (Laasko and Taaepera, 1979)

$$\text{NEFF} = {}^{1}\!/_{\sum_i P^2{}_i}$$

Where P_i represents the share of seats of party i in the incumbent parliament. This index will measure the number of parties in parliament with appropriate weight to small and large parties. This will measure the decentralization of power in the parliament as well as a proxy of taking appropriate policy decision.

Political Cohesion of the Government: the COAL variable
In addition to identifying the political polarization, it is important to understand the composition of parliament or the governing body. This will try to measure whether effectiveness of government is hampered by having cooperated with coalition parties. This is a dummy variable.

COAL = 0 for one-party majority parliamentary government
1 for coalition parliamentary government with two or more coalition partners

Electoral Indecision: The Volatility Index
Uncertainty about the political process and its outcomes is a major potential cause for politically driven vulnerability. Since the result of elections is a major unknown, agents cannot make precise predictions about fundamentals such as inflation targets, commitment to the exchange rate regime and the budget deficit. This phenomenon is well captured in Pedersen's (1983) index, defined as

$$\text{VOLAT} = \frac{\sum_i |R_i^A - R_i^B}{2}$$

Where, R_i^A is the percentage of seats obtained by party i in the election A and R_i^B is the percentage of seats obtained by party i in election B.

Election Dates: ELECD

This is a dummy variable indicating the election years. It takes 1 if election was held in a specific year.

Thus, the final model becomes –

PI/GDP = f(GDPGR, EXP/GDP, REM/GDP, CPRI/GDP, INTRAT, EXRATGR, NEFF, COAL, VOLAT, ELECD)

To avoid non-stationary and spurious results, the ratio or growth rates rather than the level is preferred of each variable believing that this will avoid spurious results due to serial correlation of macroeconomic variables. All the variables were tested for normal distribution. It was found that all variables were almost normally distributed.

Limitation
The methodology for the study of Economic Vulnerability due to Political Instability is still on a developing stage. It will be developed further and compared with other countries' outcomes.