Analytical Review of Bangladesh's Macroeconomic Performance in FY2014
Second Reading

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CENTRE FOR POLICY DIALOGUE (CPD)
B A N G L A D E S H
a civil society think tank

CPD IRBD 2014 Team

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Expert Group

The CPD team is grateful to all of those presented at the consultation on 22 January 2014 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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Contents

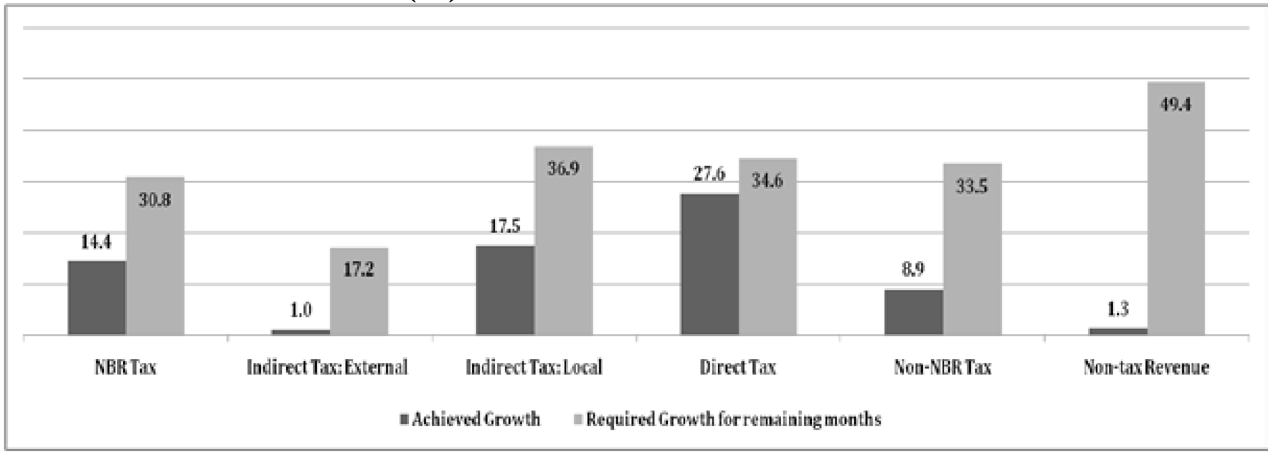
1. Introduction

- The present document is the second instalment of FY14 prepared under the abovementioned programme focusing on the first six months and also looking ahead.
- The document seeks to address three areas –
  - 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;
  - consequences of the impacts for macroeconomic management and the required adjustments in policies; and
  - taking cue from the above, to undertake projection on growth prospects and identify required policy measures in view of the emerging challenges.

Fiscal Sector

- Mobilisation from NBR sources, as also collection from non-NBR tax and non-tax-revenue heads, were found to fall behind the targets
  - During Jul-Nov FY14, NBR achieved 14.4% growth (against 25.3% annual growth target)
  - shortfall was about Tk. 8,500 crore target in H1 FY14 from target
  - Non-tax revenue head may not reach the target

GROWTH (%) OF DIFFERENT SOURCES OF REVENUE



2.MACROECONOMIC MANAGEMENT IN FY2014

- The slack in the revenue collection performance could be explained by-
  - Fiscal incentives provided in the budget (increase in the threshold for individual non-taxable income; reduction and exemption of a number of tax rates; raising the investment for tax rebate limit; enhancing the related tax exemption margin)
  - Decline in domestic demand due to recent political impasse
  - Impeded initiatives concerning expansion of tax net during first half of FY14
  - Growth in import payments did not correspond to import related tax collection- global commodity prices were stable and exchange rate of BDT experienced some appreciation against USD

2.MACROECONOMIC MANAGEMENT IN FY2014

Public Expenditure

- Public expenditure growth for FY14 will be to a higher tune of 27.7 % over the actual expenditure in FY13. (17.5% in BFY14 over RBFY13)
  - Actual expenditure in FY13 was only 14.3% higher compared to the same of FY12
  - In the first five months of FY14, total public expenditure 13.1%
  - During the first five months of FY14, the non development revenue expenditure head registered only 8.0% growth, whilst development expenditure increased by 22.6%
  - Expenditure is expected to increase beyond target on pay and allowances (dearness allowances), domestic interest payments
  - Non-development capital expenditure may fall short of the target due to shortage of funds from revenue mobilisation.
- One significant feature of FY14 could be lower demand on account of subsidy payments
  - Fuel demand in check
  - Fertiliser prices in the international market has declined

2.MACROECONOMIC MANAGEMENT IN FY2014

- Low ADP implementation à 20% in Jul-Nov FY13 (24.7% in FY12):
  - low utilisation of both project aid (PA) and GoB (Taka) allocation
  - continuing levels of low implementation for all months
  - depressing performance of top 10 ministries
- Implementation of ADP is largely influenced by expenditure against Padma Multipurpose Bridge Project (PMBP) à 0.4% of total allocation
  - major part of the allocation for PMBP will remain unutilised

COMPARISON OF EXPENDITURES CONTROLLING PMBP (Jul-Nov FY14)

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)*	24.9	18.2	**22.3**	21.7

2.MACROECONOMIC MANAGEMENT IN FY2014

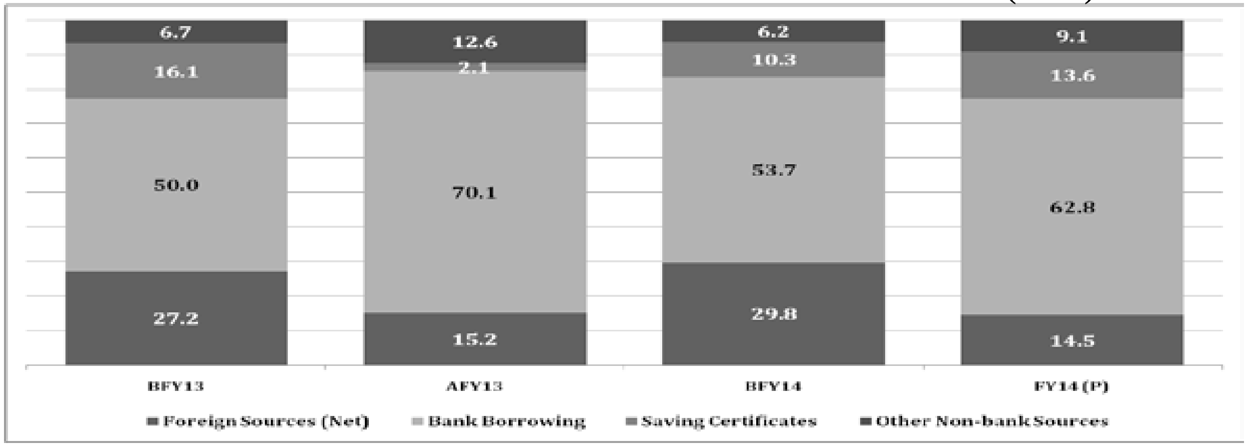
Financing of Budget Deficit

- Fiscal deficit in the first five months of FY14 was limited (only 13.1% of planned budget). But will rise since expenditure are backloaded
  - net bank borrowing was only 22.8% of planned budget
  - net sales of NSD certificates was encouraging- Tk. 3,414 crore
- Governments income and expenditure trend suggest that FY14 will experience a lower mobilisation of resources and lower expenditure, alluding to a low level equilibrium
  - with lower utilisation of project aid and soaring amortisation payments, the foreign financing is expected to remain lower than the budget target
  - envisaged budget deficit will contain the bank borrowing within the planned limit

2.MACROECONOMIC MANAGEMENT IN FY2014

- CPD Projections suggest that, as a share of total budget deficit financing, bank borrowing may reach about 60.8% of total financing and exceed the planned target of 53.7% due to lower utilisation of foreign resources.

SOURCES OF FINANCING THE DEFICIT AND SHARE (in %)



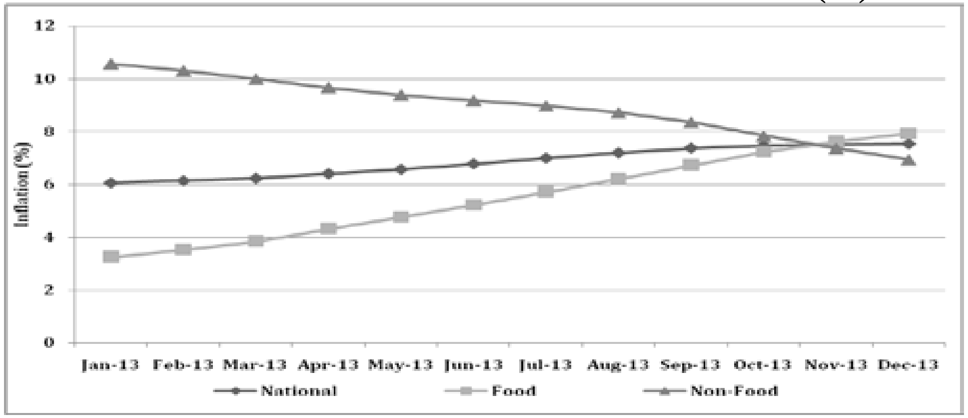
- These predicted developments will depend on
  i. the political situation in the second half of FY14;
  ii. revision of plans as regards revenue mobilisation; and
  iii. patterns of expenditure cut in preparing revised budget.

2.MACROECONOMIC MANAGEMENT IN FY2014

Inflation and Monetary Policy

- Inflation experienced a upward trend during Jul-Dec of FY14
  - annual average inflation reached 7.5% in Dec 2013 (the target was 6-6.5%)
  - rise in inflationary trend was driven by food inflation.
  - Higher price of rice was identified as one of the major factors.
  - With exception of a few (such as milk and spices), prices of most other food items were lower
  - non-food inflation has come down.
  - urban inflation was higher than rural inflation
  - continuing supply disruption due to political violence

ANNUAL AVERAGE INFLATION in Jan-Dec 2013 (%)



2.MACROECONOMIC MANAGEMENT IN FY2014

- 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 Nov'13 (16.7%) remained below the target of 17.2% (for end of Dec'13). Much of this growth is explained by the high growth of net foreign assets (34.3% as of Nov 2013)
  - Growth of domestic credit (10.8% as of Nov'13) and credit to private sector (11.1% as of Nov'13) remained at subdued levels
  - Tk. 86,000 crore excess liquidity prevailing in the banking system (at the end of Oct '13)

Stagnation during H1 of FY14 may improve in the second half if the political environment becomes favourable for undertaking economic activities

2.MACROECONOMIC MANAGEMENT IN FY2014

External Sector

- Export earnings registered impressive growth during H1 of FY14. RMG export to the non-traditional markets rose at faster pace (31.8%) than the traditional market (18.1%). Non-RMG export achieved a significant growth in the EU market (22.0%)
- Import related activities did not pick up during Jul-Nov FY14 (increased by only 4.4%).
  - Growth was mainly driven by higher payments against imports of food grains, chemicals and RMG related intermediate goods. lower level of international prices also helped to keep the payments in check.
- Foreign exchange reserve crossed the USD 18.0 bln mark

2.MACROECONOMIC MANAGEMENT IN FY2014

- Remittances experienced (-) 8.4% growth during H1 of FY14. Possible reasons behind this sudden fall in remittance inflow are several:
  - lower growth of manpower export (-13.8% in H1 of FY14). Manpower exports to major Middle East markets decreased by 30.8%
  - difficulties faced in transferring remittances through banks or MTOs from a number of transferring countries including UK
  - appreciation of BDT creating incentives for transfer of remittance through informal channels (BDT appreciated by 4.3%)
- Possible reasons behind lower overseas jobs -
  - a higher number of returnee migrant workers in recent period
  - G2G system is not giving the expected results
  - limited market opportunity (major traditional destinations such as KSA and UAE having virtually stopped recruiting from Bangladesh)
- During Jul-Nov FY14, BoP observed a favourable situation achieving a surplus balance of USD 2.0 bln because of robust export performance and lower import payments
  - the surplus also emanated from the commercial borrowing of private sector from foreign sources

2.MACROECONOMIC MANAGEMENT IN FY2014

- The outlook of external balance suggests that export is likely to remain robust while import payments may pick up to some extent

The central bank should continue its current policy stance of keeping exchange rate stable and allow foreign exchange reserve to adjust accordingly

2.MACROECONOMIC MANAGEMENT IN FY2014

Concluding Observations

- 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
- Economic performance of a number of indicators continued to deteriorate in H1 of FY14 including inflation, ADP implementation, remittance inflow and foreign aid utilisation

- Proposed fiscal framework for FY14 is in need of a revisit
- The analysis for the H1 of FY14 also confirms that, the economy in FY14 did not manage to make any significant shift from arrested growth towards a higher growth trajectory
- In view of available information on various sectors and assuming that there will be (i) *no major supply-side disruption* and (ii) *uncertainty (arising out of political turmoil)* over the rest of FY14, it is likely that GDP growth rate in FY14 will be between 5.6-5.8% for FY14 (according to 2005-06 base year)

3. AGRICULTURE

Crop Production: Disrupted Boro Cultivation could Hamper Achieving Overall Target

- Due to input supply chain disruption, CPD projects a lower production of *boro* rice for FY14, if immediate measures are not taken
- CPD estimates indicate *crop (rice, wheat and maize)* production in FY14 may increase about *0.5-1.4 %* (*0.83-1.76 %* lower than the target
- *Aus* and *Aman* production is likely to rise by about *1.5-1.9 %* and *2-3 %* respectively and *boro* production is likely to increase by *0.10 %* (best case) or decline by (-) 1.0% (worst case)
- In order to confirm 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 fertilizer supply in a timely manner (iii) proper monitoring to protect the produce from any pest attack and (iv) announcing procurement plan at the very beginning of harvest period

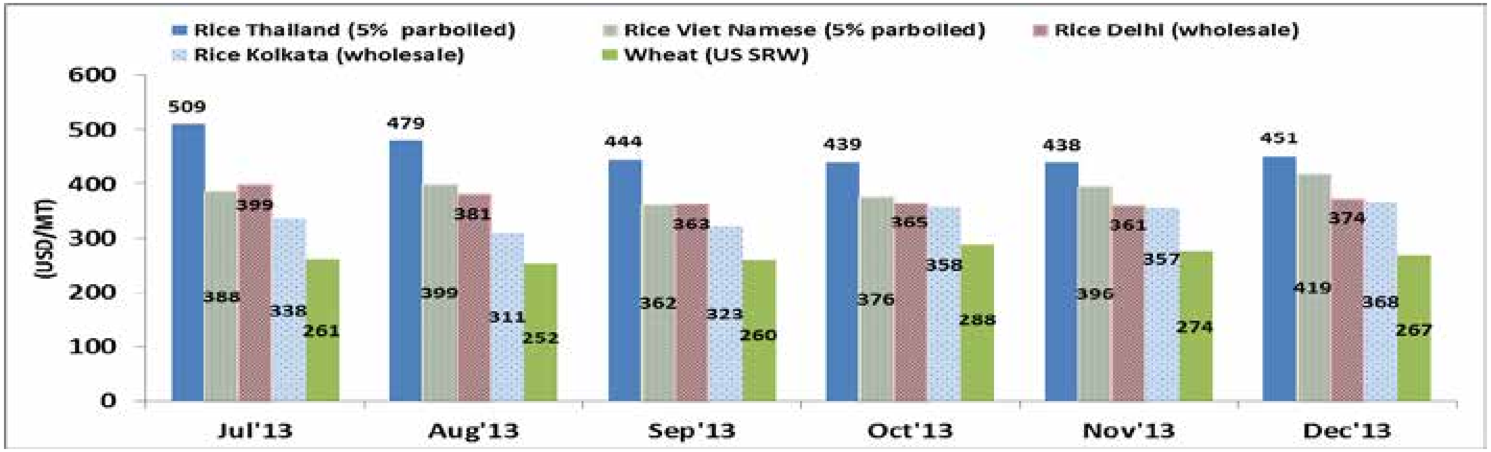
Ensuring Adequate Food Stocks: A Challenge for the Rest of the Fiscal Year

- In December 2013, public food stocks were to the tune of *0.951 mmt*, which was *31% lower* than that of December 2012 and *38 % lower* than that of December 2011
- Since current food stocks are less than the standard level of 1.0 mln 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
- 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*

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

- Bangladesh could prefer importing rice from the Indian market at present since this would be cheaper than Thailand and Vietnam.

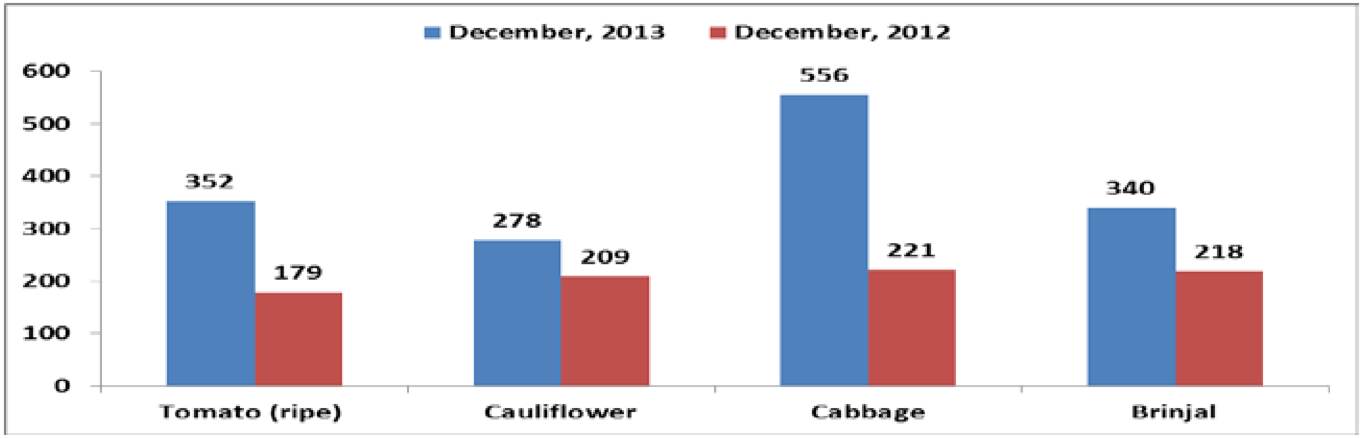
RICE PRICE IN INTERNATIONAL MARKET



- CPD estimation shows that, if the prices of Dec'13 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.
- Currently appreciated Bangladeshi Taka against USD and Indian Rupee could also be an advantage

Significant Gap between Growers Level and Retail Prices of Vegetables

PRICES IN DHAKA AS PERCENTAGE OF GROWERS LEVEL PRICE



- Average retail price of ripe tomato in Dhaka was *3.52* times higher than at growers' level in Dec'13, which was *1.79* times higher in Dec'12
- The average retail price of cabbages in Dhaka was *5.56* times higher than at growers' level in Dec'13, which was *2.21* times higher in Dec'12

To restore the interest of vegetables farmers, for the next season government needs to provide agricultural credit on easy terms on an urgent basis

Poultry Sector: An Incentive Package is Required on an Urgent Basis

- Poultry sector has suffered significant losses due to recent political turmoil.

- According to the estimates by Bangladesh Poultry Industries Co-ordination Committee, during Oct-Dec 2013
  - the sector has incurred a loss of around Tk. 4,000 crore &
  - around 36 thousand poultry farms have been closed

- CPD has carried out a number of consultations with poultry farmers, feed suppliers & the leaders of breeders association

Poultry Sector: An Incentive Package is Required on an Urgent Basis

- Based on the consultations, CPD concludes that the government should carry out an assessment of the losses suffered by the sector and came up with an incentive package.

- In order to revive the sector CPD suggests:
  - 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.
  - a special schemes for opening up firms, which have gone out of operation

4. BANKING SECTOR

- Banking sector is still struggling to recover from the earlier setbacks while political impasse has made the situation worse
- Issues in the banking sector that are currently considered to be of major concern

Soaring Non-performing Loan (NPL)

- NPL stood at 12.8% in Sep'13 (as a share of total outstanding loan)- the highest since FY09!
  - Attributed to large scale financial frauds and subdued economic activities due to political violence and agitation
- Failure to practice due diligence to undertake proper investigation
- Several business people have failed to service their loans because of losses

4. BANKING SECTOR

Downward Capital Adequacy

- Risk weighted capital asset ratio (CAR), has increased marginally from 9.12% in Jun'13 to 9.14% in Sep'13
- The central bank has recapitalised the SCBs to the tune of Tk. 4,100 crore at the end of Dec'13
- A number of remedial measures have been put in place by the central bank with a view to regaining the trust of customers:
  - introduction of the Bank Company (Amended) 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
  - a number of reform measures at the administrative level

High Excess Liquidity, Low Private Sector Credit Growth

- Excess liquidity in the banks has risen by 73.8 % at the end of November 2013 over the corresponding period of Nov'12

- Lower credit to the private sector (11.1%) 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

Lower Interest Rate Spread in New Banks

- At the end of Nov'13 IRS stood at 4.97 percentage points (5.4 p.p in Nov'12) for some banks this is unusually low, even negative (NRB Global Bank Limited's interest spread in Nov'13 was (-) 6.45 p.p)
- New banks are having to operate in a relatively shallow market

Earnings and Profitability Exhibit Mixed Results

- ROA and ROE are positive for the SCBs in 2013 as opposed to the negative record of FY2012
- PCBs have lost some ground in FY13 which is revealed from the lower ROA and ROE in FY2013 compared to FY12
- the overall low performance of banks and losses incurred by them have led to some erosion of confidence

Response to Political Unrest by the Bangladesh Bank

- Bangladesh bank has extended the time for classification of bank loans by six months - a temporary relief for some banks
- The government has decided that the RMG sector will be provided with 3% subsidy on export related loan
- Support should be given to SME and agriculture sectors. However, this could come from dedicated funds instead of subsidy on loan since it may create pressure on banks' profitability

5.EXPORT SECTOR PERFORMANCE

Impressive Performance

- Export registered an impressive growth of 16.6% during H1 in FY14
  - RMG increased by 20.0% (Woven 20.4% & Knitwear 19.6%); - was primarily volume-driven
  - However Non-RMG growth was only 3.8%
  - Leather (43.6%), frozen food (30.3%), Footwear (35.5%) experienced impressive growth
  - Export growth of Jute and Jute goods (-17.1%) and Home textile (-6.3%) declined

EXPORT GROWTH OF MAJOR PRODUCTS during Jul-Dec FY14

Product	Growth Target FY13	Actual Growth FY13	Growth Target FY14	Actual Growth Jul-Dec FY14	Required Growth Jan-Jun FY14
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**
TOTAL EXPORT	**15.3**	**11.2**	**12.9**	**16.6**	**9.7**

5.EXPORT SECTOR PERFORMANCE

Market Decomposition

- *US Market (during Jul-Oct of FY14 as compared to Jul-Oct of FY13)*
  - Performance of Bangladesh for RMG sector either surpassed or matched the performance of major competing countries
  - Bangladesh achieved significant growth for RMG sector (17.6%)
  - Cambodia (0.8%), China (2.8%) and Indonesia (-0.6%) did not post high growth where as Vietnam (12.8%) and India (16.3%) recorded high growth
- *EU Market (during Jul-Sep of FY14 as compared to Jul-Sep of FY13)*
  - RMG sector of Bangladesh achieved 17.5% growth in the EU market
  - Performance of the other competitors of Bangladesh in the EU market was found to be rather mixed
  - RMG export of Cambodia (36.7%) was significantly better whereas Turkey (3.5%), Vietnam (1.5%) and India (5.0%) experienced only a moderate growth

5.EXPORT SECTOR PERFORMANCE

Disruption and Its Implications for the Sector

- Export-oriented sectors had to face a host of problems over the past several months. These are: lower production, congestion at warehouse, shipment delay at ports, air shipment, higher transportation cost and losses due to vandalism

BGMEA Estimates:

  - Air Shipment related cost overrun: Tk. 1,200 crore
  - Order cancellation & others: Tk. 2,000 crore

- According to the Impact Assessment Survey carried out by BGMEA from the **response of 42 appeal enterprises** (during Dec'13 and W1of Jan'14)
  - Losses due to order cancellation-USD 5.6 mln
  - Losses occurred by vandalism –USD 3.6 mln
  - Excess transport cost –USD 0.1 mln
  - Total losses for 42 enterprises –USD 26.1 mln
  - Averages losses (per enterprise)-USD 0.6 mln
- Air Shipment (volume in tonnes) increased by 38.7% (Biman 9.0% & Foreign Carrier 43.5%)
- However, in absence of any comprehensive assessment it is difficult to come to a reliable estimate of the losses, although it is safe to say that profit margins have taken a hit

5.EXPORT SECTOR PERFORMANCE

Demands Emanating from various Export Sectors

- Reduction of tax at source to 0.25% instead of 0.8%
- 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
- A five-year installment facility to repay the converted block loans with moratorium facility for two years
- Bank loans equivalent to four months' wages of workers, starting from Nov 2013 which would be repaid over a period of two years
- Not to categorize default loans as 'classified' within two years
- 100% waiver of interest on all types of loans taken from state-owned and private banks between Oct'13 to Mar'14 for frozen food sector
- 15% cash incentive instead of 10% for frozen shrimp and other fish from Jul'13

5.EXPORT SECTOR PERFORMANCE

Government Initiatives

- 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
  - loan up to USD10 million from the Export Development Fund at an interest rate of 1.5%
  - reduced tax at source to 0.3% from the current rate of 0.8% for the apparel and textile sector (Tk. 500 crore worth of foregone revenue)
  - exporters of woven, knitwear and terry towels have been allowed to get cash incentive at the existing level of 5.0% against advance TT
  - Bangladesh Bank proposed to the government to give a 3% subsidy on export loan interest
  - government was also considering a rise in the amount of cash incentive for export sector to 6% from the existing 5% rate for cash incentive

5.EXPORT SECTOR PERFORMANCE

- Whilst the rationale for the proposed incentives cannot be denied, several factors should be taken into cognisance
  - the incentives will have fiscal implications, as well implications for banks
  - should be implemented in a manner that takes into cognisance the interests of the SMEs, is broad-based, but selective
  - a transparent and time bound exit policy will be needed

New Developments Impacting on Near-term Performance

- US has suspended the GSP facility for Bangladesh (27 Jun'13)
- **Other implications** :GSP for other products, FDI from USA, EU-GSP
- tripartite action plan on fire safety and structural integrity
- monitor the impact of various multilateral and bilateral initiatives (EU-GSP for Pakistan, Japan-India FTA, India-EU FTA, India-ASEAN FTA, Trans-pacific Partnership Agreement)

Outlook

- If there is no major disruption emanating from domestic developments, export sector is likely to exceed the target

6. STATE OF PRODUCTION AND INVESTMENT IN THE MANUFACTURING SECTOR

Overall Performance of Production

- Significant impact of political instability on production, supply of raw materials, sales in domestic and export markets was 11.7% but this was mostly underwritten by growth of export-oriented industries
- Growth in production of LME
- Growth in production of SSE remained at a much lower level
  - Widened the gap with that of LME s;
- Production of domestic market-oriented industries suffered more compared to export-oriented industries with its growth rate decelerating towards December

% CHANGE OF QIP IN JULY-SEP'13 OVER CORRESPONDING PERIODS OF THE PREVIOUS YEAR

Categories	***% change***
L &M enterprises	***11.7***
Largely domestic market-oriented	
Overall	7.6
Other than Food	2.6
Largely export-oriented	
Overall	11.8
Other than RMG	0.02
Small scale enterprises	***5.4***
Food, beverage and tobacco	4.4
Jute, cotton, RMG and leather	18.1

- Collected data from eight firms: experienced similar level of changes

6. STATE OF PRODUCTION AND INVESTMENT IN THE MANUFACTURING SECTOR

RMG	• Foreign sales: Slightly increased • No. of foreign orders: Unchanged • Employment generation: Unchanged • Layoff: Moderate level
Pharmaceutical	• Production: Decreased • Domestic & foreign sales: Slightly increased • No. of foreign orders: Unchanged • Employment generation: Slightly increased • Capacity utilisation: Moderately negative decline
Light Engineering	• Production: Decreased • Domestic & foreign sales: Slightly increased • No. of foreign orders: Unchanged • Employment generation: Slightly increased • Capacity utilisation: Moderately negative decline
Furniture	• Production: Moderately declined • Foreign sales: Significantly declined • No of foreign orders: Moderately declined • Capacity utilisation: significantly declined
Agro-processing	• Foreign sales: Slightly declined • No of foreign orders: Slightly declined • New employment: Significantly declined • Capacity utilisation: Significantly declined

6. STATE OF PRODUCTION AND INVESTMENT IN THE MANUFACTURING SECTOR

- L/C opening for import of raw materials and intermediate products for manufacturing industries were either low or negative: chemical products, cotton yarn, scrap vessels, iron and steel, clinker and limestone etc.
  - Reduced demand for working capital for large, medium and small industries
- The share price indices of listed manufacturing companies both in DSE and CSE were less responsive to the volatility
  - Average daily trade value increased in Jul-Dec'13 by 22.1% compared to corresponding period of previous year

6. STATE OF PRODUCTION AND INVESTMENT IN THE MANUFACTURING SECTOR

- The performance of the manufacturing sector (positive and negative) during the first half of FY14 could be explained both by economic and non-economic factors
  - Economic factors: inflationary trends, reduced interest rate on advances from bank and appreciation of taka against USD, rise in global demand, appreciation of taka over Indian rupee vis-a-vis USD, withdrawal of GSP in US market and crisis in the image of RMG sector following the Rana Plaza tragedy
    - Difficult to explain the trend of 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

Public Sector Investment

- ADP implementation by the Ministries, (industry, energy and mineral and power division) which can help development of the manufacturing sector, performed below average
  - A number of ministries peformed better than last year: industry, railway and labour and employment
- Slow progress in infrastructure related projects was caused by
  - Disruption in completion of the tendering processes
  - Delay in the supply of construction materials due to prolonged political violence

ADP Expenditure in Selected Sectors

Ministry/ Division	Jul- Nov'12	Jul- Nov'13
M/o Industries	6%	17%
Energy & Mineral Res.	26%	17%
Power Division	39%	13%
Roads Division	40%	20%
M/o Railway	13%	25%
M/o Labour & Employment	5%	24%

Private Investment in Manufacturing Sector

DISBURSEMENT AND RECOVERY OF TERM LOAN: VALUE, SHARE AND GROWTH

	Disbursement (July-September)				Recovery (July-September)			
	LSI	MSI	SSCI	Total	LSI	MSI	SSCI	Total
Growth of disbursement of term loan (%)								
2011	-6.2	12.7	18.2	-0.5	-12.7	99.3	72.9	15.2
2012	23.2	55	15.8	30.7	37	-4.7	16.6	20.3
2013	3.7	-44.8	37.5	-8.64	35.4	-3	45.4	24.9

- Disbursement of industrial term loan (Jul-Sep'13) declined by 8.6%
  - Borrowing by LSI increased by 3.0% and by MSI declined (- 44.8%)
  - Term loan borrowing by small industries (37.5%)
- Higher amount of bank advances, particularly to small industries
- Low level of risks since most advances were related to trade financing particularly for financing wholesale and retail trade
    - Repayment period generally tends to be low
- If advances are pushed primarily by commercial banks' excess reserve, the risk of possible default is likely to be high

6. STATE OF PRODUCTION AND INVESTMENT IN THE MANUFACTURING SECTOR

Private Investment in Manufacturing Sector

- Import of capital goods (Jul-Nov, 2013) registered a growth of about 5.5%; gradual deceleration in Jul-Oct, negative in a few cases
  - Industries such as leather, jute, pharmaceuticals and packing: registered either low or negative growth
- Trend in advances for LMIs and SSIs, both in cases of E-O and D-O industries, followed the overall trend in advances during Jun’12 to Jun’13
  - Better performance in case of SSIs

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

Economic Purposes	% change over the corresponding period of the immediate past quarter				
	As of June, 2012	As of Sept., 2012	As of Dec., 2012	As of Mar., 2013	As of June, 2013
Industry	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

Investment in IPOs in the Capital Market

- A total of six companies have gone for initial public offering (IPO) during the first two quarters of FY2014 (face value of Tk.427 million); previous year there were only three IPOs with total face value of Tk.111.7 million
  - Performance of equity finance was better in the first half of FY2014

Foreign Direct Investment (FDI)

- Overall FDI flow (Jul-Oct'13): USD 538 million was 1.3 per cent higher compared to that of the previous year. FDI flow decelerated in later months (September and October 2013)
- EPZs, on the other hand, have registered a rise in investment (both local and foreign) by about 26.5% during Jul-Dec, FY14 compared to that of the previous year
- Registration for new investment both by local and hundred per cent foreign owned companies have declined during the calendar year 2013
  - 27% in case of local investment and 10% in case for hundred per cent foreign owned companies

6. STATE OF PRODUCTION AND INVESTMENT IN THE MANUFACTURING SECTOR

- Econometric exercise carried out to understand the impact of political uncertainty on private investment in Bangladesh; model is as follows –

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

  - Four political variables : *Political Polarisation: The Effective Number of Parties (NEFF), Political Cohesion of the Government (COAL variable), Electoral Indecision (Volatility Index) and* Election Dates (ELECD)

Findings

  - Political polarization: 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: found to be strongly and negatively related to private investment
  - Negative relationship between volatility variable and private investment: Indicates that investors are concerned more when political indecision or volatility arises
  - Election years: not a major concern for private investment

6. STATE OF PRODUCTION AND INVESTMENT IN THE MANUFACTURING SECTOR

Outlook

- Majority of the manufacturing sectors severely affected:
  - Impact more acute for small scale domestic market-oriented industries:
  - Political factors are the critically important determinant.
- Democratic system with political competition pre-requisites to ensure higher levels of investment in Bangladesh
- Assessment on the damages of different sectors urgently needed
  - Damage caused in the supply chain relating to various infrastructure related to domestic and export market-related supply chains.
- Comprehensive package required with financial, technical and policy tools;
  - Should ensure ‘distributive justice’ in terms of access by various categories of enterprises
- Government should take targeted approach (at least for a year) to support selected sectors that have short turnover period
  - Contribute more in production and employment

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

7. CONCLUDING OBSERVATIONS

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

7. CONCLUDING OBSERVATIONS

Restructuring the Fiscal Framework

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

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.

7. CONCLUDING OBSERVATIONS

Support to *Boro* Harvest and Rural Economy

- 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.

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.

7. CONCLUDING OBSERVATIONS

Compensatory Measures for the Affected Sectors

- 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).
- Exchange rate needs to stay stable.
- Monetary policy should not emphasise contraction of aggregate demand due to its preoccupation to contain inflation.

7. CONCLUDING OBSERVATIONS

Compensatory Measures for the Affected Sectors

- 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.

Ensuring Policy Predictability

- 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.
- 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.

7. CONCLUDING OBSERVATIONS

Ensuring Policy Predictability

- 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.

THANK YOU