CHAPTER 1

State of the Economy in FY2012-13 and Early Signals of FY2013-14

This chapter was originally presented at a CPD press briefing titled *Bangladesh Economy in FY2013-14: Three Months after the Budget, Three Months before the Election*, held at the CPD office on 22 October 2013.

1.1

INTRODUCTION

The present chapter has been prepared as a study under the Centre for Policy Dialogue's (CPD) flagship programme *Independent Review of Bangladesh's Development (IRBD)* which keeps the performance of the country's economy under continuous scrutiny. With a view to get an overview of the current state of the Bangladesh economy, the study seeks to address three aspects. *First*, it builds on the preceding studies produced under the IRBD programme including the Second Interim Report for the fiscal year 2012-13 (CPD 2013a) and CPD's immediate response to the National Budget for FY2013-14 (CPD 2013b). It considers the year closing figures of FY2012-13, reconsiders the starting benchmarks of FY2013-14, and anticipates their implications for budgetary targets for the fiscal year.

The present study focuses on the distinguishing features concerning the macroeconomic performance of Bangladesh economy in FY2013-14

Second, as the first reading of the early signals of FY2013-14, the present study focuses on the distinguishing features concerning the macroeconomic performance of Bangladesh economy in FY2013-14. It reviews the movements of a set of key indicators for the first quarter (Q1) of the current fiscal year and attempts to forecast an outlook for the rest of the year.

Third, an earlier study of CPD, conducted in April 2013, predicted that the persistent political impasse would leave an unfavourable footprint on the economic performance in FY2013-14 (Bhattacharya *et al*. 2013). As Bangladesh moves towards another democratic transition, the present paper analyses the relevance of political business cycle (PBC) in Bangladesh to understand its implication for macroeconomic prospects and performance.

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Following this introduction, the subsequent three sections of the chapter have been fashioned around the three aspects mentioned above. The chapter closes with a set of summary observations.

1.2

RESETTING THE BENCHMARK OF FY2012-13

In the run-up to the National Budget for FY2013-14, on 3 June 2013, CPD released its Second Interim Report on Bangladesh's macroeconomic performance in FY2012-13 (CPD 2013a). The report, based on six to ten months data of FY2012-13, underscored that the apparent overall economic stability and growth performance are underpinned by weakening of certain key macroeconomic fundamentals. It was observed that economic growth decelerated to 6.0 per cent in FY2012-13 from 6.2 per cent in FY2011-12, and was off-track compared to the ambitious target of 7.2 per cent. The fall in crop sector's (and hence agriculture sector's) contribution to the gross domestic product (GDP) growth paralleled the stagnation, if not the decline in GDP rate. The deceleration of GDP growth in FY2012-13 was accompanied by one percentage point fall in private investment (as a share of GDP). Indeed, a wide variety of indicators including import of capital machineries and credit flow to private sector reconfirmed the picture of depressed private

The fall in crop sector's (and hence agriculture sector's) contribution to the GDP growth paralleled the stagnation investment demand. In contrast, public investment in FY2012-13 was expected to pick up the slack in private investment and elevate the total investment above the level of the preceding fiscal year. Domestic savings rate continued to remain subdued in FY2012-13.

Stagnation in private investment and weakening economic growth also got reflected in other macroeconomic correlates

Stagnation in private investment and weakening economic growth also got reflected in other macroeconomic correlates in FY2012-13 including slowdown in revenue collection by the National Board of Revenue (NBR) and decline in overall import payments. On the other hand, export receipts and remittance inflow remained quite robust during FY2012-13. Steady inflow of foreign direct investment (FDI) and buoyant net flow of foreign aid contributed to a substantial surplus in the balance of payments (BOP). Hence, Taka appreciated against all major currencies in the backdrop of significant rise in foreign exchange reserves. Inflation in FY2012-13 was also tamed to certain extent, largely thanks to stable price of rice, declining international commodity prices, stronger domestic currency and slackening of domestic demand.

Overall, the economy in FY2012-13 was found to be at a state, where, in the absence of necessary structural and institutional reforms, the country remained handicapped in transcending to a higher growth trajectory. CPD in its pre-budget review of the state of the economy maintained that these trends were unlikely to change during the remaining few months of FY2012-13 (for which data were not available then).

A review of the closing figures for FY2012-13 indicates that the observations made by CPD regarding the macroeconomy in the wake of annual national budget in June 2013 remain quite valid till date

Three months into the FY2013-14, with the final figures for FY2012-13 in hand, we are now able to take a fuller look at the elapsed fiscal year. A review of the closing figures for FY2012-13 indicates that the observations made by CPD regarding the macroeconomy in the wake of annual national budget in June 2013 remain quite valid till date. A comparative picture based on the data available at the time of the announcement of the budget and the final figures for FY2012-13 may be obtained from the Annex Table 1.1. Table 1.1, on the other hand, reports the new budgetary targets imputed from the relevant actual figures of FY2012-13.

What do the Final Figures of FY2012-13 Say?

Private Investment

Growth of credit to private sector secularly declined throughout FY2012-13

In the area of private investment, one does not observe any reversal of the prevailing sluggish trend during the last quarter (Q4) of the fiscal year. Rather, growth of credit to the private sector secularly declined throughout FY2012-13. At the end of June 2013, growth of private sector credit was only 11 per cent – as against the target of 18.5 per cent – which was the lowest in the last decade. This was a clear indication of lack of investment demand in the country on the part of the private sector. The sluggish investment demand was also demonstrated by the augmented excess liquidity in the banking system. At the end of FY2012-13, the banks had about Tk. 79,441 crore as investable liquidity. Curiously, despite having a large surplus liquidity in the banking system and falling inflation, the lending rate did not decline by any discernible margin during this period.[1] The lack of investment demand was also demonstrated by the fall in payments against import of capital machineries. Capital machineries import declined by (-) 8.5 per cent in FY2012-13.[2] One may recall that, CPD in its previous review identified five plausible

[1]The interest rate on lending was 13.7 per cent in June 2013, which was 13.8 per cent in July 2012.

[2]This slide continued throughout FY2012-13, although during the last quarter the magnitude was lower as capital machinery import during this quarter fell by (-) 1.9 per cent. However, one may need to consider that such growth rate was attained in the backdrop of a more favourable benchmark. During the corresponding quarter of FY2011-12, import of capital machinery declined by (-) 31.2 per cent.

reasons underpinning the worrisome investment climate. These are: (i) demand-side stabilisation measures undertaken to improve macroeconomic balances and contain inflation; (ii) slow recovery of global economic environment; (iii) weak banking system afflicted by a number of loan scams; (iv) adverse developments to the readymade garments (RMG) sector including frequent labour unrest; and (v) uncertain and violent political outlook.

Fiscal Framework

The ambitious fiscal targets, both from income and expenditure sides, set for FY2012-13, did not materialise at the end of the fiscal year. In fact, growth rates of both revenue collection and non-development expenditures declined during the later months of FY2012-13. Revenue collection by the NBR remained Tk. 3,644 crore lower than the target. One may recall that CPD in its pre-budget report estimated that the shortfall of NBR revenue mobilisation could be between Tk. 3,000-4,000 crore (CPD 2013a). Curiously, Ministry of Finance (MoF) estimates this shortfall to be Tk. 8,921 crore.[3] This means the target growth for FY2013-14, which was set at 19.9 per cent based of the Revised Budget for FY2012-13, will now be about 30 per cent (Table 1.1). Bangladesh economy is yet to achieve such high revenue growth in any year.

The ambitious fiscal targets, both from income and expenditure sides, set for FY2012-13, did not materialise at the end of the fiscal year

In a similar vein, the actual growth rates of the expenditure components in FY2012-13 were much lower compared to the targets. On a welcome note, the Annual Development Programme (ADP) expenditure (Taka component) attained a much higher growth, thanks to about 99 per cent utilisation of the original allocation. However, despite a much better project aid utilisation capacity, the overall ADP expenditure growth was 30.7 per cent as against the target of 46.5 per cent. This implies that a lofty 34.3 per cent growth will be required to attain the targeted ADP expenditure for FY2013-14. Expanding the realised size of ADP by more than one-third in one-single year is a highly challenging target to chase, particularly in an election year.

The actual growth rates of the expenditure components in FY2012-13 were much lower compared to the targets

Fiscal deficit turned out to be 4.4 per cent of GDP against the target of 5.0 per cent of the GDP. But this was for the wrong reason, i.e. because actual expenditure was lower than the target. What is to be noted in this connection is that, the financing structure of the budget deficit did not go according to the programme. Borrowing from the banking system by the government was Tk. 3,852 crore higher than the budget estimates, but remained lower than the revised target by Tk. 1,648 crore.[4] Similarly, in absence of availability of programmed resources from the sales of National Savings Bond (NSD) certificates, the government surpassed the target of borrowing from 'Others' sources of non-bank financing which include short-term borrowing from state provident fund and other internal sources.

Evidently, the targets for FY2013-14 were set under the assumption that the revised targets for FY2012-13 will be attained finally. The year closing final figures now reveal that the revenue collection and public expenditure figures used for preparation of the fiscal framework were inflated by substantial margins. Taking note of the past trends, one may safely assume that the financing plan for budget deficit in FY2013-14 will also diverge significantly. One may recall, anticipating such a development, CPD in its initial reaction to the National Budget for FY2013-14 on 7 June 2013, pointed out that the proposed fiscal framework for FY2013-14 has 'water in it' and described this to be the 'weakest link' of the budget.

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[3]The difference in revenue collection estimates for FY2012-13 between NBR and MoF (which uses the iBAS data) is Tk. 5,277 crore. One will need to remember that such discrepancy between the two sources is not uncommon. For FY2011-12 estimates, the difference was Tk. 3,464 crore.

[4]While preparing the Revised Budget for FY2012-13 the target for bank borrowing was raised by Tk. 5,500 crore.

Table 1.1

New Targets for FY2013-14 Imputed from Actual Figures of FY2012-13

Indicators	Growth (%)			
	FY2013 (Target)	FY2013 (Actual)	FY2014 (Budget) over FY2013 (Revised)	FY2014 (Budget) over FY2013 (Actual)
Total Revenue	**21.8**	**12.3**	**19.9**	**30.0**
NBR Tax[1]	22.6	12.8	21.2	31.7
Taxes on Income and Profit	25.4	22.2	36.8	40.4
Value Added Tax (VAT)	19.3	14.0	23.5	29.2
Import Duty	20.6	4.8	0.7	15.8
Supplementary Duty	22.2	-0.2	4.4	27.9
Non-NBR Tax	25.7	13.4	12.4	24.5
Non-Tax Revenue	17.5	9.9	14.9	22.8
Total Expenditure	**25.8**	**14.3**	**17.5**	**27.7**
Annual Development Programme (ADP)	46.5	30.7	25.8	34.3
Non-ADP Expenditure	19.0	8.9	14.4	25.1
Loans and Advances	39.2	20.6	-25.3	-8.6
Others	16.2	7.3	21.4	30.4
Budget Deficit	**37.8**	**20.2**	**10.8**	**21.2**
Financing	**37.8**	**18.2**	**10.8**	**23.3**
Foreign	157.6	75.3	22.6	66.5
Grants	68.3	79.0	26.3	3.8
Loans	114.4	39.7	18.9	78.5
Amortisation	33.5	20.0	15.9	32.0
Domestic	9.6	4.7	4.6	6.2
Banking Sources	-15.4	-1.2	-8.8	-3.2
National Savings Bond (NSD)	2631.6	203.7	152.0	504.2
Others	-0.4	39.5	50.0	-30.6

Source: Calculated from the Ministry of Finance (MoF) data.

Note: [1]According to NBR sources the shortfall in NBR revenue collection in FY2012-13 was Tk. 3,644 crore. The corresponding figure reported by the MoF report showed a Tk. 8,921 core shortfall.

Crop Production

As was mentioned, stagnating value addition from the crop sector was a major setback for FY2012-13. The provisional estimate of GDP growth in the crop sector did not consider the production data of a number of crops including Boro rice. The final estimates show that rice production in FY2012-13 declined by (-) 0.2 per cent in FY2012-13 as Boro production increased by only 0.1 per cent. One may recall that during the last few seasons farmers did not get adequate price incentive for paddy cultivation. As a result, it may be the case that a section of farmers moved away from paddy cultivations to other crops. Indeed, overall cultivated area of paddy declined by (-) 1.2 per cent in FY2012-13. In contrast, cultivated area of non-traditional crops (other than jute and cotton) increased by 8.4 per cent. Indeed, upsurge in production was observed in case of maize (11.5 per cent), wheat (26.1 per cent), pulse (15.3 per cent) and vegetables (5.1 per cent). This new dynamics of crop production has both positive and negative consequences for Bangladesh economy. On the one hand, it is important that the farmers get motivated by the price signals and diversify their production structure to maximise returns. On the other hand, this may lead to increased reliance on imported rice for food security and price stability. It is important to note that, over the last few years, the goal of

Stagnating value addition from the crop sector was a major setback for FY2012-13 'self-sufficiency' in rice production has remained under the national policy spotlight. Decline in rice production and lack of rice import in FY2012-13 consequently led to a decline in public food stock by more than 200 thousand metric tonnes (MT). One can, thus, assume that the government may have to rely on imported rice to run its food distribution programmes in a significant way in the current fiscal year, which will then obviously have additional fiscal consequence. Hence, import of rice by both public and private sector is likely to increase in FY2013-14. One wonders whether that would have a knock on effect in the domestic price situation.

Inflation and Monetary Growth

Inflationary trend had been downwards during the first ten months of FY2012-13, and this continued during the remaining two months of the current fiscal year

As mentioned earlier, inflationary trend had been downwards during the first ten months of FY2012-13, and this continued during the remaining two months of the current fiscal year. The annual average inflation in June 2013 was 7.7 per cent, which was marginally higher than the target of 7.5 per cent. The growth rates of the monetary aggregates in the elapsed fiscal year remained quite subdued as against their respective targets. The growth rate of broad money came down to 16.7 per cent at the end of June 2013, whereas the corresponding target was 17.7 per cent. Conversely, credit expansion to public sector was beyond the target, due to excessive bank borrowing required to underwrite the fiscal deficit in the face of shortfall from other sources of finances. This trend of money supply was, however, underpinned by excessive flow of net foreign assets which posted a growth rate of 43.8 per cent against the target of 14 per cent. Indeed, the accumulation of foreign exchange reserve contributed towards this end.

Banking Sector

The recent trend in the banking sector is not supportive of incremental and sustained economic growth as it is fraught with inefficiency and malpractices

Earlier analysis reveals that the recent trend in the banking sector is not supportive of incremental and sustained economic growth as it is fraught with inefficiency and malpractices.[5] In the backdrop of decelerating private investment, the classified loans in Bangladesh banking sector rocketed during FY2012-13. Share of classified loan to total outstanding increased to 11.9 per cent as of June 2013 which was only 7.2 per cent at the end of FY2011-12. As a result, the state-owned commercial banks (SCBs) faced serious capital deficit, which in turn created additional fiscal pressure for the government.[6] Curiously, such a deterioration of the performance of the banking sector took place at a time when the economy remained under the disciplines imposed by an IMF (International Monetary Fund) programme.

External Sector

Foreign exchange reserve continued to climb throughout FY2012-13 as the inflow of foreign exchange increased in the form of export revenue, remittances, foreign aid and FDI

As mentioned earlier, foreign exchange reserve continued to climb throughout FY2012-13 as the inflow of foreign exchange increased in the form of export revenue, remittances, foreign aid and FDI. Export registered an impressive growth of 11.2 per cent, thanks to enhanced performance in the fourth quarter (14.3 per cent). Similarly, net foreign aid disbursement was about USD 1.9 billion in FY2012-13 which was USD 1.2 billion in FY2011-12.[7] Net FDI inflow in FY2012-13 increased to USD 1.3 billion, which was USD 1 billion in FY2011-12. The only exception was remittance inflow, which registered only 0.9 per cent growth during the last quarter. Overall, in FY2012-13, remittance inflow increased by 12.6 per cent. The decline in remittance growth was coupled with fall in manpower export in FY2012-13. The number of workers going abroad fell by (-) 36.2 per cent in FY2012-13.

[5]See CPD (2013a) for details.

[6]The Budget for FY2013-14 eventually allocated Tk. 5,000 crore for the recapitalisation of the SCBs.

[7]The gross foreign aid flow in FY2012-13 was USD 2.8 billion while the amortisation payment was USD 0.9 billion.

On the payment side, import payments declined by (-) 4.1 per cent in FY2012-13. It may be noted that total import payments increased by 2 per cent during Q4 of FY2012-13 in accordance with higher export demand. High inflow of foreign currencies and lack of payment demand resulted in the rise in foreign exchange reserve and led to appreciation of Bangladeshi Taka (BDT) against all major currencies. Indeed, to contain the exchange rate of Taka (vis-à-vis USD), the central bank had to mop up the excess foreign currencies from the market. Hence, foreign exchange reserve of the country augmented by about USD 5 billion in a single fiscal year. As aggregate demand remained low, the excess money supply arising from accumulation of net foreign assets had a rather marginal impact on inflation. Interestingly, a stronger domestic currency is yet to perceptibly affect Bangladesh's export competitiveness and performance.

Foreign exchange reserve of the country augmented by about USD 5 billion in a single fiscal year

The final figures for FY2012-13 suggests that the fiscal year closed with a much more diminished performance than what was depicted in the budget documents for FY2013-14. The slowdown which set in the economy in the second half of FY2011-12 gathered further momentum in the fourth quarter of FY2012-13. While relatively robust performance of the external sector and enhanced public expenditures provided some relief, depressed private investment remained the 'Achilles' Heel' of the economy. As one readjusts the benchmarks incorporating the latest figures for FY2012-13, the budgetary targets for FY2013-14 look increasingly 'surreal'. The need to readjust the fiscal parameters will be no less an important task in tandem with the urgency of maintaining fiscal discipline in FY2013-14.

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1.3

INTERPRETING THE EARLY SIGNALS OF FY2013-14

This section tries to trace the early signals of FY2013-14 based on limited data available for the first quarter of the fiscal year. In this connection, we reflect on the performance of fiscal sector (revenue collection, public expenditure, ADP implementation and fiscal balance), inflation and monetary sector, productive sector (i.e. crop production, private investment, power and energy) and external sector (exports, remittances and BOP). Table 1.2 presents available information on key macroeconomic indicators in FY2013-14.

Revenue Collection

According to the available data for the first two months for FY2013-14, growth of tax revenue collection by NBR was well below the target

According to the available data for the first two months for FY2013-14, growth of tax revenue collection by NBR was well below the target. Growth of NBR collection had been 16.2 per cent during July-August of FY2013-14 as against the annual target of 25.3 per cent. One may recall that, NBR collection growth started to slow down from the last quarter of FY2012-13.[8] Indeed, growth of revenue collection from all the heads of NBR tax revenue remained below their respective targets. Throughout FY2013-14 NBR will have to chase a daunting effective growth target of 25.3 per cent. It is reported that Large Taxpayers Unit (LTU) has also missed its first quarter targets for income tax and VAT collection. In August FY2013-14, import duty head has seen negative growth ((-) 1.5 per cent) indicating continued depression in import situation.[9] However, the government will attain almost USD

[8]In Q4 of FY2012-13, NBR's revenue collection attained only 10.7 per cent growth.

[9]Such performance came in the backdrop of a low benchmark; as in August FY2012-13, import duty collection growth was (-) 15.2 per cent. Curiously, import payments increased in August 2013.

525 million from the sale of 3G licenses and spectrums under non-tax revenue head, 60 per cent of which has already been realised. Nevertheless, it is expected that overall revenue collection at the end of FY2013-14 will miss the budgetary target by a substantial margin.

Public Expenditure

Planned expansion of total public expenditure in FY2013-14 is rather ambitious – a growth of 27.7 per cent over actual expenditure in FY2012-13, while actual growth of expenditure in FY2012-13 was 14.3 per cent over actual expenditure in FY2011-12. Data is yet to be available for revenue expenditure in FY2013-14. In the run-up to the elections, the government has declared 20 per cent Dearness Allowance (on the basic salary) for public sector employees which was likely to increase the non-development expenditure by a notable margin. The government, in the recent past, has been recruiting new employees on an extensive scale and this would also have implications in terms of increasing the revenue expenditure.[10] Disbursement of Tk. 5,000 crore for recapitalisation of the SCBs is also likely to fuel the non-development expenditure.[11] At the same time, about Tk. 7,334 crore has been allocated in the budget for investment in capital market. Interest payment is also emerging as a significant element of the revenue expenditures along with significant surge in transfers and subsidies. In fine, in the backdrop of modest growth in revenue collection, substantial increase in revenue expenditure is anticipated in FY2013-14.

It is expected that overall revenue collection at the end of FY2013-14 will miss the budgetary target by a substantial margin

ADP Implementation

Allocation for ADP FY2013-14 has been Tk. 65,872 crore (about one-third more than the actual expenditure of FY2012-13). ADP implementation has got on to a slower start in this fiscal year. During the first two months of FY2013-14, only 6.2 per cent of the allocation has been spent, whereas the corresponding figure for FY2012-13 was 8.3 per cent. During the months of July-August 2013, only 4.2 per cent of aid component has been utilised, whereas the comparable figure for the preceding year was 6.6 per cent.[12] It may be pointed out that among the ministries having highest allocations, Local Government Division (LGD) has spent equivalent to 14.6 per cent of its allocation in first two months of FY2013-14. In the run-up to the elections, it is likely that LGD, along with Roads Division and Ministry of Housing and Public Works would speed up disbursement for projects earmarked in the ADP. Curiously, the latter two agencies have spent only 5 per cent and 1.8 per cent of their respective allocations. Additionally, one may also recall that, ADP for FY2013-14 includes an allocation of Tk. 6,582 crore – 10.4 per cent of total allocation in ADP for FY2013-14 – for Padma Multipurpose Bridge Project (PMBP). The state of affairs regarding implementation of this project suggests that the total allocation may remain mostly unrealised. This implies that a major part of planned development expenditures will remain unimplemented, and the ADP for FY2013-14 has to be seriously downsized during its revision in the second part of the fiscal year.[13] Low implementation of ADP may provide some relief concerning the fiscal stress which may build up in the coming months.

In the backdrop of modest growth in revenue collection, substantial increase in revenue expenditure is anticipated in FY2013-14

Low implementation of ADP may provide some relief concerning the fiscal stress which may build up in the coming months

[10] Recruitment of a large number of employees is also underway. For example, 37,672 assistant teachers are to be recruited shortly as reported by the Finance Minister during his budget speech.

[11] One may recall that SCBs' capital shortfall surged by at least 3.6 times during the second half of FY2012-13 in the backdrop of rise in non-performing loans (NPLs).

[12] 37.3 per cent of total allocation under ADP is attributable to project aid component.

[13] However, Executive Committee of the National Economic Council (ECNEC) continues to approve new projects during FY2013-14. ECNEC has approved at least 64 projects worth about Tk. 50,000 crore (average project cost is about Tk. 780 crore) during the first quarter of FY2013-14. Most of these projects are related to power transmission, infrastructure development and social sector.

Table 1.2

Key Macroeconomic Indicators in FY2013-14

Indicator	Actual FY2012	Actual FY2013	Target FY2014	Latest
GDP Growth (%)	6.2	6.0	7.2	NA
NBR Revenue Growth (%)	19.0	14.3	25.3	16.2 (Jul-Aug FY2014) 12.3 (Jul-Aug FY2013)
Non-Development Expenditure Growth (%)	15.1	10.6	15.0	NA
ADP Implementation (% of Original Allocation)	82.3	91.0	31.7% growth over actual expenditure of FY2013	6.2 (Jul-Aug FY2014) 8.3 (Jul-Aug FY2013)
Budget Deficit (% of GDP)	4.1	4.4	5.0	NA
Money Supply (End June)	17.4	16.7	17.0	16.3 (Aug 2013)
Private Sector Credit	19.7	11.0	16.5	11.3 (Aug 2013)
Inflation (2005-06) Moving Average (End June)	8.7	6.8	6.0-6.5	7.4 (Sep 2013) 7.2 (Aug 2013)
Export Growth (%)	6.0	11.2	12.9	21.2 (Jul-Sep FY2014) 2.1 (Jul-Sep FY2013)
Import Growth (%)	5.5	(-) 4.4	10.0 (MTMF)	10.7 (Jul-Aug FY2014)
Remittance Growth (%)	10.2	12.6	15.0 (MTMF)	(-) 8.1 (Q1 FY2014) 19.7 (Q1 FY2013)
Manpower Export Growth (%)	57.4	(-) 36.2	NA	(-) 53.4 (Q1 FY2014)
Forex Reserve (Billion USD; End June)	10.4	15.3	14.6 (MTMF)	16.6 (as of 8 Oct 2013) 11.3 (as of 8 Oct 2012)

Source: Various Government data documents.
Note: MTMF: Medium Term Macroeconomic Framework.

Fiscal Balance

Financing of the budget deficit will not pose a major challenge, notwithstanding weaker revenue collection in the early months of FY2013-14 because of relatively poor progress in the ADP delivery

Budget deficit was contained within 4.4 per cent of GDP in FY2012-13. In FY2013-14, it is envisaged that the deficit will once again remain within the planned limit, i.e. below 5 per cent. Financing of this deficit will not pose a major challenge, notwithstanding weaker revenue collection in the early months of FY2013-14 because of relatively poor progress in the ADP delivery. Interestingly, in spite of slow off-take in development expenditures, government borrowing from domestic sources in July FY2013-14 reportedly amounted to Tk. 4,231 crore – almost 10 times higher than that of in July FY2012-13. The central bank sources report, during July-August FY2013-14, government borrowing from non-bank sources also shot up to Tk. 1,936 crore, which is 2.7 times higher than that in the corresponding months of FY2012-13. On the other hand, net foreign aid disbursement is found to be in negative terrain in July FY2013-14 ((-) USD 41.8 million)), underpinned by low disbursement of project aid.[14]

Inflation and Monetary Growth

Certainly the rise in commodity price level was influenced by the recent increase in rice price in the domestic market

The central bank in its Monetary Policy Statement (MPS) of July 2013 announced that annual average inflation target for FY2013-14 would be between 6.0-6.5 per cent (as per the new base year of 2005-06). However, inflation (moving average) has moved up by 0.6 percentage points to 7.4 per cent in September 2013 from 6.8 per cent in June 2013, while at the same period food inflation increased by 1.5 percentage points to 6.7 per cent. Certainly the rise in commodity price level was influenced by the recent increase in rice price in the domestic market. In September (annual average) increase in retail price of rice was 5.7 per cent. Retail

[14] Total aid inflow was USD 170.55 million, while amortisation payment (principal) was USD 212.39 million.

price of coarse rice increased by more than Tk. 8 per kilo between October 2012 and October 2013 (33.4 per cent). Interestingly, during this period international price of rice (Thai 25 per cent) declined by (-) 10.5 per cent. This was also a period when Taka has gained in value against all major currencies. Prices of a number of other daily essentials also increased during this period. The most talked case is the recent rise of onion price. As the trend suggests, the inflationary target set for FY2013-14 may not be achievable. Given the apprehension of major supply disruption in view of uncertain political developments, it will be difficult to keep the price level under leash. Although one can observe that the demand-side pressure on commodity prices remained low during the early months of FY2013-14.

Given the apprehension of major supply disruption in view of uncertain political developments, it will be difficult to keep the price level under leash

Growth of money supply has declined marginally to 16.3 per cent as of August 2013, and remained below the planned limit of 17 per cent for June 2014. It appears that the relative stagnation in economic activities observed in FY2012-13 may continue in the current fiscal year as well, while any significant pressure on prices from the demand-side may not be expected. The only exception could be if the country is able to have a breakthrough from the current political impasse and a participating and credible national election takes place. One may then expect an enhanced aggregate demand in the following months. Ensuring supply of commodities and enhancing market management capacity will be the key in this context.

Crop Production

The upside of enhanced prices for agricultural commodities is that this would benefit the farmers. However, it is uncertain to what extent farmers receive an adequate share in the incremental benefits. Certainly, maintaining a price incentive for the agri-products continues to be a challenge given the relative movement of input and output prices in crop sector.[15] Lack of price incentives may force the farmers to shift from production of foodgrains to other crops in the context of limited availability of cultivable land. The government has already taken a few initiatives towards containing rice production by introducing special incentives for Aus producers. The administered price of urea fertiliser has been also slashed by Tk. 4/kg. Agricultural credit disbursement has been beefed up during the first two months of FY2013-14 by 14.2 per cent over the corresponding period in FY2012-13. However, information collected from different sources suggest that farmers are not receiving reasonable profit while selling their produce.

Farmers are not receiving reasonable profit while selling their produce

Private Investment

Certainly, during FY2013-14 in the area of macroeconomic management much attention will be attached to the conduct of private investment. There is little indication that investment demand has picked up in the early months of FY2013-14. This is perhaps because the investors are taking a cautionary approach given the political uncertainty looming in the horizon. Private sector credit growth is stagnating at 11.3 per cent as of August 2013 – much lower than the target of 16.5 per cent (for end of June 2014). FDI inflow in July-August FY2013-14 was USD 290 million, which stood USD 266 million in July-August FY2012-13. However, investment registered with the Board of Investment (BoI) had declined by (-) 24.1 per cent in FY2012-13. On the other hand, import of capital machineries experienced a growth of 14.7 per cent during July-August of FY2013-14. Letter of credit (L/C) opening has also seen a rise in July FY2013-14. However, one has to remain mindful of the low base on which these numbers are imputed; for

The investors are taking a cautionary approach given the political uncertainty looming in the horizon

[15] One may recall that the government planned to start procuring Boro during the period of 2 May to 30 September, 2013 at a price of Tk. 740/maund. But as the government failed to start the procurement in due time, the farmers had to sell their paddy at an average price of Tk. 550/maund. As a result, the farmers incurred loss of almost an average Tk. 50/maund.

example, over the corresponding period in FY2012-13 import of capital machinery had declined by (-) 18.8 per cent.

As was the case in FY2012-13, amid stagnating private investment, excess liquidity with the commercial banks continued to rise and reached Tk. 82,344 crore by the end of July 2013. Despite having a favourable BOP situation and with accumulation of investable funds lying with the local banks, the BoI and the central bank continued to approve foreign credit to the private sector. According to the BoI statistics, about USD 953.3 million worth such credit lines were approved during January-August of 2013 in favour of 66 enterprises.[16] Under the present macroeconomic scenario, these measures will not be helpful for the banking sector in the economy. However, more enterprises are moving towards such options as the interest rate on commercial lending in the country did not decline even when private investment demand was depressed.

More enterprises are moving towards such options as the interest rate on commercial lending in the country did not decline even when private investment demand was depressed

Power and Energy Sector

With regard to power generation, government may be pursuing a restrictive consumption policy in operating the plants. As of October 2013, the plants have derated capacities of more than 8,500 MW (mega watts), whilst the present demand was just over 6,400 MW. However, daily generation data shows that, these plants produce around 6,000 MW with a load-shedding of about 500-600 MW. Data also indicate that plants having more than 2,000-3,000 MW capacities are currently out of operation either due to maintenance reasons or fuel shortage. As it appears, limited load-shedding may have been imposed to tackle fuel subsidy pressure and informed by prudent macroeconomic management practice. Nevertheless, from the investment perspective, the power situation remains in a flux as a number of quick rental and rental power plants are expected to be phased out by FY2013-14. On the other hand, a number of dual fuel and gas-based power plants (both private and public-owned) are expected to come into operation in the current fiscal year. However, given the shortage of the primary fuel (gas), their effective output turns out to be not so significant. It is thus anticipated that contracts of a number of private sector power plants may be renewed in the near future. It is maintained that Bangladesh, at least for the medium term, will remain stuck with these high cost and imported liquid fuel-based power supply. Moreover, the accountability of such actions will remain suspect as they are covered by legislations that empower them with immunity.

It is maintained that Bangladesh, at least for the medium term, will remain stuck with the high cost and imported liquid fuel-based power supply

Production of gas did not improve by any significant extent during FY2012-13 and the early months of FY2013-14. More importantly, the additional gas brought on stream was not used by the productive sectors including industry, fertiliser and captive power. For example, gas utilisation by the industry sector in FY2012-13 declined by (-) 6.1 per cent. It appears that the highest priority was given to power production which received 3.9 per cent more gas in FY2012-13 compared to the corresponding figure of FY2011-12. Indeed, this supply was made at the cost of reduced fertiliser production. However, one will also need to consider that every day about 1,000 MW of electricity is not being produced due to gas shortage. Despite this, the government has decided to provide new gas connections to households. Certainly, the forthcoming national election may have influenced such a decision, to some extent. On the other hand, the industrial entrepreneurs keep complaining that they are unable to get new gas connection for setting up production factories for which they have obtained loans from the banks. Certainly, without resolving such critical infrastructure bottlenecks, Bangladesh economy will not be able utilise its full potential.

Certainly, without resolving the critical infrastructure bottlenecks, Bangladesh economy will not be able utilise its full potential

[16] These credits were granted at an interest rate of LIBOR plus 3-4 per cent.

Exports

In the backdrop of the robust export growth of 21.2 per cent in Q1 of FY2013-14 compared to the corresponding period of the previous year, exports will need to grow by 10.9 per cent over the remaining three quarters if the export target of 12.9 per cent for FY2013-14 is to be achieved. In view of the current market dynamics and trends of order placement till now, this appears to be attainable even though performance in Q1 of FY2013-14 was on a low base of 2.1 per cent growth of Q1 in FY2012-13; in contrast, the growth over the next three quarters will be on the high benchmark of 14.4 per cent growth. A number of factors, however, is likely to impact on Bangladesh's competitive position and export performance over the next few months: whether Rana Plaza had any impact on post-April order placement will be visible only over next few months; likely negative impact of sharp depreciation of Indian Rupee (INR) on export of common items of Bangladesh (e.g. of Bangladesh's top ten knit items in the European Union (EU) market eight are common with India; for top ten woven six are common); heightened demand for compliance assurance leading to higher cost and likely negative implications for sub-contracting business; high competitive pressure from Vietnam in the United States (US) and Cambodia in the EU market; higher production costs arising from new minimum wages. To ensure sustained performance, in the short to medium-term, Bangladesh RMG sector will need to put renewed emphasis on measures to raise both labour and capital productivity through technological and skills upgradation, on moving up the value chain, and product and market diversification.

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Remittances

Growth of remittances started to decline (by (-) 8.1 per cent) in the first quarter of FY2013-14 after the robust growth in FY2012-13. This is mainly due to decline in the number of people going abroad for work, limited market opportunity, hazards in channelling remittances through banks or Money Transfer Operators (MTOs), and appreciated exchange rate of BDT against USD. Number of outgoing expatriate workers declined by (-) 53.4 per cent in the first quarter of FY2013-14 compared to corresponding figures for FY2012-13. Manpower export to one of the major destinations fell drastically – this was United Arab Emirates (UAE), particularly since October 2012. Only 4,001 workers left Bangladesh for UAE in the first quarter of FY2013-14, while the figure was 45,643 for the same period in FY2012-13. The much vaunted Government-to-Government (G2G) arrangement with Malaysia is yet to produce any tangible result. Moreover, notwithstanding steady increase in the forex reserve of the country (USD 16.6 billion), the exchange rate gap between the banks and the informal market is increasing. This may further lead to fall in remittance flow through official channels in the coming months.

The much vaunted Government-to-Government arrangement with Malaysia is yet to produce any tangible result

Balance of Payments

The balance of payments of the country, in July-August FY2013-14, observed a favourable situation because of stellar export performance. At the same time imports have also picked up recording 10.7 per cent growth, corresponding to the enhanced export-related import demand. Overall BOP enjoyed a surplus balance of USD 655 million in July-August, FY2013-14. However, overall BOP in the corresponding period in FY2012-13 was USD 1,064 million. Current account balance has seen slight decline to USD 674 million during July-August of FY2013-14 compared to that of USD 687 million for the corresponding months of FY2012-13.

The balance of payments of the country, observed a favourable situation because of stellar export performance

The macroeconomic developments during the early months of the ongoing FY2013-14 reflect a set of mixed signals. While some of the strong areas of FY2012-13 including export earnings, FDI and BOP maintained resilience, some of the correlates including import payments which showed diminished performance demonstrated signs of recovery. Concurrently, economic performance of a number of indicators deteriorated in the first quarter of FY2013-14 including inflation, ADP implementation, remittance inflow and foreign aid utilisation. The proposed fiscal framework for FY2013-14, as was anticipated, is already losing its bearing in the initial months of the fiscal year. More importantly, we fail to observe any major breakthrough in the area of private investment. Key economic institutions such as banking sector, has weakened further.

We fail to observe any major breakthrough in the area of private investment

In fine, our analysis reveals that in FY2012-13 Bangladesh economy moved towards an area where apparent economic stability was accompanied by arrested economic growth. The early trends of FY2013-14 suggest that, while the economy not only failed to make any significant shift towards a higher growth trajectory, economic stability in at least one key area (i.e. inflation) has also deteriorated. While in terms of fiscal deficit the economy is expected to remain within the programmed level, the revealed financing mix will remain inefficient. One may recall that in our Second Interim Report on macroeconomic performance in FY2012-13 we concluded that as FY2013-14 will be the fiscal year of democratic transition, the economic performance during the fiscal will critically hinge on an early consensus between the two major political camps in the country. Regrettably, during the first four months of the current fiscal year no such resolution was in sight. Thus, at the margin, this apparently non-economic factor will likely determine the ultimate outcome of Bangladesh economy in FY2013-14.

At the margin, an apparently non-economic factor will likely determine the ultimate outcome of Bangladesh economy in FY2013-14

1.4

EXPLORING THE POLITICAL BUSINESS CYCLE

1.4.1 Conceptual Issues

Political business cycle (PBC) is the notion which suggests that a business cycle is caused by elected government leaders who manipulate the economy to achieve personal political goals, i.e. to remain in office. The leaders stimulate the economy leading up to an election – creating a business cycle expansion that is expected to improve their re-electability, then induce a business cycle contraction after the election to correct the problems created by pre-election stimulation (Alesina *et al*. 1997). In other words, political business cycle is a theory which states that politicians have the ability to modify an economy for their personal (partisan) benefits, generally during the period of elections (Jula 2001). It is a matter of significant policy interest to explore the existence of PBC for Bangladesh as the country is expected to experience another round of national elections in FY2013-14 period.

Political business cycle is a theory which states that politicians have the ability to modify an economy for their personal (partisan) benefits, generally during the period of elections

A large body of literature exists that analyse the implications of PBC in a wide range of countries. Bates (1988) found presence of public investment cycle in Zambia. Similar were the findings of Krueger and Turan (1993) for Turkey. Schuknecht (1998) analysed data from a group of 35 developing countries which suggested that governments try to implement expansionary fiscal policies before elections and fiscal austerity afterwards. Kraemer (1997) shows for a sample of 21 countries of Latin America and the Caribbean, that the budget deficit had been higher and unpredictable in election years when compared to other periods. Government fiscal deficit, on average increases by almost 1 per cent of GDP in election years. Developed countries have recorded an increase in budget deficit by roughly 0.6 per cent on average, whereas in developing countries the average percentage was around 1.3 per cent (Shi and Svensson 2006). Using panel data on 17 Latin American countries between 1947 and 1982, Ames (1987) found that public expenditures increased by 6.3 per cent in the pre-election years and decreased by 7.6 per cent in the post-election years. Governments in low-income countries (LICs) tend to increase consumption expenditures during election years, while investments are unchanged. Overall fiscal deficit ratio tends to increase by about 1 percentage point of GDP during the election year. Effort put in by the government in collecting overall taxes improves significantly in years following an election, but public investment significantly fall in years following election (Ebeke and Olcer 2013). Governments use public spending systematically in infrastructure and current transfers as means to earn votes (Gonzalez 2000). Khemani (2000) showed that state elections in India were preceded by a government spending spree in road construction. Heckelman and Berument (1998) found monetary cycle in Japan and inflation cycle in UK. Hence, there is evidence to show that elections are endogenous in the developed countries.

Overall fiscal deficit ratio tends to increase by about 1 percentage point of GDP during the election year

The foregoing brief review of literature allows us to derive the following stylised facts.

i. Budget deficit/fiscal deficit (as percentage of GDP) are higher and unpredictable in election years.
ii. Public expenditure increases in pre-election year and decreases in post-election year.
iii. During election years public consumption significantly increases.
iv. Public investment (as percentage of GDP) significantly falls following elections.
v. Revenue mobilisation or overall tax collection efforts by the government improves significantly in the years following an election.

Governments use public spending systematically in infrastructure and current transfers as means to earn votes

In the following paragraphs we explore to what extent Bangladesh's experience confirms existence of PBC in the country.

1.4.2 The Bangladesh Experience

Fall in Real GDP during Election Years

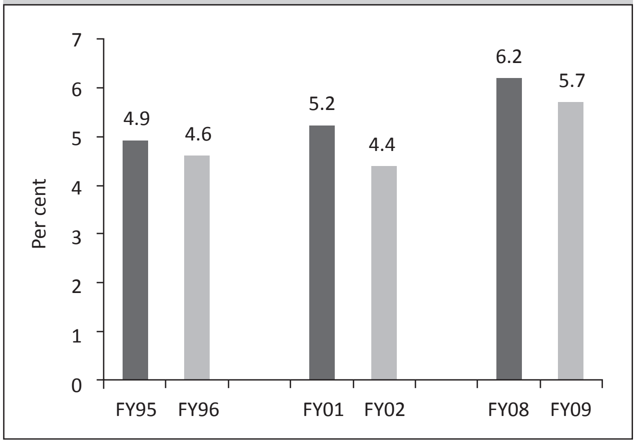
A large number of countries around the world experience impact of PBC on GDP growth. Bangladesh has also witnessed a fall in real GDP growth during the election years. This is also because Bangladesh tends to experience significant violence during periods of political transition. Data covering the period from FY1990-91 to FY2012-13 reveal that in election years in Bangladesh, real GDP growth has consistently declined for each of the previous four election years. This has happened in 1991, 1996, 2002 and 2009 (see Figure 1.1).

Data covering the period from FY1990-91 to FY2012-13 reveal that in election years in Bangladesh, real GDP growth has consistently declined for each of the previous four election years

Tax Revenue Falls during the Election Years

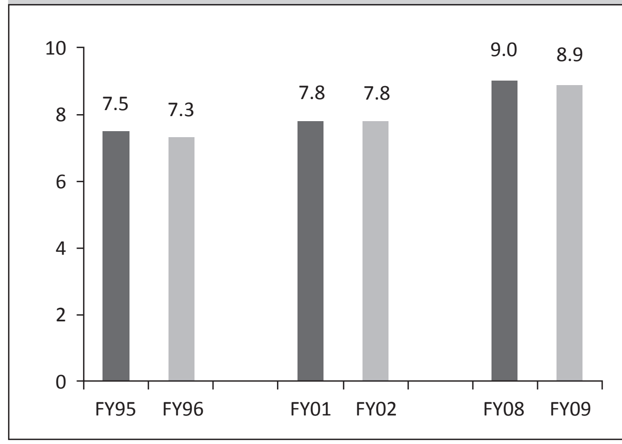
As Figure 1.2 depicts tax revenue (as percentage of GDP) has fallen during all the election years in Bangladesh, except in FY2001-02. In FY2001-02 it remained almost stagnant compared to that of FY2000-01. Imposing more taxes prior to election may make the incumbent government unpopular to the voters. Low off-take of taxes may be also the result of slowdown in economic activities leading to decline in economic growth.

Figure 1.1
Real GDP Growth in Pre-Election and Election Years



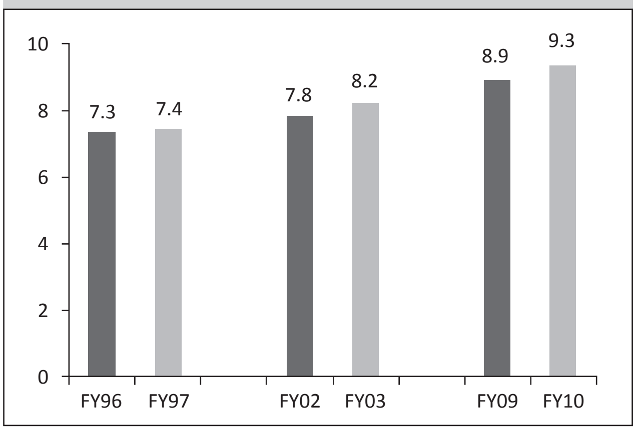
Source: Ministry of Finance (MoF).

Figure 1.2
Tax Revenue (as % of GDP) in Pre-Election and Election Years



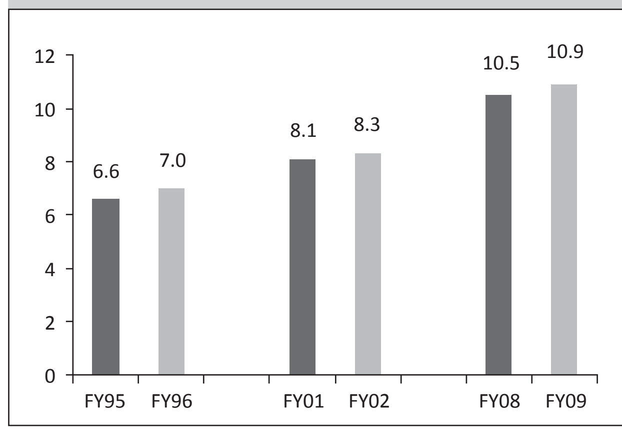
Source: Ministry of Finance (MoF).

Figure 1.3
Tax Revenue (as % of GDP) in Election and Post-Election Years



Source: Ministry of Finance (MoF).

Figure 1.4
Revenue Expenditure (as % of GDP) in Pre-Election and Election Years



Source: Ministry of Finance (MoF).

Tax Collection Improves in the Years Following Election

Tax revenue (as percentage of GDP) augments in the years following elections. As Figure 1.3 reveals, it has been the case for Bangladesh. This occurs as the government tends to undertake necessary adjustments in fiscal arena in the post-election years to meet up the enhanced expenditure demands to deliver on the election pledges. This suggests that the government has to rebuild the policy buffers on the revenue side through increased mobilisation of domestic resources.

Revenue expenditure significantly rises during election years

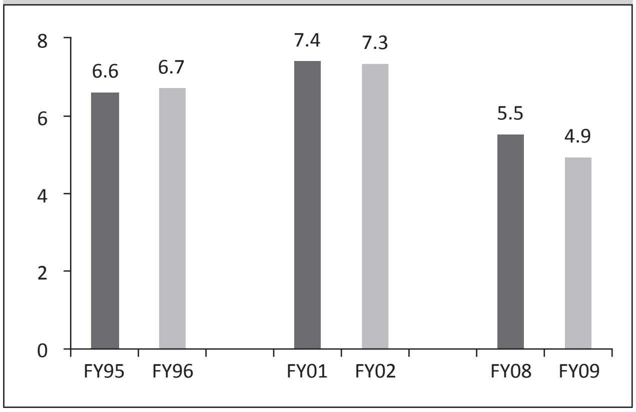
Revenue expenditure (as percentage of GDP) significantly rises during election years. Figure 1.4 validates this contention in case of Bangladesh. Creation of new jobs, enhancement of salary of the government employees and larger allocations for Transfers and Subsidies are some of the drivers of enhanced revenue expenditures in election years. All these features are quite visible in contemporary Bangladesh.

Public Investment Falls during the Election Years

Public investment (as percentage of GDP) fell during the election years in Bangladesh, except in FY1995-96. Democratic transition in Bangladesh is often

Figure 1.5

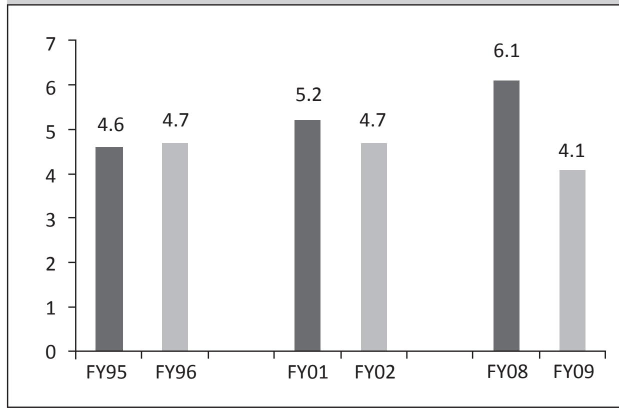
Public Investment (as % of GDP) in Pre-Election and Election Years



Source: Ministry of Finance (MoF).

Figure 1.6

Budget Deficit (as % of GDP) in Pre-Election and Election Years



Source: Ministry of Finance (MoF).

associated with changes in choice of projects, if not changes in policy regimes. As a result, stagnation afflicts implementation of public investment projects during election years. This has also to do with the paralysis of development administration which sets in during the run-up to elections. Figure 1.5 presents the relevant data for Bangladesh in this regard.

Budget Deficit during Election Years

Trends relating to budget deficit (as percentage of GDP) in Bangladesh do not correspond fully with the general cross-country experience. In election years FY2001-02 and FY2008-09, budget deficit declined instead of increasing when compared to preceding fiscal years (see Figure 1.6). However, in FY1995-96 it rose slightly compared to previous fiscal year. It appears that fall in revenue collection in election years in Bangladesh is paralleled by decline in public expenditures. The increase in revenue expenditures is largely offset by the fall in public investment expenditures, thus preserving the status quo in fiscal balance.

Trends relating to budget deficit in Bangladesh do not correspond fully with the general cross-country experience

The Endogeneity Issue regarding Election Timing

All past national (Parliament) elections in Bangladesh have been held between the months of October to March, except the third national election in 1986 and seventh national election in June 1996 (which was unanticipated). The election period in Bangladesh usually corresponds with non-monsoon or non-high summer season. This may suggest that the timing of national elections also tends to be structurally endogenous.

The timing of national elections also tends to be structurally endogenous

1.4.3 Econometric Modelling of PBC for Bangladesh

To test the robustness of the foregoing conclusions based on descriptive statistics and to empirically test the existence of PBC in Bangladesh, an Ordinary Least Square (OLS) based regression model was developed. The model uses time series data covering FY1990-91 to FY2012-13. It attempts to establish the relationship between the dependent variables and budget deficit, real GDP growth, public consumption, public investment, public borrowing, revenue expenditure and tax revenue. The dependent variables are defined as election year dummy, one year lagged value of election year dummy, one year after the election year dummy and lagged dependent variable. The findings of the econometric model are reported in Table 1.3.

Table 1.3

Estimates of Political Business Cycle in Bangladesh: 1991-2013

Dependent Variable	Real GDP Growth	Public Consumption (as % of GDP)	Public Investment (as % of GDP)	Public Borrowing (as % of GDP)	Revenue Expenditure (as % of GDP)	Tax Revenue (as % of GDP)	Budget Deficit (as % of GDP)
Election Year Dummy	-0.674* (-1.850)	-0.120 (-0.566)	-0.207 (-0.759)	0.138 (0.343)	0.167 (0.611)	-0.160 (-0.637)	0.403 (0.751)
One Year Lagged Value of Election Year Dummy	0.461 (1.243)	0.083 (0.415)	-0.526** (-2.133)	-0.312 (-0.862)	-0.282 (-1.140)	0.304 (1.313)	0.024 (0.055)
One Year after Election	-0.157 (-0.431)	-0.366* (-1.750)	0.069 (0.256)	-0.128 (-0.319)	0.225 (0.823)	0.615** (2.368)	1.149** (2.185)
Lagged Dependent Variable	0.669*** (4.175)	1.188*** (7.249)	0.846*** (6.760)	0.545** (2.790)	0.939*** (14.020)	1.01*** (11.422)	-0.368 (-1.383)
Intercept	1.945* (2.115)	0.737 (0.963)	1.010 (1.290)	1.075** (2.539)	0.677 (1.208)	-0.057 (-0.078)	6.032*** (5.320)
N	23	23	23	23	23	23	23
R^2	0.58	0.74	0.75	0.92	0.89	0.36	0.26

Note: ***,**,* denote significant at 1 per cent, 5 per cent and 10 per cent respectively. Figures in parentheses denote t-statistics.

Table 1.3 indicates that real GDP growth in Bangladesh falls during the election years. The regression results demonstrate that real GDP growth is 0.67 percentage point lower during election years. The result is statistically significant. In pre-election period (one year before election), GDP growth is 0.46 percentage point higher, but this was not found to be statistically significant. Real GDP growth is 0.16 percentage point lower even in one year after national election. However, this was not statistically significant.

Public consumption falls by 0.37 percentage point one year after the national election

The result shows that public consumption (as per cent of GDP) falls by 0.12 percentage point during election years, but it is not statistically significant. It falls further by 0.37 percentage point one year after the national election which is statistically significant. Public investment (as per cent of GDP) falls by 0.21 per cent during election years; however, this is not statistically significant. One interesting fact which may be noted is that, public investment (as per cent of GDP) tends to fall even one year before election, by 0.53 percentage point. This is significant at 5 per cent level. Public borrowing (as per cent of GDP) rises by 0.14 percentage point during election years. However, these results are not statistically significant. Public borrowing is 0.13 percentage point lower one year after election, but it is also found to be statistically insignificant.

The analysis finds evidence in favour of existence of PBC in the context of Bangladesh

The results suggest that budget deficit (as per cent of GPD) is 0.40 percentage point higher during election years, though it is not statistically significant. Regression results demonstrate that tax revenue (as per cent of GDP) is 0.28 percentage point lower during the election years, but it is not statistically significant. Tax revenue (as per cent of GDP) falls by 0.16 percentage point during election years. It is not statistically significant. However, tax revenue (as per cent of GDP) is 0.62 percentage point higher one year after election and this is found to be significant at 5 per cent level. Revenue expenditure (as per cent of GDP) rises by 0.17 percentage point during election years. However, these results are not statistically significant. Tax revenue rises further by 0.23 percentage point one year following national election. However, this is also statistically insignificant (Table 1.4). Hence, the analysis finds evidence in favour of existence of PBC in the context of Bangladesh.

Table 1.4
Summary of Findings from Econometric Analyses

Indicator	Election Year	One Year before Election	One Year after Election
Real GDP Growth	0.67 percentage point lower*	0.46 percentage point higher	0.16 percentage point lower
Public Consumption (as % of GDP)	0.12 percentage point lower	0.08 percentage point higher	0.37 percentage point lower**
Public Investment (as % of GDP)	0.21 percentage point lower	0.53 percentage point lower**	0.07 percentage point higher
Tax Revenue (as % of GDP)	0.16 percentage point lower	0.30 percentage point higher	0.61 percentage point higher**
Revenue Expenditure (as % of GDP)	0.17 percentage point higher	0.28 percentage point lower	0.23 percentage point higher
Budget Deficit (as % of GDP)	0.40 percentage point higher	0.02 percentage point higher	1.15 percentage point higher***

Note: ***, ** and * denote significant at 1 per cent, 5 per cent and 10 per cent respectively.

1.5

CONCLUDING REMARKS

Analysis of year closing data for FY2012-13 and early signals of FY2013-14 reveal both the upside opportunities and downside risks facing the Bangladesh economy in a period of democratic transition. The economic growth prospect remains circumscribed because of depressed private investment demand. Economic growth in the current fiscal year also runs the risk of low delivery of public investment programme. The incumbent policymakers would need to redefine the fiscal goal posts, promote credit expansion in private sector, maintain support to the crop sector and contain potential inflationary pressure. As the remittance flow declines and foreign aid flow falters, it would be important to consolidate the resilience of the export sector in the face of all odds. Any supply-side shock or pressure on the exchange rate may be counteracted by prudent use of the forex reserve.

The incumbent policymakers would need to redefine the fiscal goal posts, promote credit expansion in private sector, maintain support to the crop sector and contain potential inflationary pressure

Our analysis further suggests that the Bangladesh economy has entered into a political business cycle. This would mean that conduct of Bangladesh economy during greater part of FY2013-14 will be largely dictated by the evolving electoral dynamics. One needs to be mindful of the fact that adverse implications of PBC in critical areas including revenue collection and public expenditure may run much beyond the current fiscal year. Reverting back to benchmark growth path may need a couple of years.

In this context, the critical question is – can the country afford to pursue a benign business-as-usual policy in the area of economic management, while the country sorts out the process of electing its next government? It is now obvious that economic policy instruments will increasingly have limited value in counteracting the impact of emerging political situation in the country. The international economic and development community will also have little appetite for this. In other words, the political elites will have to provide the resources to protect the real achievements and potential prospect of the Bangladesh economy.

It is now obvious that economic policy instruments will increasingly have limited value in counteracting the impact of emerging political situation in the country

Given the potential mutuality of interests on the part of the contesting political elites in maintaining economic stability and growth, one may consider agreeing on a set of safeguard approaches and measures for shielding the economy from the negative spillovers of electoral transition. This would mean no economic activities and livelihood concerns, however large and small (not only concerning the export-oriented clothing sector) should be held hostage to our unique democratic practices. Working out this package of economic safeguards is, in our view, no less important than generating a consensus on electoral modalities.

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Annex Table 1.1

Macroeconomic Performance of Bangladesh Economy in FY2012-13

Indicator	Assessment at the Time of the Budget	Assessment with the Year Closing Data	Comments
GDP Growth	6.2 per cent in FY2012 6.0 per cent in FY2013	Revised estimate of FY2013 was not prepared yet	According to the rebased GDP growth estimate: 6.5 per cent in FY2012 6.2 per cent in FY2013
Private Investment	20.0 per cent in FY2012 19.0 per cent in FY2013	Rebased figures are not available	Expected to decline in the revised estimates
Public Investment	6.5 per cent of GDP in FY2012 7.9 per cent of GDP in FY2013	Rebased figures are not available	Expected to increase in the revised estimates but lower than the provisional estimates
Total Investment	26.5 per cent of GDP in FY2012 26.8 per cent of GDP in FY2013	According to the rebased GDP growth estimate: 28.7 per cent of GDP in FY2012 28.7 per cent of GDP in FY2013	The new GDP estimates has two new investment components – research and development related expenditures and production and purchase of arms and ammunitions by the defense sectors
NBR Revenue Collection	Growth Target: 18.5 per cent Jul-Apr: 16.1 per cent An evident shortfall (between Tk. 3,000 crore and Tk. 4,000 crore) in FY2013	Jul-Jun: 14.2 per cent Shortfall: Tk. 3,644 crore According to MoF report shortfall is Tk. 8,921 crore	Slowed down in the last quarter
Non-Development Expenditure	Growth Target: 12.8 per cent Jul-Dec: 12.6 per cent	Growth Target: 11.4 per cent Jul-Jun: 10.6 per cent	Slowed down in the last quarter
Annual Development Programme (ADP) Expenditure	Jul-Mar: 44.8 per cent of allocation in FY2012 Jul-Mar: 49.5 per cent of allocation in FY2013	Jul-Jun: 82.3 per cent of allocation in FY2012 Jul-Jun: 91.0 per cent of allocation in FY2013	Substantial rise
Budget Deficit and Financing	Jul-Dec: 7.7 per cent of planned budget Bank borrowing to contribute 60 per cent of deficit financing	Jul-Jun: 87.2 per cent of planned budget Bank borrowing contributed 60.1 per cent of deficit financing	Heavy reliance in bank borrowing continued
Money Supply	Target Jun: 17.7 per cent Mar: 18.1 per cent	Jun: 16.7 per cent	Came down below the target as both growths of private sector credit and net foreign assets declined
Private Sector Credit	Target Jun: 18.5 per cent Mar: 12.7 per cent	Jun: 11.0 per cent	Declined to the lowest level in a decade
Inflation	Target: 7.5 per cent Apr: 7.8 per cent	Jun: 7.7 per cent	Remained stable but higher than the target
Loan Default	Mar: 11.9 per cent of total outstanding	Jun: 11.9 per cent of total outstanding	Continued to remain high
Exports	Target: 15.3 per cent Jul-Apr: 8.4 per cent	Jul-Jun: 11.2 per cent	Picked up during the last quarter
Imports	Jul-Mar: (-) 6.11 per cent	Jul-Jun: (-) 4.4 per cent	Picked up to some extent during the last quarter
Remittances	Jul-Apr: 15.9 per cent	Jul-Jun: 12.6 per cent	Growth declined during the last quarter
Foreign Aid	Jul-Mar: 29.8 per cent	Jul-Jun: 51.2 per cent	Substantial rise during the last quarter
Foreign Exchange Reserve	USD 14.5 billion as of May FY2013	USD 15.3 billion as of June FY2013	Continued to elevate

Source: Calculated from Ministry of Finance (MoF), Bangladesh Bank and Bangladesh Bureau of Statistics (BBS) data.