Chapter I

State of the Bangladesh Economy in FY2007-08

1.1 INTRODUCTION

The tenure of the caretaker government (CTG), which came to power on 11 January 2007, spanned over three fiscal years, between FY2006-07 and FY2008-09. However, FY2007-08 was the only period when the CTG was in charge of macroeconomic management for the full fiscal year. FY2007-08 started in the backdrop of considerable uncertainties associated with transition to the third CTG, anti-corruption drive and consequent impact on the country's investment climate. The efficiency of economic management was also seriously undermined by two consecutive floods, cyclone Sidr, high inflationary pressure and rising global prices with adverse implications on domestic prices. Thus, by all accounts, FY2007-08 was a difficult time. Common people in Bangladesh experienced severe erosion of purchasing power and the country in general witnessed a reversal of poverty reduction trends. It needs to be, however, put on record that notwithstanding the formidable challenges, the CTG was able to tackle the emergent situation with commendable success. Immediate post-disaster relief operations were carried out with considerable success and measures were speedily taken to avoid famine, and to expand and strengthen public food distribution and safety net programmes, with support also from the Army and the Bangladesh Rifles (BDR). In the second half of the fiscal, some of the indicators started to demonstrate an upturn, helped by higher industrial and agricultural loan disbursement, a bumper Boro crop and buoyant export and remittance performance. In the end, although the target of 6.5 per cent gross domestic product (GDP) growth was not achieved, the (provisional) growth figure of 6.21 per cent attained in FY2007-08 ought to be considered as a significant achievement. However, high inflation, particularly of essential food items, continued to undermine macroeconomic stability and subsequently requiring adjustments of various prices, increased domestic borrowing and higher budgetary deficit. Thus, the overall scenario with regard to macroeconomic management and performance remained a mixed one.

1.2 BENCHMARK SITUATION IN FY2007-08

1.2.1 Macroeconomic Benchmark at the Beginning of FY2007-08

FY2006-07 concluded in line with the recent performance trend. The provisional estimate of GDP growth rate of 6.51 per cent was however subsequently revised downward to 6.43. Investment rate (as percentage of GDP) stood at low levels though, while the gap between national savings and investment widened indicating investible surplus that looked for opportunities. The fiscal balance continued to face challenges, underpinned by modest revenue mobilisation, relatively higher growth of revenue expenditure, weak implementation of public investment programmes and low foreign aid disbursement. Macroeconomic correlates were further strained, owing to moderate credit expansion in manufacturing and agriculture sectors. The balance of payments (BOP) situation was put under some pressure, because of higher trade deficit, as imports continued to surpass exports. Buoyant remittance flow emerged as a saviour providing a much needed breathing space and ensuring a positive overall balance in the current account. Whilst marginal improvement over a low benchmark in foodgrain production gave rise to some anxiety, heightened growth in manufacturing sector was a welcome development. On the flip side, FY2006-07 experienced serious inflationary pressure manifested largely through food inflation, of which the rural population was the worst victims. Frequent power outages continued to affect not only trade and investment, but also disrupted the normal public life. Capital market posted moderate improvement, while policy decisions with regard to off-loading of shares and some large scale foreign direct investment (FDI) projects remained unresolved.

1.2.2 Major Developments in FY2007-08

Macroeconomic management in FY2007-08 had been a challenging job for the CTG. FY2007-08 experienced a number of developments, both domestic and global, that had important implications for the Bangladesh economy. These included higher revenue expenditure leading to higher deficit, increased subsidy burden, all time low implementation of annual development programme (ADP) and acute shortage of power and energy. Uncertainties about political transition to democratic governance and anti-corruption drives undermined investor confidence which resulted in decline in domestic private as well as foreign investments. Industrial slowdown characterised the earlier months of the fiscal year. The situation was aggravated by price hike of essentials, fuelled by both the increase in global commodity prices and domestic market inefficiencies. Two consecutive floods and the cyclone Sidr undermined macroeconomic management and threatened food security.

On the other hand, FY2007-08 witnessed a number of developments which had positive implications on the performance of the economy. These included significant improvements in revenue mobilisation, higher disbursement of credit to the agriculture and industrial sectors, robust export growth, rejuvenated capital market and buoyant remittance flow. Reform efforts started to yield positive results, particularly for port operation. A bumper Boro harvest helped to recover the loss emanating from consecutive natural disasters and commendable success was achieved in the immediate post-flood and post-Sidr management.

It is to be noted that, by the time the CTG handed over the helm of governance to the newly elected democratic government on 6 January 2009, it was able to address many of the challenges that plagued macroeconomic performance in FY2007-08, leaving high food stocks, high reserves, a robust export and remittance performance and a declining inflationary trend. Nevertheless, fact remains that FY2007-08 tested all the skills at the disposal of CTG during a most challenging time.

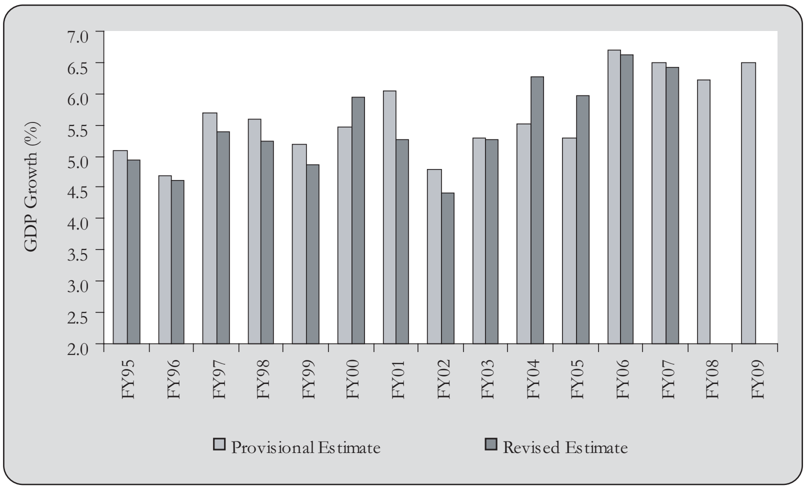
1.3 GROWTH, SAVINGS AND INVESTMENT

1.3.1 GDP Growth

According to the preliminary estimates presented in the budget for FY2008-09, GDP posted a growth of 6.21 per cent during FY2007-08. This growth was attained in the backdrop of two floods and the devastating cyclone Sidr experienced in the first half of the fiscal year FY2007-08. Along with the crop loss, agriculture sector also suffered from avian flu which affected the livestock sub-sector. Industry and service sectors suffered from loss of business confidence due to the anti-corruption drive of the CTG, eventually leading to depressed investment climate and a sluggish growth in export in the first two quarters of FY2007-08. Such adverse conditions led to lower than 6 per cent GDP growth projections by many, including the International Monetary Fund (IMF) and the Asian Development Bank (ADB). However, improved business confidence, upturn in industrial production, regaining of the lost momentum in the export sector and a bumper Boro harvest during the second half of the fiscal year had positive impact on the growth performance of the latter half of FY2007-08, with consequent positive impact for the performance for the entire fiscal year.

Following what has now become a tradition, the provisional GDP was revised downward in FY2006-07, from 6.51 per cent to 6.43 per cent (Figure 1.1). (It may be noted here that such downward revisions occurred 10 times during the last 13 years!) The growth of the agricultural sector was revised upward for FY2006-07 as a result of bumper Boro production; however, slow down in industrial production

Figure 1.1: Provisional and Revised GDP: FY1994-95-FY2008-09

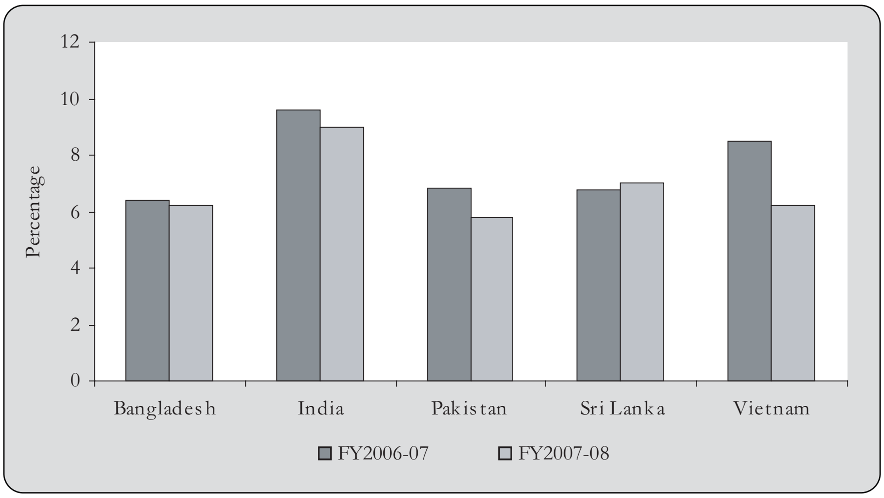


Source: CPD-IRBD database.

informed downward revision of overall GDP growth. The usual trend of revising GDP growth rates in the revised budget of the subsequent year, however, would suggest that this year's growth figure would change when the next budget (for FY2009-10) is placed in June 2009. It is possible that this would then be revised downward to about 6 per cent from the 6.21 per cent mentioned in the budget for FY2008-09.

Compared to the major Asian counterparts, Bangladesh's GDP growth rates appear to follow the trend rather than being exceptional. As can be seen from Figure 1.2, most countries in South and South-East Asia are going through a period of moderately high growth trajectory. Inflation is also high in the region and maintaining macroeconomic stability through modestly high GDP growth rate and low levels of inflation remain the foremost challenge for all policymakers of the South Asian region.

Figure 1.2: GDP Growth in Asian Countries



Source: CPD-IRBD database.

1.3.2 Sources of Growth

Pre-dominant position of the service sector in the structure of Bangladesh's GDP has had implications for overall economic performance in FY2007-08. Service sector contribute about 50 per cent share in the real GDP of Bangladesh. Shocks experienced by agriculture and industry sectors also influenced the growth performance of the service sector. Both agriculture and industry sector experienced slower growth of 3.6 per cent and 6.9 per cent respectively in FY2007-08, while their respective growth rates in FY2006-07 were 4.6 per cent and 8.4 per cent. Even then the overall growth (6.21 per cent) was only 0.22 per cent lower compared to the previous year, owing to the relatively stable performance of service sector. Service sector experienced 6.7 per cent real growth in FY2007-08, compared to 6.9 per cent growth achieved in FY2006-07, contributes to the overall growth rate of 6.2 per cent in FY2007-08. When the numbers are rechecked, they would throw light on whether service sector was really capable of registering such high growth at a time when growth rates of both agriculture and industry had come down significantly.

Adverse impact of the avian flu becomes evident from the fact that real growth in livestock sub-sector in FY2007-08 was only 2.4 per cent, compared to 5.5 per cent achieved in FY2006-07. In view of the high share of the crop sub-sector in the GDP (11.6 per cent in FY2006-07), loss arising from the floods and the cyclone was a major concern in this period. A bumper Boro harvest, however, had contributed significantly in terms of offsetting the loss and resulted in a lower than expected fall (1.0 per cent) in the real growth performance (3.4 per cent) of the crop sub-sector.

Within the industry sector, real growth in production of the manufacturing sub-sector (contributing 17.1 per cent in the total GDP) experienced the largest slowdown, posting a real growth of 7.4 per cent in FY2007-08 against 9.7 per cent growth in FY2006-07. Major surprise was the real production growth of 4.9 per cent achieved in electric, gas and water supply sub-sectors, higher by 2.8 per cent compared to the growth of 2.1 per cent achieved in FY2006-07. This growth does not reflect the growing scarcity experienced in real life, both by households and industrial units. It is to be noted that this sub-sector faced the most drastic downward revision last year.

Among the nine sub-sectors of the service sector, only three experienced higher growth performance (transport and communication, hotel and restaurant and community, social and personal services), while for others real production growth were lower in FY2007-08 compared to FY2006-07.

An analysis of the real growth in GDP achieved in FY2007-08 reveals that service sector contributed 51.2 per cent of the incremental GDP, while industry and agriculture sectors contributed 31.5 per cent and 12.0 per cent respectively. Share of agriculture in the total GDP of FY2007-08 declined by 0.5 per cent, while the share of service sector increased by 0.2 per cent. Much desired improvement in the share of industrial sector has not, however, taken place and remained almost stagnant at 28.6 per cent against 28.5 per cent in FY2006-07.

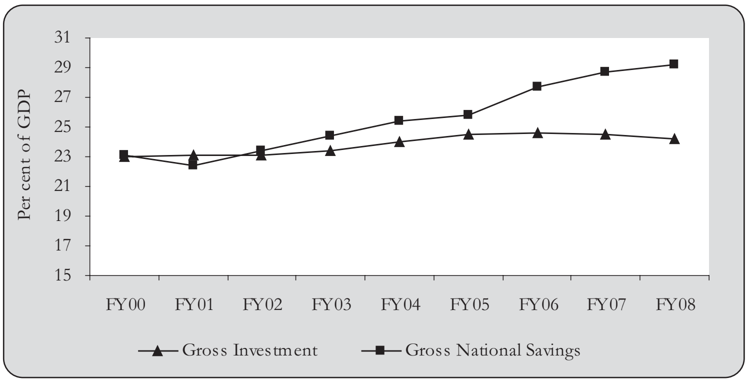
1.3.3 Per Capita Income

Per capita GDP stood at USD 554 in FY2007-08, while per capita gross national income (GNI) stood at USD 599, recording 8.9 and 9.9 per cent annual growth rates respectively. Moderate growth rates accompanied by stable exchange rate facilitated this achievement. However, one should also consider that these averages conceal a high degree of worsening income distribution.

1.3.4 Savings

Stagnation in domestic savings rate remains a major concern for the transitional economy of Bangladesh. Domestic savings as a percentage of GDP in Bangladesh has declined further from 20.3 per cent in FY2006-07 to 20.1 per cent in FY2007-08 as a share of GDP (Figure 1.3). It implies that consumers had to allocate a larger share of their income for consumption on account of rising prices of essential items, particularly for food items.

Figure 1.3: Savings Rate as Percentage of GDP



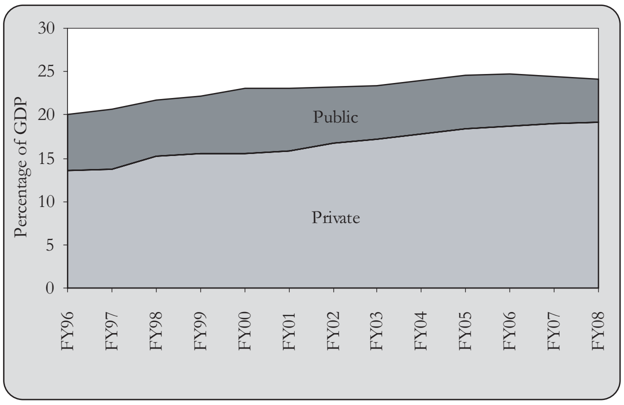
Source: CPD-IRBD database.

On the other hand, inspired by continued robust remittance inflow, national savings rate has been demonstrating encouraging movements since FY2004-05. The share of national savings to GDP increased considerably further in FY2007-08 to reach 29.2 per cent of GDP, as against 28.7 per cent in FY2006-07, registering an impressive rise to the tune of 0.5 per cent of GDP. It is to be noted that, the gap between national and domestic savings is increasing in a consistent manner in recent years. A continuation of such savings behaviour may result in further deterioration in income distribution.

1.3.5 Investment

For the second consecutive year the gross investment rate has declined as per cent of GDP. After achieving an insignificant improvement in FY2005-06 to 24.7 per cent of GDP (from 24.5 per cent of GDP in FY2004-05) the gross investment rate fell back to 24.5 per cent in FY2006-07 and then to 24.2 per cent of GDP in FY2007-08 (Figure 1.4). This is considerably lower than the Medium Term Macroeconomic Framework (MTMF) target of extended Poverty Reduction Strategy Paper (PRSP) which was set at 24.9 per cent in FY2007-08.

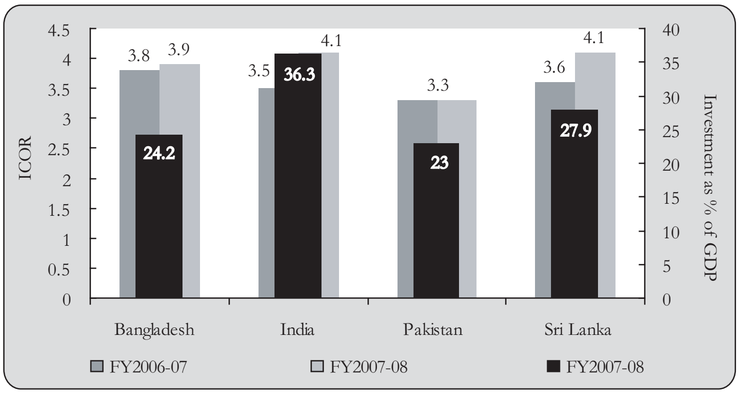
Figure 1.4: Investment as Percentage of GDP



Source: CPD-IRBD database.

Public investment continued to plunge and yet again scored a historic low rate of 5 per cent of GDP in FY2007-08, lower compared to the earlier low levels of 5.5 per cent in FY2006-07. Low implementation of ADP also signifies the slow down in the pace of public investment. Similarly, the slack in public expenditure explains stagnating gross investment in recent times. Private investment, which covers four-fifths of total

Figure 1.5: Investment Scenario in Regional Context



Source: CPD-IRBD database.

investment of the country, as a share of GDP increased marginally from 19.0 per cent in FY2006-07 to 19.2 per cent in FY2007-08.

Bangladesh continued to remain an under-invested country; her national savings rate (29.2 per cent) remains higher than the gross investment rate (24.2 per cent), indicating availability of idle investible surplus equivalent to about Tk. 27,470 crore (almost 5 per cent of GDP).

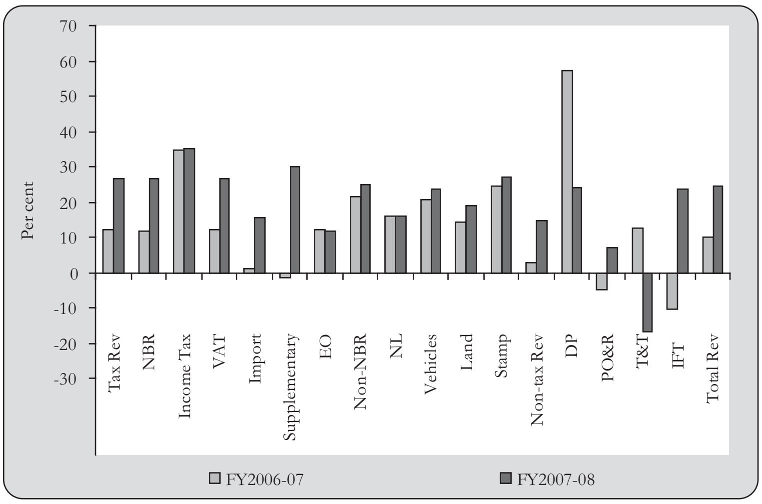
The incremental capital-output ratio (ICOR) increased marginally during FY2007-08 from 3.8 in FY2006-07 to 3.9 in FY2007-08, implying a minor fall in capital productivity. From a regional perspective, Bangladesh's investment performance has been better than the political turmoil-hit Pakistan, while India's investment scenario remains formidably strong (Figure 1.5).

1.4 PUBLIC FINANCE

1.4.1 Revenue Receipts

In contrast to the declining trend of the recent past, revenue-GDP ratio of the country increased by 0.8 per cent to 10.7 per cent in FY2007-08. Total revenue collection during FY2007-08 (Tk. 58,170 crore) increased significantly by 24.3 per cent over the actual

Figure 1.6: Growth in Revenue Collection during FY006-07 and FY2007-08



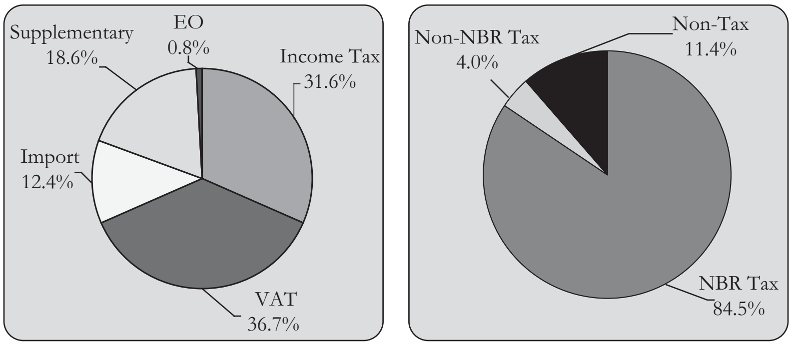
Source: CPD-IRBD database.

collection of FY2006-07 (Figure 1.6); 1.6 per cent more than the target set in the budget for the fiscal year, a unique record. National Board of Revenue (NBR) tax revenue, constituting about 78.7 per cent of the total revenue, posted impressive growth of 26.6 per cent, 4.4 per cent above the original target. This phenomenal growth was mostly driven by the growth in value added tax (VAT) collection of 26.4 per cent and direct tax (income tax) collection of 34.7 per cent (Figure 1.6). Anti-corruption drive and the NBR effort to legalise untaxed income may have resulted in high growth in income tax collection. In addition, individual tax return submission increased from 0.53 million in FY2006-07 to 0.64 million in FY2007-08. Higher imports and high commodity prices in the international market during FY2007-08 marked their impact on import duty collection, achieving a substantial growth of 15.7 per cent (against a marginal growth of 0.9 per cent in FY2006-07). High growth was also achieved in the collection of supplementary duty (SD) (29.9 per cent).

A dissection of the achieved growth of the different components of NBR reveals that highest contribution to the additional revenue of NBR was made by VAT (36.7 per cent), followed by income tax (31.6 per cent) (Figure 1.7). Within the total additional revenue of FY2007-08 over that of FY2006-07, NBR contributed 84.5 per cent. Non-NBR tax and non-tax revenue (achieving 24.7 per cent and 14.8 per cent growth respectively in FY2007-08) contributed 4.0 per cent and 11.44 per cent to this addition respectively.

In view of the real GDP growth of 6.21 per cent, high inflation of 9.93 per cent in FY2007-08 somewhat undermined the efforts in domestic resource mobilisation. However, the performance surpassed that of the preceding year by quite a margin and the achieved revenue-GDP ratio of 10.7 per cent, approximating the original target of 10.8 per cent. Higher revenue mobilisation also provided a cushion to the national exchequer at a time of high expenditure pressure experienced throughout the fiscal year.

Figure 1.7: Contribution of Different Components in Revenue Growth: FY2007-08

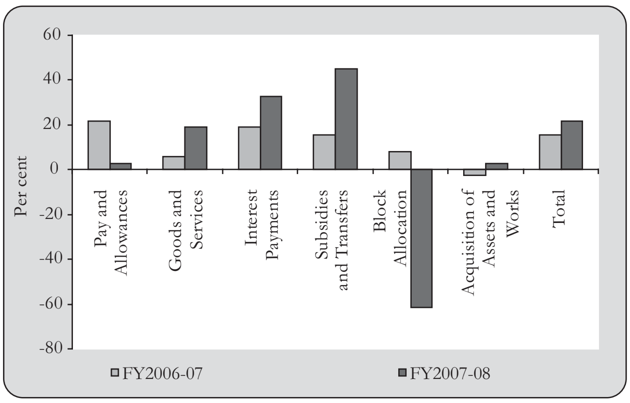


Source: CPD-IRBD database.

1.4.2 Revenue Expenditure

FY2007-08 experienced mounting expenditure pressure on a number of fronts. Increasing fuel price in the international market required fuel subsidy to grow by a significant margin. Worldwide food shortage, and associated food price hike in the world market as also in the domestic market necessitated larger food subsidy and more extensive open market sales (OMS) activities. Higher import of food grains by the government was also necessary due to crop damage owing to the consecutive floods and the cyclone, and larger distribution of food through vulnerable group feeding (VGF) and other safety nets. At the same time, fertiliser subsidy was also expected to overshoot the target because of higher import price.

Figure 1.8: Revenue Expenditure Growth by Economic Classification: FY2006-07 and FY2007-08

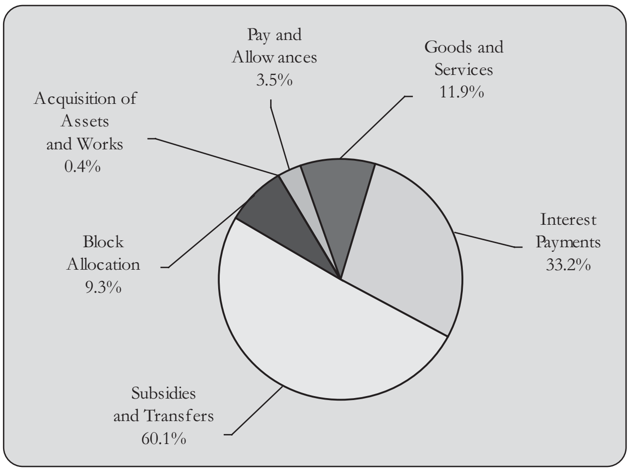


Source: CPD-IRBD database.

On top of it, financing the post flood/cyclone rehabilitation efforts added to significant expenditure burden on the government.

Economic classification shows 21.8 per cent higher revenue expenditure at the end of FY2007-08 over the actual figure of the previous year. Targeted growth rate for FY2007-08 was 19.0 per cent. Among the major three heads that accounted for 82.9 per cent in the total actual revenue

Figure 1.9: Contribution to Revenue Expenditure Growth by Economic Classification: FY2007-08



Source: CPD-IRBD database

expenditure, "subsidies and transfers" and "interest payments" registered significant increase with 45.2 per cent and 32.5 per cent growth respectively. "Salary and allowances" on the other hand posted a rise of only 2.7 per cent during the fiscal year (Figure 1.8).

FY2007-08 experienced substantial rise in subsidies, by 97.8 per cent. When the national budget for FY2008 was prepared, crude petroleum and diesel were selling at USD 67 and USD 85 per barrel at the international market. These prices went up to around USD 140 and USD 175 per barrel at the end of the fiscal year. Such upward movement of prices in the international market made the prevailing local prices unsustainable, calling for a readjustment that was made just after the end of the fiscal year. At the same time, import of rice (Thailand, 5 per cent broken) and fertiliser (Urea) got costlier by 130 per cent and 135 per cent respectively during FY2007-08. High fuel, food and fertiliser subsidy demand made the "subsidies and transfers" head the single largest contributor to the revenue expenditure growth in FY2007-08 (Figure 1.9).

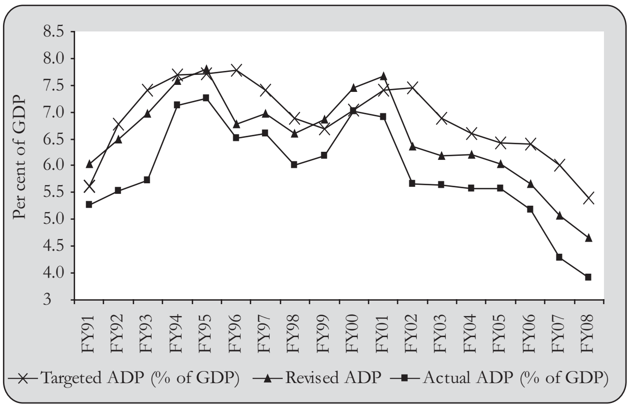
With the unexpected rise in expenditure pressure, fiscal balance got stressed at the end of FY2007-08, notwithstanding the higher revenue mobilisation achieved in the fiscal year. This led to a higher resource constraint reinforcing the difficulties in implementing the ADP.

1.4.3 Annual Development Programme (ADP)

The deteriorating trend of ADP implementation during the recent past continued in FY2007-08 and marked the poorest show ever. The original ADP for FY2007-08 was fixed at Tk. 26,500 crore which was revised downwards by 15.1 per cent to Tk. 22,500 crore in the end. Expenditure record shows that only 82.2 per cent of the revised allocation (69.8 per cent of the original) was spent during the fiscal year which approximated the 82.9 per cent achievement of the preceding year.

When estimated as a percentage of GDP, ADP implementation status has been gradually falling since FY2000-01 and the lowest was in FY2006-07, at 3.8 per cent. But in FY2007-08, actual ADP as percentage of GDP stood at 3.4 per cent, the lowest ever (Figure 1.10). However, in terms of absolute spending, ADP expenditure in FY2007-08 surpassed that of FY2006-07 by Tk. 575 crore, amounting to Tk. 18,492 crore (Tk. 17,917 crore in FY2006-07).

Figure 1.10: ADP as Per cent of GDP: FY1990-91-FY2007-08



Source: CPD-IRBD database.

Among the five Ministries/Divisions which received the highest allocation in the revised ADP (RADP) of FY2007-08, Power Division did not even manage to match the overall poor performance of ADP implementation with only 78.6 per cent of the revised allocation being spent in this period. It is to be noted that this sector was given priority in the original ADP of FY2007-08 with the largest increase over the RADP of FY2006-07. The Local Government Division and the Ministry of Primary and Mass Education did relatively better with 95.5 per cent and 88.2 per cent utilisation of their respective revised allocations. The Ministry of Health and Family Welfare (MoHFW) and the Ministry of Communication on the other hand spent 84.2 per cent and 84.1 per cent respectively. Implementation status of the 16 Ministries, mandated to develop their own budget under the Medium Term Budgetary Framework (MTBF), has shown marginally better performance (84.4 per cent utilisation) compared to the average of the others.

Low expenditure of FY2007-08 needs to be seen from the perspective of higher expenditure requirement of the government on account of revenue expenditure and disaster management linked to floods and Sidr. Another factor behind the slow pace of ADP implementation this time has been the rising cost of inputs which undermined the cost estimations of earlier contracts and led to slowdown of development works by many contractors who asked for review of cost estimation. Apart from these, risk aversion and fear psychosis appears to have played a major role behind the lower performance in FY2007-08.

1.4.4 Budget Deficit and Financing

During the last few years, budget deficit in Bangladesh tended to remain around 3 per cent of GDP. However, national budget for FY2007-08 had targeted the deficit to rise substantially to 4.2 per cent of the GDP. In view of the escalating expenditure pressure, revised budget projected an even higher deficit of 4.8 per cent of GDP. At the end of the fiscal year, actual deficit stood at 4.9 per cent of GDP, highest since FY1999-00.

Total deficit financing amounted to Tk. 26,650.9 crore at the end of FY2007-08, posting a substantial growth of 103.0 per cent over the actual deficit of FY2006-07. In financing the deficit, commendable success was achieved in mobilising foreign resources. Net foreign financing during the year increased by 178.7 per cent, amounting to Tk. 7,775.5 crore (Table 1.1).

Table 1.1: Growth in Deficit and Sources of Financing

	Actual FY06	Actual FY07	Actual FY08	Growth FY07	Growth FY08
	(in Crore Tk.)			(%)	
Net foreign financing	3530.6	2790.0	7775.5	-209.8	178.7
Grant	1061.5	1037.4	2007.4	-22.7	93.5
Loan	6052.1	5743.7	10137.7	-51.0	76.5
Amortisation	3583.1	3991.1	4369.5	113.9	9.5
Domestic financing	9128.2	10335.4	18875.4	132.2	82.6
Non-bank borrowing	2646.7	4282.6	2501.4	618.1	-41.6
Bank borrowing	6431.4	5982.3	16349.3	-69.8	173.3
Sale of assets	50.1	70.6	24.7	409.2	-65.0
Total financing	12658.8	13125.4	26650.9	36.9	103.0
Total financing as % GDP	3.0	2.8	4.9		

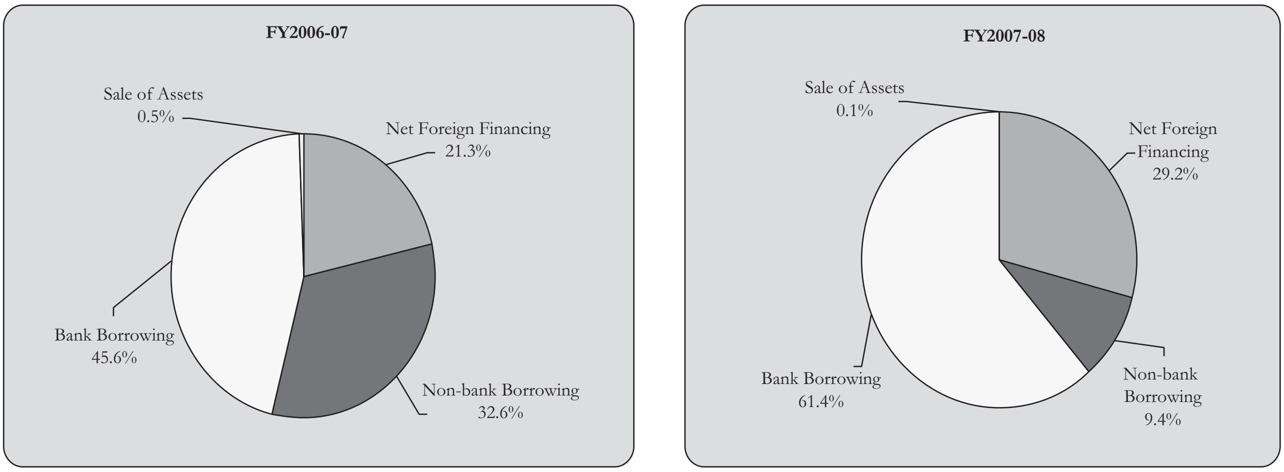
Source: CPD-IRBD database.

In mobilising domestic resources to finance the deficit, the government mostly had to draw on the banking sources, as non-bank financing was not readily available in the backdrop of falling sale of National Savings Directorate (NSD) certificates; probably an impact of the anti-corruption drive that led to a shift of private investment towards the equity market. While domestic financing as a whole increased by 82.6 per cent, non-bank borrowing declined by (-)41.6 per cent. On the other hand, borrowing from the banking sources increased significantly by 173.3 per cent.

Foreign financing was about one-third (29.2 per cent) of the total financing in FY2007-08 with its share increasing from 21.3 per cent of FY2006-07 (Figure 1.11). While the share of domestic financing declined from 78.7 per cent to 70.8 per cent, share of bank borrowing increased substantially from 45.6 per cent to 61.4 per cent. This could leave some impact on the inflationary pressure as bank borrowing has a greater net impact on money supply, compared to non-bank borrowing. Share of non-bank borrowing declined from 32.6 per cent in FY2006-07 to 9.4 per cent in FY2007-08.

Although the amount of deficit is significant, actual deficit could have been substantially higher if the ADP implementation would have been better. A gradually rising deficit not only gives rise to concerns over mobilising resources to finance the deficit itself, but also over the cumulative debt burden that results in higher interest payments over the subsequent years. The viable option would be to strive for a higher revenue mobilisation where there is, in fact, enough scope to do so with only about one-twelfth of the earners over the tax exemption limit actually paying the taxes.

Figure 1.11: Structure of Deficit Financing: FY2006-07 and FY2007-08



Source: CPD-IRBD database.

1.5 MONETARY SECTOR

In view of high inflation rate during the FY 2007-08 Bangladesh had to deal with the challenge of following a monetary that would curb the rise in price levels and help to maintain macroeconomic stability. These objectives could be achieved only through sustainable output growth by channeling adequate resources in the productive sectors of the economy. A prudent monetary policy can play a vital role in resource allocation through the banking and financial framework of the country. The Bangladesh Bank has been pursuing its monetary policy in a transparent way through its successive Monetary Policy Statement (MPS) since January 2006. In its six monthly MPS for the period January - June 2008 the Bangladesh Bank aimed to "support the highest sustainable output growth along with maintaining price stability." To this end, the Bangladesh Bank had earlier resisted the suggestion of the IMF to raise interest rate and follow a contractionary monetary policy and has been pursuing an accommodative policy in view of the emerging domestic and global economic developments. It is expected that the Bangladesh Bank will follow an independent monetary policy to control inflation and stimulate investment in future as well, keeping in view the domestic and global realities.

A brief overview of the trends of some of the major variables in the monetary sector during the FY2007-08 is presented below to understand the recent dynamics in the sector.

1.5.1 Demand and Time Deposits

Striking a balance between high inflation and interest rate has always been a challenge for the Bangladesh Bank while devising a monetary policy. The long-term interest rates in Bangladesh have either declined or remained the same over the years. For example, interest rates on 5-year and 10-year Bangladesh Government Treasury Bond (BGTB) have declined, while the interest rate on NSD certificates remained the same in June 2008 when compared to December 2007 (Table 1.2). This would imply that the real rate of interest (RRI) has declined in the face of high inflation. This has acted as a disincentive to the depositors who are currently shifting towards the capital market instead of saving in NSD certificates. As a matter of fact, net sale of NSD certificates during July-June FY2007-08 was 39.68 per cent lower compared to July-June FY2006-07, while total sale was 6.73 per cent less during the same period (Table 1.3).

Table 1.2: Weighted Average Interest Rate of Government Long-term T-bill/Bonds and Inflation

Period	BGTB		NSD		Inflation Rate (12 Month Average)	Real Rate of Interest on BGTB		Real Rate of Interest on NSD	
	5-Year	10-Year	3-Year	5-Year		5-Year	10-Year	3-Year	5-Year
June 2004	8.00	10.00	10.50	11.00	5.83	2.17	4.17	4.67	5.17
June 2005	8.75	9.93	10.00	10.50	6.49	2.26	3.44	3.51	4.01
June 2006	10.60	12.09	10.00	12.00	7.16	3.44	4.93	2.84	4.84
June 2007		12.14	11.50	12.00	7.20		4.94	4.30	4.80
Dec 2007	10.65	11.73	11.50	12.00	9.11	1.54	2.62	2.39	2.89
March 2008	10.60	11.72	11.50	12.00	10.00	0.60	1.72	1.50	2.00
June 2008	10.60	11.72	11.50	12.00	9.94	0.66	1.78	1.56	2.06

Source: Monetary Policy Department, Bangladesh Bank.

Deposits increased by 16.90 per cent during FY2007-08 compared to FY2006-07. Of this, Demand

Table 1.3: Sale and Repayment of NSD Certificates

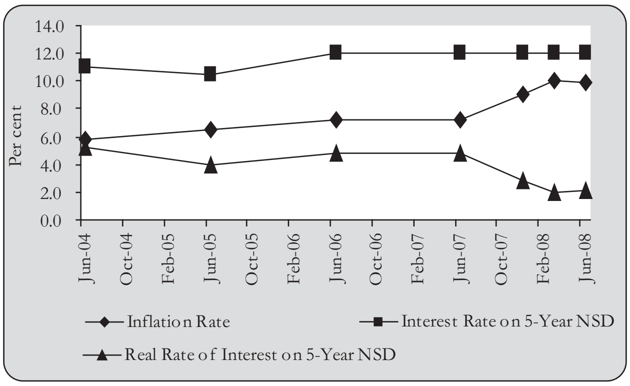
(in Crore Tk.)

Period	Sale	Repayment	Net Sale	Outstanding at the End Period
FY2006-07	15123.53	10948.61	4174.92	43639.18
FY2007-08	14105.79 (-6.73)	11587.50 (+5.84)	2518.29 (-39.68)	46157.47 (+5.77)

Source: National Savings Directorate, Bangladesh Bank.

Deposits (DD) increased by 15.46 per cent and Time Deposits (TD) by 17.11 per cent during this period. A comparison between July 2008 and July 2007 shows that DD increased by 11.18 per cent and TD by 18.21 per cent between the two time periods. The increase in TD implies that even with high inflation rate, the opportunity cost of holding money in these instruments is still attractive.

Figure 1.12: Real Rate of Interest



Source: Bangladesh Bank.

The RRI has been declining on all deposits. For example, the RRI in June 2008 was only 0.66 per cent on 5-year BGTB, 1.78 per cent on 10-year BGTB, 1.56 per cent on 3-year NSD certificate and 2.06 per cent on 5-year NSD certificate (Figure 1.12). Such low interest rate has made savings instruments such as NSD less attractive and led private savers to move towards other forms of investment, such as the capital market. The heated capital market of FY2007-08 is a reflection of such moves. Table 1.2 shows the weighted average interest rates and real interest rates of various savings instruments.

1.5.2 Money Supply, Reserve Money and Liquidity

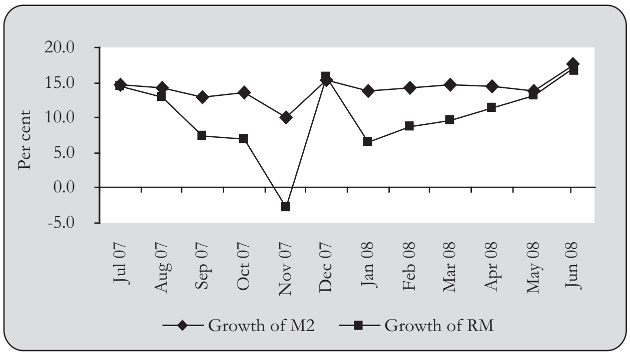
There has been an upward trend in case of Broad Money Supply (M2) during the FY2007-08. M2 has posted a rise of 17.48 per cent as of end of June 2008 compared to July 2007 (Figure 1.13). This growth has been due to growth in the domestic credit by 20.05 per cent during July 2007 and June 2008. Due to increased remittance flow, Net Foreign Assets (NFA) has continued to increase in recent times. NFA increased by 15.07 per cent during FY 2007-08. Net Domestic Assets (NDA) has also experienced an increase of 18.10 per cent during the same period.

Reserve Money (RM) recorded an increase of 19.78 per cent (Tk. 8,716.50 crore) in FY2007-08 compared to increase of 17.67 per cent (Tk. 6,691.80 crore) in FY2006-07. The money multiplier (M2/RM) increased to 4.71 at the end of June 2008 compared to 4.70 in July 2007.

The scheduled banks had an excess liquidity of Tk. 12,988.58 crore as of end of June 2008 which was lower compared to Tk. 14,279.42 crore as of end of June 2007. This is reflected in attempts at undertaking deposit collection drive on the part of some commercial banks through offering of higher interest rates on long-term deposits. Banks have been borrowing from the call money market at a high interest rate for their day-to-day operations.

In order to ease the liquidity crisis, the government has also started to inject money in the economy. The government had earlier withdrawn an amount of Tk. 5,000 crore in FY2007-08 from the banking sector, through primary dealers (by way of sale of treasury bills (T-bills) to nationalised banks and some commercial banks) for government's use, and to control inflation by reducing the money supply in the market. However, this has raised the call money rate, which sometimes reaches as high a level as 15 to 20 per cent. The government is now trying to keep the call money rate around 8 to 8.5 per cent and has recently injected Tk. 1,000 crore to this end.

Figure 1.13: Growth Rate of Money Supply and Reserve Money



Source: Bangladesh Bank.

The reasons behind a decline in excess liquidity could be the following. First, private sector credit has increased to some extent (Section 1.5.3). Second, due to anti-corruption drive since January 2007, a large part of the black money has been taken out of the banking system. Third, due to high inflation rate and high commodity prices, the middle-income group is having to use their savings to cope with high cost of living.

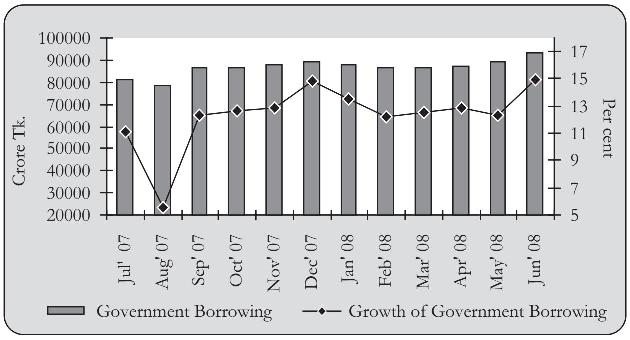
1.5.3 Domestic Credit

Total domestic credit increased by 20.05 per cent (Tk. 41,545.6 crore) during July 2007-June 2008 against the increase of 13.55 per cent (Tk. 24,550.3 crore) during July 2006-June 2007. The rise in domestic credit is due to the rise of both private sector and public sector credit. Private sector credit experienced an increase of 24.38 per cent (Tk. 37,271.3 crore) during FY2007-08. Domestic credit to the public sector experienced an increase of 7.86 per cent (Tk. 4,274.3 crore) in the same period. On the other hand, credit to other public sectors declined by 32.52 per cent during FY2007-08.

Government Sector Borrowing

There has been an increase in government sector borrowing which comprises of bank borrowing plus non-bank borrowing. The increase was 15 per cent

Figure 1.14: Government Sector Borrowing



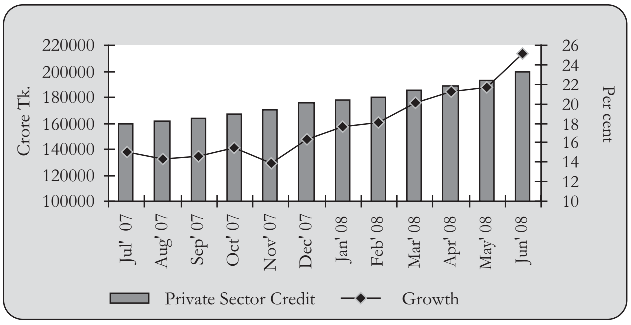
Source: Bangladesh Bank Economic Trends.

during July 2007 and June 2008. In June 2008 government sector borrowing was Tk. 93,157.17 crore, of which, banking sector contributed 50.45 per cent and the remaining from non-banking sector. Outstanding borrowing of the government through NSD certificates as of end June 2008 stood at Tk. 46,157.47 crore, recording an increase of Tk. 2,266.19 crore or 5.16 per cent, against Tk. 43,891.28 crore as of end July 2007. The volume and growth of the government sector borrowing are shown in Figure 1.14.

Private Sector Borrowing

Private sector demand experienced a decline in the beginning of the FY2007-08, partly due to uncertainty and fear created in view of the changed governance framework following takeover by the third CTG in January 2007 and anti-corruption drive pursued by the CTG. The situation started to improve gradually with renewed activities in the economy, which was reflected

Figure 1.15: Private Sector Borrowing



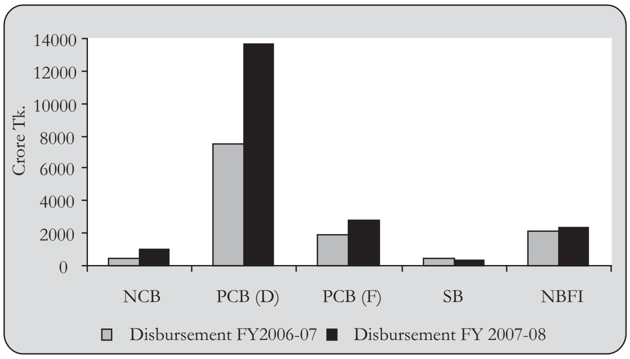
Source: Bangladesh Bank Economic Trends.

in strong growth of the private sector credit during FY2007-08. In FY2007-08 total outstanding domestic credit to the private sector posted an increase of 25 per cent over FY2006-07 (Figure 1.15). Within total credit to the private sector, 92.5 per cent came from the banking sector while the rest came from the Non-bank Depository Corporations (NBDCs).

1.5.4 Industrial Loan

Industrial term loan disbursement stood at Tk. 20,150.8 crore in FY2007-08, registering a high growth of 62.58 per cent from FY2006-07. Term loan recovery in this fiscal year was also 50 per cent higher than previous fiscal year. Term loan disbursed by the nationalised commercial banks (NCBs) increased

Figure 1.16: Disbursement of Term Loan: FY2006-07 and FY2007-08

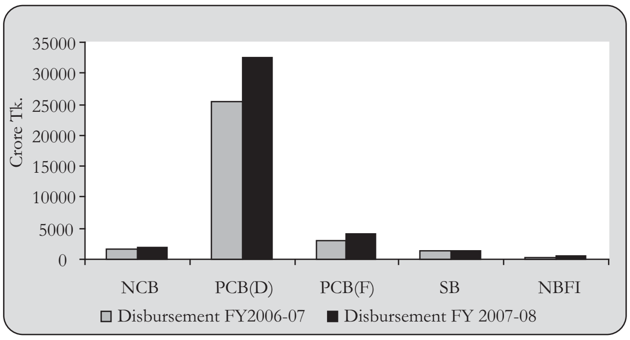


Source: Bangladesh Bank.

significantly by 105 per cent, and their share in total disbursement also increased by a significant margin, from 3.9 per cent in FY2006-07 to 4.9 per cent in FY2007-08 (Figure 1.16). Furthermore, in FY2007-08 disbursements by all other banks have increased significantly except for the specialised banks (SB) that recorded a negative 17 per cent growth compared to the previous fiscal year.

Disbursement of working capital in FY2007-08, recorded a relatively high growth of 26.3 per cent. In

Figure 1.17: Disbursement of Working Capital: FY2006-07 and FY2007-08



Source: Bangladesh Bank.

FY2007-08, an amount of Tk. 39,963.49 crore was disbursed against the sanctioned amount of Tk. 30,489.73 crore (Figure 1.17). Private commercial banks (PCBs) (domestic) accounted for more than 81 per cent of the total disbursement of working capital, while the highest growth (53.8 per cent) was registered by the non-bank financial institutions (NBFIs). On the other hand, disbursement of working capital by the SBs recorded negative growth of 2.6 per cent.

1.5.5 Loan Default Scenario

Total classified loan as on June 2008 was Tk. 24,997.67 crore. Total classified loan increased by 12.09 per cent as on June 2008 compared to the corresponding period of the previous year. Except for the development finance institutions (DFIs), none of the bank was able to make progress in reducing classified loans. The increase in classified loan was 17.09 per cent for the state-owned commercial banks (SCBs), 43.72 per cent for foreign banks (FBs) and 11.69 per cent for PCBs. However, the DFIs made an impressive progress in reducing total classified loan which recorded a negative growth rate of (-)5.28 per cent as of June 2008 from the corresponding time of the previous year (Table 1.4).

Table 1.4: Classified Loan *(in Crore Tk.)*

Bank Type	As on June '07	As on June '08	Growth in FY2007-08 Compared to FY2006-07
SCBs	13058.24	15289.36	17.09
PCBs	5150.62	5752.97	11.69
FBs	160.03	230.00	43.72
DFIs	3933.16	3725.34	-5.28
Total	22302.05	24997.67	12.09

Source: Banking Regulation and Policy Department, Bangladesh Bank.

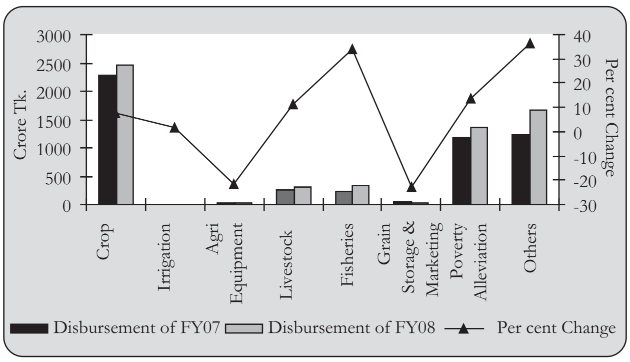
The negative performance in loan recovery is partly due to the anti-corruption drive which put several businessmen behind the bar and led many to flee from the country. Since the corporate governance of most of the companies in Bangladesh is weak with heavy dependency on particular individuals, business has experienced a downward trend due to such cleansing operation. Consequently, many of these companies are not being able to service their respective loans. Also due to the fear factor among the businessmen there was very limited investment during the beginning of the FY2007-08 leading to weak performance of their business which in turn could have had an impact on the loan default scenario.

1.5.6 Agricultural Credit

The Bangladesh Bank has directed all NCBs and PCBs to increase disbursement of agricultural credit in order to increase agricultural production in view of global food crisis, and the loss of domestic production due to flood and cyclone in 2008. The emphasis of the Bangladesh Bank was reflected in increased disbursement of agricultural credit by the NCBs, SBs, Bangladesh Rural Development Board (BRDB) and Bangladesh Samabay Bank Limited (BSBL).

In the backdrop of the prevailing high inflation total credit disbursement to the agricultural sector posted a positive growth of 16.5 per cent in FY2007-08. While total disbursement amounted to Tk. 6,167 crore in FY2007-08, total recovery amounted to Tk. 4,374.6 crore which was 6.45 per cent lower than the recovery of FY2006-07. Crop loan and poverty alleviation received credit with respective disbursements of Tk. 2,463.72 crore and Tk. 1,349.72 crore. Poverty alleviation recorded a positive growth of 13.47 per cent in disbursement for FY2007-08 over that of FY2006-07 (Figure 1.18).

Figure 1.18: Agricultural Credit Position: FY2006-07 and FY2007-08 (July to June)



Source: Agricultural Credit & Special Programme Department, Bangladesh Bank.

Though private banks have also initiated programmes for disbursing agricultural credit, the effort is still very limited. Private banks are lending to the agriculture sector in two ways. First, following the model of the Indian ICICI Bank's Para Banking (which has in fact been developed on the basis of the Grameen Bank model blended with the Indian reality), a number of private banks have come to an agreement with some large non-government organisations (NGOs), such as BRAC, ASA and TMSS to disburse agri-loan through them. They are now finding out that lending in agriculture sector could also be a profitable operation. Such arrangements have been made in view of the fact that these NGOs have infrastructural and institutional set up in the rural areas, and it is not always financially viable for the banks to establish a new set up in the remote areas. Second, under a tri-partite arrangement among the government, private banks and NGOs, credits are being disbursed in the agriculture sector. Currently, a pilot project is being implemented through two private banks - Eastern Bank Ltd. and BASIC Bank. The ADB has provided a fund of USD 42 million to the Ministry of Finance (MoF) for this. The government has disbursed USD 36 million to these two private banks at 3.5 per cent interest rate. The private banks are lending these funds to the aforesaid three NGOs at 7 per cent interest rate.

1.5.7 Consumer Price Inflation

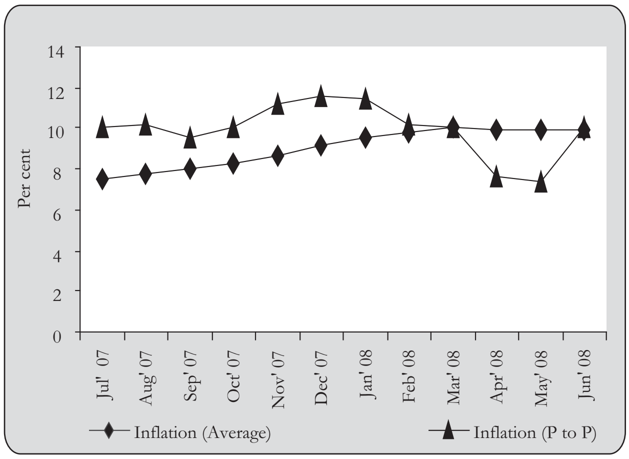
National Consumer Price Index (CPI)

The annual average rate of inflation (12-month annual average CPI, 1995-96 = 100) increased to 9.94 per cent in June 2008 from 7.49 per cent in July 2007. The increasing trend continued till March 2008 when it reached 10.0 per cent. It has declined slightly during April-June 2008. Higher inflation was due to higher domestic price of food and higher global commodity prices. However, as food comprises about 59 per cent of total CPI in Bangladesh, higher domestic food prices was the dominant factor contributing to the high inflation (Figure 1.19).

Urban and Rural Inflation

Both rural and urban consumers have been feeling the heat of high prices. The point-to-point (P to P) inflation rate in rural areas in June, 2008 was 10.29 per cent, an increase from 10.10 in July 2007. The food price inflation rate was 14.0 per cent while non-food

Figure 1.19: CPI Inflation



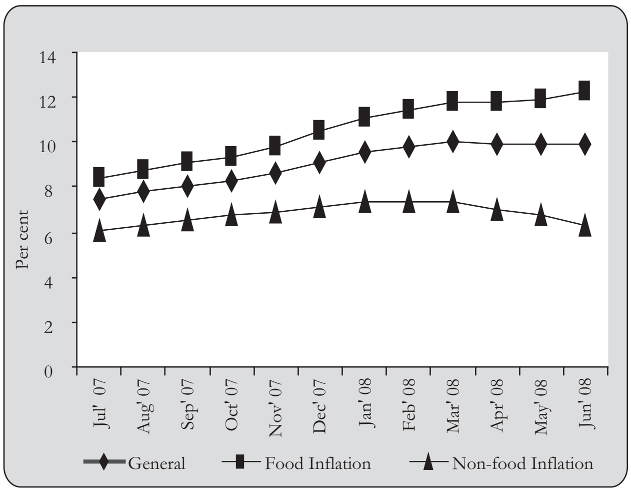
Source: Bangladesh Bureau of Statistics (BBS).

price inflation rate was 3.50 per cent in June 2008. The point-to-point inflation rate in urban areas in June, 2008 was 9.40 per cent, compared to 10.09 in July 2007. The urban food and non-food price inflation rates were 14.33 per cent and 3.64 per cent respectively in June 2008.

Food and Non-food Inflation

At the end of June 2008, food and non-food inflation rates on a point-to-point basis were 14.10 per cent and 3.54 per cent respectively, compared to 11.42 and 8.23 respectively in July 2007. On the other hand, food inflation rate on the basis of 12-month average increased from 8.45 per cent in July 2007 to 12.28 per cent in June 2008. Non-food inflation rate increased from 6.09 per cent to 6.32 per cent during the same period (Figure 1.20).

Figure 1.20: General, Food and Non-food Inflation (12 Month Average)



Source: Bangladesh Bank Quarterly (January to March).

Global Price Scenario

As opposed to previous years prices of most commodities, especially those of wheat, rice, edible oil, and crude oil have increased at an unprecedented rate during FY2007-08. Prices of rice (for 5 per cent broken parboiled) increased to USD 934.2 per metric ton (MT) in June 2008 from USD 342.5 per MT in July 2007. Crude oil price touched a record high of USD 133 per barrel in June 2008 from USD 77.2 per barrel in July 2007. Similar trend was observed in case of wheat. Prices of soybean oil jumped to USD 1,537 per MT in June 2008 from USD 886 per MT in July 2008 (Table 1.5).

Table 1.5: Global Price of Some Important Commodities

Period	Rice USD/MT
	5 % broken parboiled
July 2007	342.5
January 2008	412.5
June 2008	934.2
	Crude Oil, Brent USD/Barrel
July 2007	77.2
January 2008	91.9
June 2008	133.0
	Soybean Oil USD/MT
July 2007	886.0
January 2008	1276.0
June 2008	1537.0
	Wheat, US, HRW USD/MT
July 2007	238.4
January 2008	370.7
June 2008	348.6

Source: World Bank, The Pink Sheet.

Regional Inflation

High inflationary trend was also observed in South Asian countries. The point-to-point inflation was 11.9 per cent in India and 28.2 per cent in Sri Lanka in June 2008, compared to 4.7 per cent and 15.4 per cent in India and Sri Lanka respectively in July 2007. In Pakistan, inflation rate was 21.5 per cent in June 2008. Table 1.6 shows a comparison of inflation rates at various points of time.

Table 1.6: Regional Comparison of Inflation (Point-to-Point)

Period	Bangladesh	India	Pakistan	Sri Lanka
December' 06	6.1	6.6	8.9	19.3
December' 07	11.59	5.9	8.8	16.4
July' 07	10.10	4.7	6.4	15.4
March' 08	10.06	7.9	14.1	28.1
June, 08	10.04	11.9	21.5	28.2

Source: Bangladesh Bank, http://www.sbp.org.pk, http://www.statistics.gov.lk/.

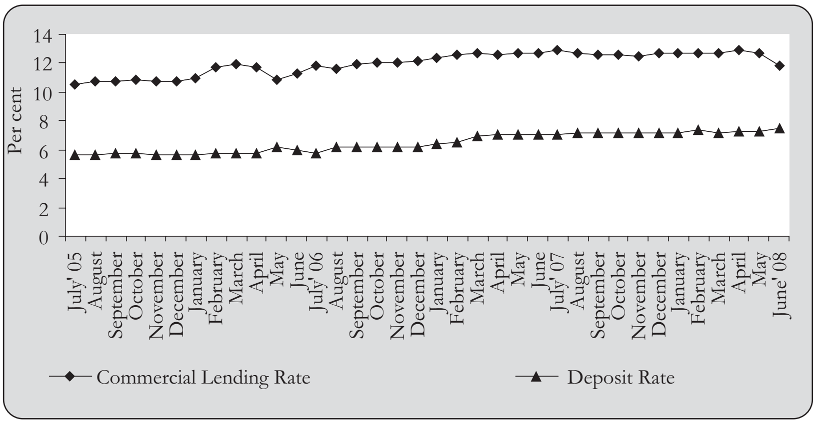
Impact of Inflation on Real Income

Inflationary pressure during the last several months has had an adverse impact on the consumers through reduction of their purchasing power due to income erosion. High inflation, particularly high food inflation, has particularly affected the poor and people in the fixed income group. A Centre for Policy Dialogue (CPD) estimate shows that those below the poverty level of income experienced an income erosion of 36.7 per cent during January 2007 to March 2008. This section of the population spends 45.6 per cent of their income on rice alone. Given the increase of rice price by 66.9 per cent during January 2007 and March 2008, income erosion (due to price hike of rice alone), was about 30.5 per cent. For the remaining 54.4 per cent expenditure, income erosion would be to the tune of 6.2 per cent, if only the overall inflation rate was considered. Indeed, most of the workers in the manufacturing and other sectors whose income level is very low have experienced considerable income erosion. If wages of the lower income groups are adjusted against this inflationary trend, real wage would be much lower. For example, monthly wages of workers in grades 5, 6 and 7 in the readymade garments (RMG) sector have been fixed at Tk. 2,046, Tk. 1,851 and Tk. 1,662.5 respectively at the time of the last minimum wage review. Taking into account an average income erosion of 36.7 per cent following the high rice price inflation, the real wages had come down to Tk. 1,295, Tk. 1,172 and Tk. 1,052 per month for workers belonging to the respective grades.

The CPD estimates also show that even when the increase in cumulative GNI is considered (between 2005 and 2008), given the price hike (particularly taking into consideration of the weighted inflationary impact of price of rice), an additional 8.5 per cent people have fallen below the poverty line in recent times because of high inflation (taking Household

Income and Expenditure Survey (HIES) data for 2005 as the reference point). This would mean that as high as an additional 2.5 million households could have fallen below the poverty line in terms of real income. Without doubt, the public food distribution system (PFDS) and other safety net programmes of the government, covering about 10 million people have helped to mitigate the food deprivation of people below the hardcore poverty line, although the overall adverse impact of such high inflation as was experienced in FY2007-08 is undeniable.

Figure 1.21: Monthly Trend of Lending and Deposit Rates



Source: Bangladesh Bank.

1.5.8 Interest Rate

In view of the high spread between lending and borrowing rates, interest rate has been a contentious issue as far as business and banking communities were concerned. This conflict of interest has persisted for quite some time now. The Bangladesh Bank has already directed major commercial banks to reduce the interest rate spread and bring down their lending rates. Commercial banks have agreed recently to fix the highest lending rate at 14.0 per cent.

Table 1.7: Weighted Average of Interest Rates

Period	Lending Rate	Deposit Rate	Call Money Rate
December 2004	10.83	5.56	7.62
December 2005	11.25	5.90	8.40
December 2006	12.60	6.99	7.16
December 2007	12.75	6.77	9.37
June 2008	12.29	6.95	9.90

Source: Bangladesh Bank.

PCBs feel that given the high cost of funds and high risks of lending in Bangladesh, any further reduction in the lending rate is not feasible. Moreover, a lower lending rate calls for a lower deposit rate which will discourage savers to keep money in the bank and thus, create liquidity crisis. This, in turn, will have an impact on the overall economy. However, the business community is still pursuing for a higher cut in the lending rate. This demand is being voiced afresh by the business community in view of the global meltdown of financial markets.

Ensuring better returns on deposits would be one way to improve the liquidity situation. The lending rate (calculated on a quarterly basis) of scheduled banks was 12.29 per cent in June 2008 compared to 12.75 per cent in December 2007. Their deposit rate (also calculated on a quarterly basis) stood higher at 6.95 per cent in June 2008 as compared to 6.77 per cent in December 2007 (Table 1.7 and Figure 1.21).

The Bangladesh Bank has to strike a balance here as the demand for liquidity in the banks has to be ensured to tackle the financial crisis. The problem of spread between banks' lending and deposit rates in Bangladesh owes also to some other factors. A study by the Bangladesh Bank pointed out that the spread is relatively high in Bangladesh because of inefficiencies, market segmentation and lack of competition.

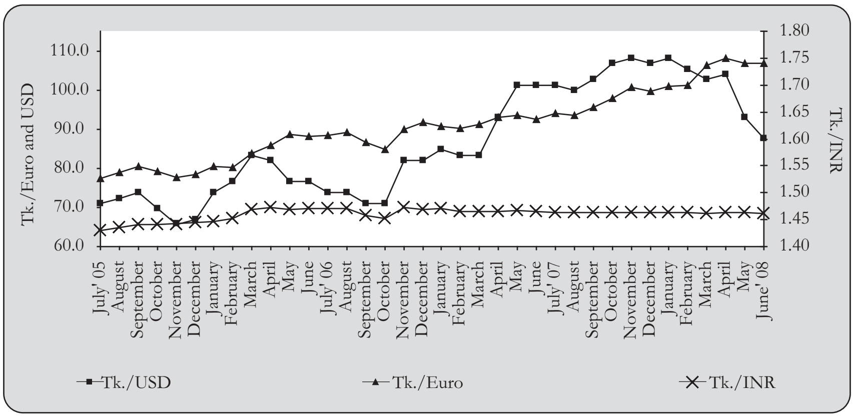
1.5.9 Exchange Rate

The exchange rate between Bangladesh Taka (BDT) and United States Dollar (USD) has remained stable for the last one year or so. As is known, floating exchange rate was introduced in Bangladesh in 2003 to contain fluctuations of Taka against foreign currencies, particularly the US Dollar. During July 2007 and June 2008, Taka appreciated insignificantly by 0.17 per cent. At the end of June 2008, Taka per USD decreased to Tk. 68.52 from Tk. 68.64 at the end of July 2007 (Figure 1.22). Taka depreciated against Euro by 13.35 per cent in June 2008 compared to July 2007.

High levels of foreign exchange reserves underpinned by unprecedented growth in remittance flows have helped BDT to remain strong against

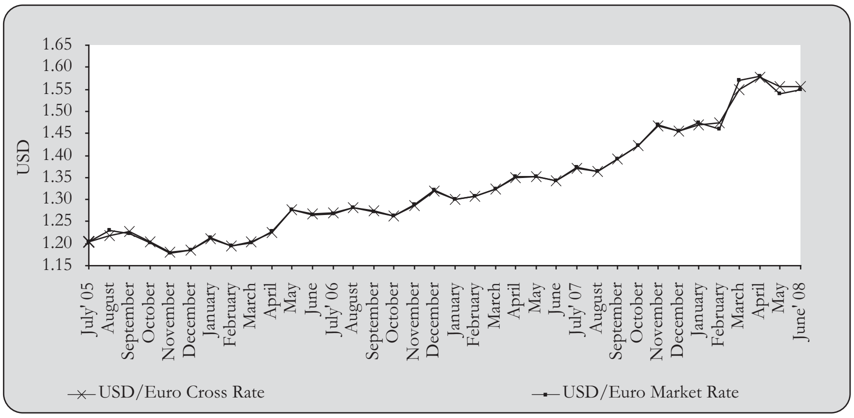
USD, notwithstanding the prevailing high inflation rate. In FY2007-08 the Bangladesh Bank injected about USD 500 million in the foreign exchange market to keep BDT from depreciating further. A stable exchange rate against the USD has been helpful in not allowing import prices to rise further.

Figure 1.22: Movements to BDT against USD, Euro and INR



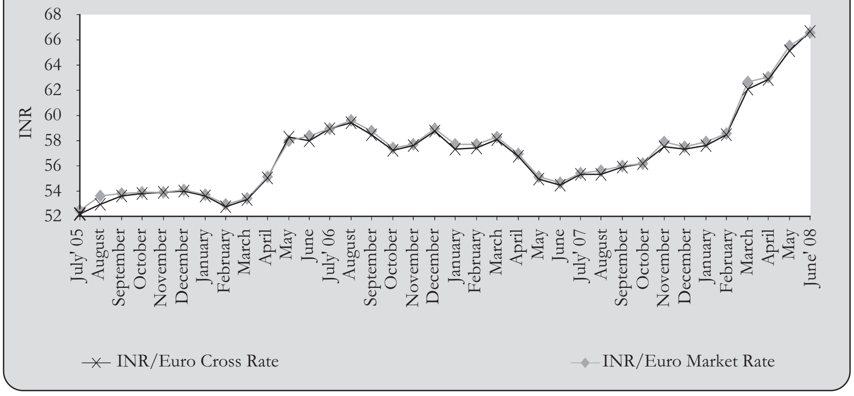
Source: Bangladesh Bank.

Figure 1.23: USD/Euro Cross Rate and Market Rate



Source: Bangladesh Bank, http://www.exchange-rates.org/history/USD/EUR/G/M.

Figure 1.24: INR/Euro Cross Rate and Market Rate



Source: Bangladesh Bank, Indian Ministry of Finance.

In Bangladesh, there is no Euro/BDT market and Euro/BDT rate is calculated from the traded rates of USD/BDT. BDT appreciated against Euro as it has been depreciating against the USD (Figure 1.23). USD continued to remain stable against BDT.

Given the increase in volume of trade between Bangladesh and India, the exchange rate of BDT with Indian Rupee (INR) is assuming importance. Depreciation of BDT against INR in recent years has helped Bangladeshi exporters. However, BDT has started to appreciate against INR as INR depreciated significantly against the USD. Indeed, whilst BDT remained stable against USD over the last one year, INR depreciated by about 5.96 per cent between July 2007 and June 2008. Figures 1.22, 1.23 and 1.24 present monthly movements of BDT against USD, Euro and INR between July 2005 and June 2008.

Some exporters have demanded that BDT should be depreciated to cover the probable loss of export income as a result of global recession. The importers oppose the idea as some of them have suffered significant loss due to fall of commodity price. In this context, the Bangladesh Bank has to devise a balanced policy to take care of the interests of both exporters and importers. The proposal of dual exchange rates appears not to be feasible under the present situation. The Bangladesh Bank has to carefully examine the request of exporters to devise special packages for making up for the likely losses of export income at this juncture of global economic crisis.

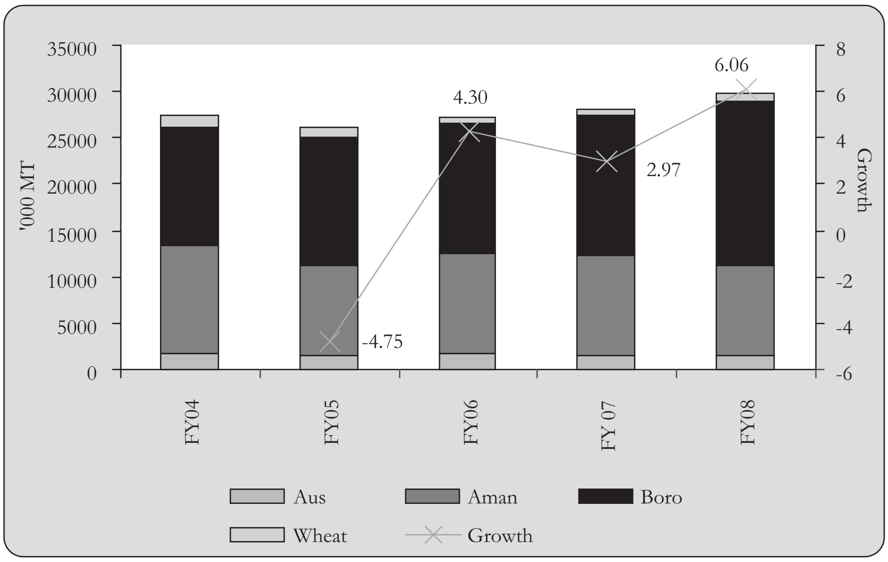
1.6 REAL SECTOR

1.6.1 Agriculture

Production of Foodgrains

According to the final estimates of Bangladesh Bureau of Statistics (BBS), total production of foodgrains (rice and wheat) in FY2007-08 was 29.77 million metric tonnes (MMT) (Aus: 1.51 MMT, Aman: 9.66 MMT, Boro: 17.76 MMT and wheat: 0.84 MMT) which was 6.06 per cent higher than that of the previous year (FY2006-07) (Figure 1.25). However, it was 9.92 per cent less than the original target for production of foodgrains in FY2007-08. Increase in production of foodgrains in FY2007-08 was mainly due to the increase in production of Boro rice. It should be noted here that wheat production in FY2007-08 was 14.5 per cent higher than the previous year, a welcome change from the declining trend since 1999.

Figure 1.25: Estimated Foodgrain Production in FY2007-08



Source: Bangladesh Bureau of Statistics (BBS), CPD estimates.

Department of Agricultural Extension (DAE) initially set the operational target for foodgrains production in FY2007-08 at 33.05 MMT (Aus 2.22 MMT, Aman 13.05 MMT, Boro 16.95 MMT and wheat 0.84 MMT) which was 15.04 per cent higher than actual production in FY2006-07. After the consecutive floods and Sidr in 2007, DAE planned for a massive agricultural rehabilitation programme and revised its target for Boro rice production. As per the revised target, DAE planned to produce 17.50 MMT of Boro rice from 4.50 million hectares (ha) of land comprising of 1.25 million ha for Hybrid rice, 3.125 million ha for high-yielding variety (HYV) rice and 0.125 million ha for local Boro rice in FY2007-08. It is pertinent to recall here that both Aus and Aman rice was affected by two consecutive floods in 2007 and super cyclone Sidr also destroyed the standing Aman crops. According to the estimates of CPD and BRAC, about two MMT of rice was lost due to flood and Sidr. According to the Ministry of Agriculture (MoA), 1.295 MMT of rice was damaged by the cyclone Sidr alone.

Published information by BBS does not provide information about the contribution of different rice cultivars to the total Boro area in FY2007-08. A study conducted by the CPD provides estimations as regards distribution of area under different cultivars in the Boro season of FY2007-08. According to these estimates, share of HYVs, Hybrids and Local varieties in this year were 85 per cent, 12 per cent and 3 per cent, respectively. Important local varieties cultivated were Kali Boro, Jagli and Binni. Popular HYV rice varieties were BR28 and BR29. These two varieties covered approximately 60 per cent of area under HYV, while BR14 (Gazi) was grown in about 4 per cent of total HYV area. Rest of the area under HYV was covered by other varieties. Among the Hybrids, most popular variety was Heera (32 per cent of all hybrids), followed by BRAC hybrids (Aloran, Jagoron and Shakti covering 22 per cent of all hybrids), Sonar Bangla (9 per cent of all hybrids), hybrids marketed by ACI (9 per cent of all hybrids), Aftab (7 per cent of all hybrids), Lal Teer (marketed by East-West Seed Company: 7 per cent of all hybrids) and others (14 per cent). Thus, area under all Hybrids in the Boro season of FY2007-08 was around 0.6 million ha.

Potato production was good in FY2007-08 but production of jute was poor compared to the previous year. According to the BBS, potato production in FY2007-08 was 6.65 MMT, which is 28.7 per cent higher than that of FY2006-07. On the other hand, jute production in FY2007-08 was 4.62 million bales which is 0.28 per cent lower than that of FY2006-07. Lower production of jute was mainly due to flood damage. Production situation of winter and summer vegetables were good.

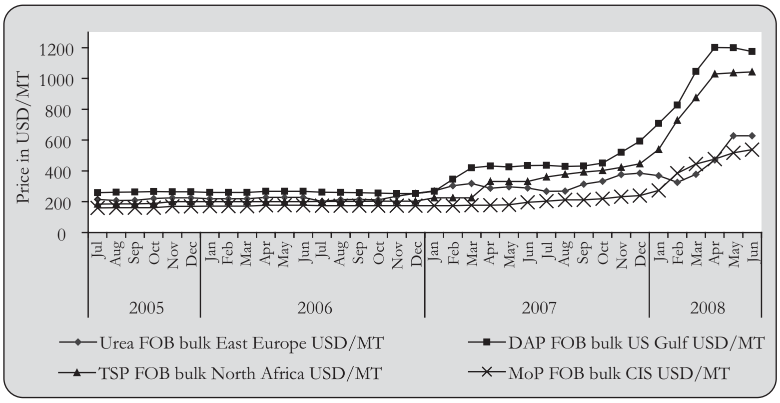
Input Supply and Subsidy for the Crop Sector

Input supply situation was relatively good in the Boro season of FY2007-08, compared to the previous year. Total consumption of electricity by irrigation pumps during July-March of FY2007-08 was 75.84 mkwh which was 17.9 per cent higher than that of FY2006-07 (comparable months). Electricity consumption by irrigation pumps during the Boro season (November-March) of FY2007-08 was 72.99 mkwh which was 24.6 per cent higher than that of FY2006-07 (comparable months). As is known, subsidy on account of irrigation reached up to Tk. 75 crore in FY2007-08.

Total supply of fertiliser was less than what was required in this period. There was a gap between actual requirement to attain high yield goals and the amount of total fertiliser distributed. However, concerned agencies were able to distribute the available fertiliser in an effective manner. National budget FY2007-08 allocated Tk. 1,500 crore as subsidy for fertiliser and Tk. 750 crore as subsidy for diesel. Fertiliser used by farmers in Bangladesh is obtained from two sources: domestic and international. The MoA estimated demand for Urea fertiliser in FY2007-08 as 28.18 lakh metric tonnes, triple super phosphate (TSP) 4.76 lakh metric tonnes, diammonium potash (DAP) 2.50 lakh metric tonnes, and muriate of potash (MoP) 4.00 lakh metric tonnes. The MoA planned that total demand for Urea would be met through 15.00 lakh metric tonnes from production of Bangladesh Chemical Industries Corporation (BCIC) factories, 4.50 lakh metric tonnes from Karnaphuli Fertilizer Company Ltd. (KAFCO) and 9.00 lakh metric tonnes from international import. According to the MoA report (October 2007), per kg production cost of Urea in Bangladesh was Tk. 7.20 which was sold at Tk. 4.80 and subsidy for per kg urea from domestic sources was thus equivalent to Tk. 2.40. On the other hand, import cost of per kg Urea was estimated at Tk. 31.00 which was sold at Tk. 5.30 and thus government had to subsidise Tk. 25.70 for each kg fertiliser imported from abroad. According to the aforesaid report, amount of total subsidy for fertiliser was estimated at Tk. 3,606 crore (Urea: Tk. 3,120 crore and TSP, DAP and MoP: Tk. 486 crore). As it happened, price of fertiliser in the international market continued to rise, and consequently, actual subsidy on account of fertiliser had to be substantially increased.

Between July 2007 and June 2008, price of all types of fertiliser rose at consistently high pace in the international market (Figure 1.26). During this period, price of Urea increased from USD 267.90 to USD 628.40 per metric ton (MT) while price of TSP increased from USD 360.00 to USD 1,043.00, and that of DAP increased from USD 436.30 to USD 1,175.00. On the other hand, price of MoP increased from USD 203.10 to USD 537.50 per MT.

Figure 1.26: International Price of Fertiliser (Urea, DAP, TSP & MoP): July 2005-June 2008



Source: Commodity market review, World Bank.

Available information suggests that total subsidy for fertiliser distribution and other related activities under the MoA could be about Tk. 3,740 crore (Tk. 3,408.5 crore for fertiliser, Tk. 75.0 crore for electricity for irrigation and Tk. 250 crore for diesel for irrigation and Tk. 6.5 crore for sugarcane). Though the amount of subsidy on account of fertiliser was increased, farmers could not reap the full potential benefit of this due to substantial (2-3 times) increase in prices of all types of fertiliser in the international market. To cope with the increased level of subsidy, the government increased administered price of Urea fertiliser on 9 June 2008, which came into effect on 11 June 2008. The mill-gate price of urea was refixed at Tk. 10,000 per ton or Tk. 10 per kg, while the new rate was to be Tk. 10,700 per ton or Tk. 10.70 per kg at the level of buffer stocks. The new farm-gate price

Table 1.8: Food Import in FY2006-07 and FY2007-08

(in '000 Metric Tonnes)

Category of Imports	FY2006-07 (July-June)			FY2007-08 (July-June)		
	Rice	Wheat	Total Foodgrains	Rice	Wheat	Total Foodgrains
Food aid	25	65	90	82	177	259
Public commercial import	0	121	121	296	0	296
Private import	695	1514	2209	1681	1235	2916
Total	720	1700	2420	2059	1412	3471

Source: Food Planning and Monitoring Unit (FPMU), Ministry of Food and Disaster Management.

of urea fertiliser was fixed at Tk. 12 per kg in remote areas and Tk. 11.50 in areas with well developed transport facilities which were Tk. 6.00 per kg previously. Prior to the increase, the official prices of urea were Tk. 4,800 per ton or Tk. 4.80 per kg and Tk. 5,300 per ton or Tk. 5.30 per kg at the mill-gate and the buffer stock levels, respectively. The government also decided to continue to provide subsidy at the rate of 15 per cent on the sale of other imported non-urea fertilisers - TSP, DAP, MOP - at farmers level. It is pertinent to mention here that the price of urea fertiliser was fixed for the last time on 3 June in 1997. In 1997 the per ton price at the factory point was Tk. 4,800 while the production cost was Tk. 4,652. The price at the buffer end was Tk. 5,300 and the import cost was Tk. 8,086.

High and rising prices of fertiliser and diesel in the international market have implications for the national budget FY2008-09. Given the global situation of export restrictions on foodgrains, particularly on rice, Bangladesh must have to produce more foodgrains to feed her increasing population. To do so, estimated fertiliser requirement in Bangladesh in FY2008-09 is likely to be 35.2 lakh metric tonnes of Urea, 5.9 lakh metric tonnes of TSP, 5.0 lakh metric tonnes of MoP and 3.2 lakh metric tonnes of DAP. Bangladesh will need to ensure availability and distribution of the subsidy on fertiliser accordingly.

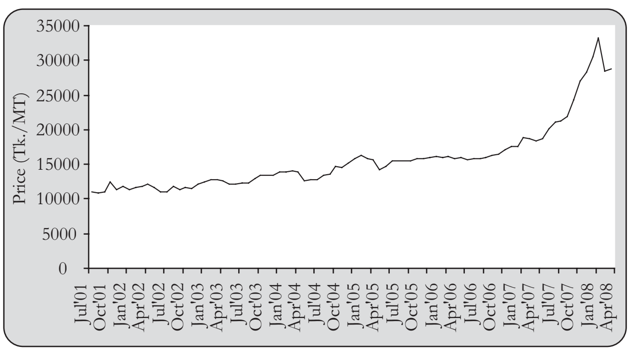
Food Aid and Commercial Import

Imports of foodgrains to Bangladesh are sustained from two sources: food aid and commercial imports. The latter comes through both government and private channels. During July-June of FY2007-08, total import of foodgrains (food aid and commercial imports) was 3,471 thousand MT, out of which 259 thousand MT was food aid, 296 thousand MT was imported as commercial import by public sector, and 2,916 thousand MT was imported by the private sector import (Table 1.8). It may be noted that private sector import of total foodgrains in FY2006-07 was 2,209 thousand MT. Private sector import of rice in FY2007-08 was 1,681 thousand MT against 695 thousand MT in FY2006-07. On the other hand, wheat import by private sector in FY2007-08 was 1,235 thousand MT against 1,514 thousand MT in FY2006-07. Total import of foodgrains and rice in FY2007-08 were respectively 43.4 and 185.8 per cent higher than those of the comparable months in FY2006-07. After two consecutive floods, when it was clear that there was substantial production loss and price was increasing in the domestic market, private sector started to import large quantities of rice. Import would have been much higher had there been no restriction on export of rice and other foodgrains by various countries. Even though import of foodgrain in FY2007-08 was much higher (10.50 lakh MT more) than that of the previous year (FY2006-07), it failed to meet the gap in view of requirement and production loss caused by flood and Sidr (to the tune of 20 lakh MT), leading to price volatility in the market.

Rice Price

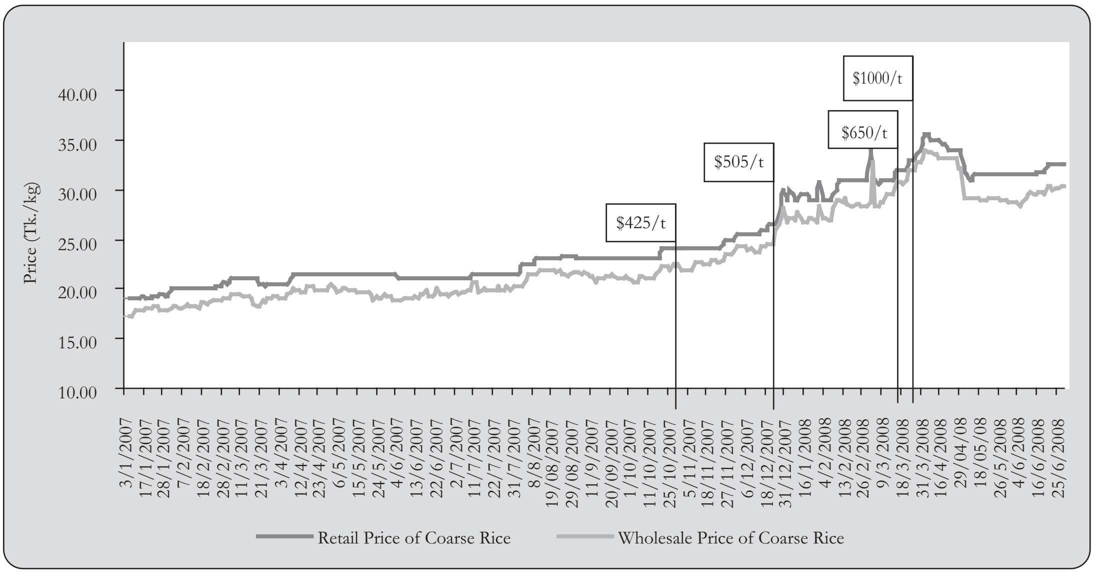
In the beginning of FY2007-08 (i.e. July 2007, the wholesale price of coarse rice in Bangladesh was Tk. 18,700 per MT which gradually increased to Tk. 29,000 per MT in early January 2008 and reached record high levels in April (Tk. 33,196) and then declined to Tk. 29,141 in May 2008 after harvest of Boro rice (Figure 1.27). Domestic prices (both for

Figure 1.27: Wholesale Price of Coarse Rice: July 2001- June 2008



Source: Food Planning and Monitoring Unit (FPMU).

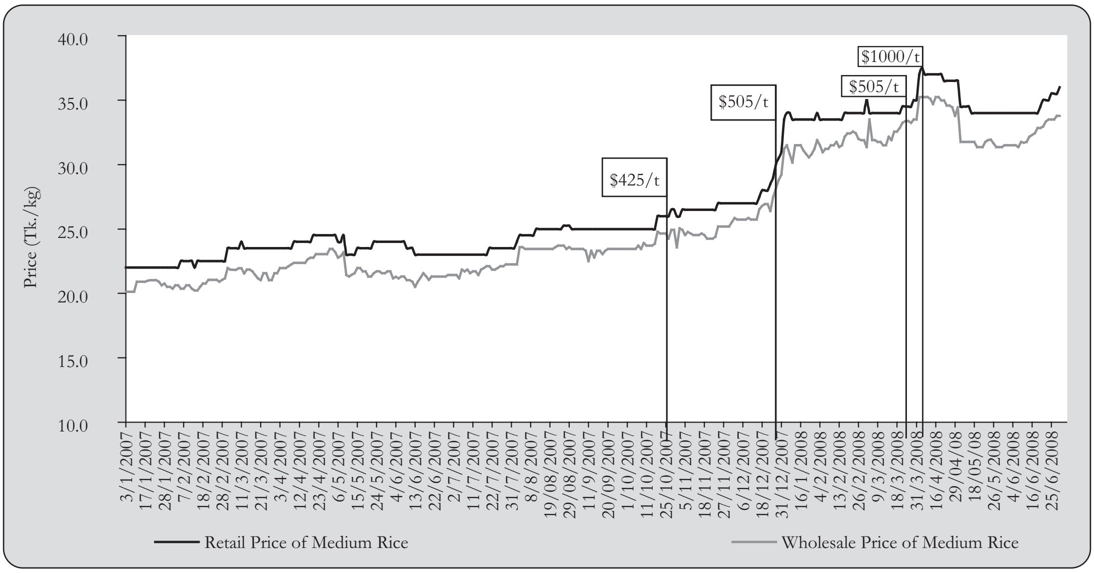
Figure 1.28: Retail and Wholesale Price of the Coarse Rice (BR 8, BR 11, Swarna): January 2007-June 2008



Source: Department of Agricultural Marketing (DAM).

wholesale and retail) of coarse and medium rice (Figure 1.28 and Figure 1.29) increased exponentially in FY2007-08. It becomes evident from analysis of price dynamics that domestic price of rice had increased sharply with the announcement of minimum export price (MEP) by India. This was true for both the retail and the wholesale market. It may be recalled here that India first fixed MEP of non-basmati rice at USD 425 per MT on 25 October 2007. Subsequently, India announced USD 505 per MT on 27 December 2007 and USD 650 per MT on 19 March 2008. Finally, India announced MEP of USD 1,000 per MT for non-basmati rice and USD 1,200 per MT for basmati rice on 28 March 2008. And then, on 1 April 2008 India banned export of non-basmati rice.

Figure 1.29: Retail and Wholesale Price of the Medium Rice (BR 28, Parija): January 2007-June 2008

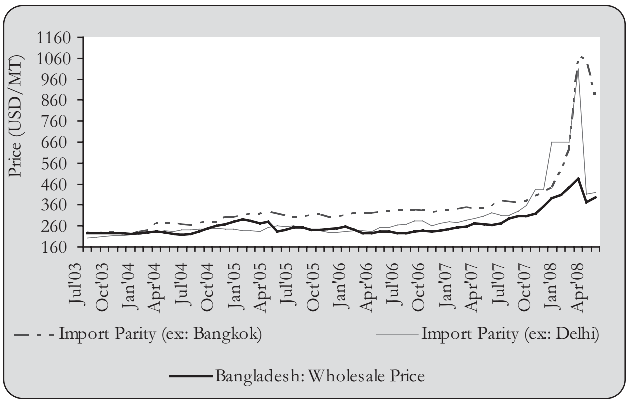


Source: Department of Agricultural Marketing (DAM).

It is possible that MEP fixed by the government of India also had an effect on the global rice price (Figure 1.30). Policies taken by India had, to some extent, influenced those of other countries such as Vietnam, Cambodia and Egypt, who were persuaded to rethink their export strategy. At some point in time these countries had also imposed temporary ban on export of rice.

In 1998 and 2004, following floods, Bangladesh was able to import huge quantities of rice and wheat from international market to offset the production loss caused by flood. Due to restrictions imposed on rice exports by major exporters, import of rice was a problem in the current fiscal year of FY2007-08. However, it is evident from Figure 1.31 that private sector of Bangladesh has responded well to the domestic and international prices and polices to bridge the gap between demand and supply in Bangladesh.

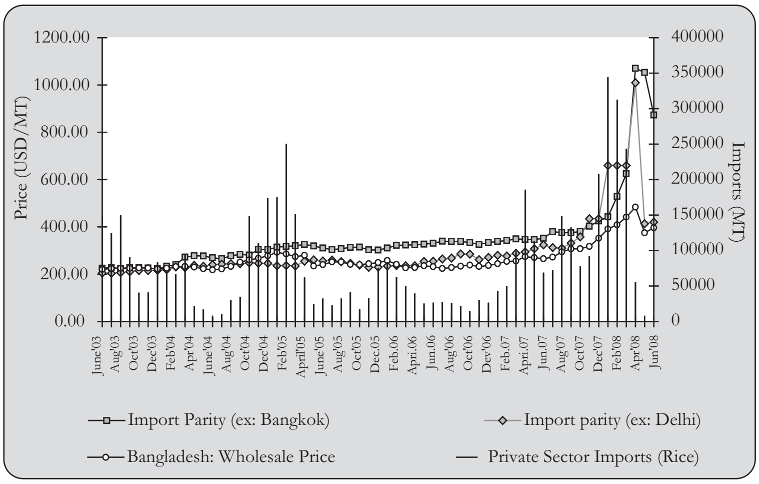
Figure 1.30: Comparison of Domestic Prices of Rice with Import Parity Price: July 2003-June 2008



Source: Food Planning and Monitoring Unit (FPMU), Bangladesh; United States Department of Agriculture (USDA); and Price Monitoring Cell, Ministry of Consumer Affairs, Food and Public Distribution, Government of India

Caution will be needed with regard to future production and prices of foodgrains in Bangladesh and also in view of movements in global production scenario. There are a number of medium and long term factors which will have an impact on future food production, to varying extent. First, the conflict between food and fuel will increase with high demand for fuel by the rich countries and also the big

Figure 1.31: Rice Prices and Quantity of Private Rice Imports in Bangladesh: June 2003-June 2008



Source: Food Planning and Monitoring Unit (FPMU), Bangladesh; United States Department of Agriculture (USDA); and Price Monitoring Cell, Ministry of Consumer Affairs, Food and Public Distribution, Government of India

emerging economies, such as India and China. The distribution of land for agriculture and fuel will be a major factor determining the possible food production scenarios. Second, the ongoing Doha Round Negotiations of the World Trade Organization (WTO) on agriculture will have an impact on net food importing countries. The objective of agriculture negotiation in the WTO is to withdraw domestic support given by the United States (US) and the European Union (EU). This will imply that net food importing countries such as Bangladesh will have to buy food at a higher and unstable price from the global market. Third, the impact of climate change will be felt more frequently and severely by low lying poor countries such as Bangladesh. Frequent flood, cyclones and other extreme weather events are early indications of this danger. This will not only destroy production, but also reduce the fertility of land and change the cropping pattern. Fourth, every year 90 million people are being added to the global population leading to increased demand for food. This will have implications both for availability and prices.

Livestock Production

In FY2007-08, total production of milk, meat and egg was 26.5 lakh tonnes, 10.40 lakh tonnes and 56,540 lakh pieces, respectively. Production of milk and eggs in 2007-08 was 16.23 and 5.31 per cent higher than that of FY2006-07 while meat production was constant. Livestock producers were severely affected by flood and Sidr in 2007. According to the Department of Livestock Services, two consecutive floods had affected 2,794 livestock farms and 5,412 poultry farms of 228 upazilas under 39 districts. Floods have also damaged about 148 thousand tonnes of livestock and poultry feed. Total loss to the livestock and poultry sector by floods in 2007 was Tk. 64.36 crore. On the other hand, Sidr led to the death of 108 thousand cattle, buffalo, sheep and goats and 2.57 million poultry birds. Sidr had also destroyed more than six thousand livestock and poultry farms. Estimated loss of livestock sector, affected by Sidr is Tk. 132.26 crore.

As part of rehabilitation measures for livestock and poultry farms affected by flood and Sidr, government and other organisations have taken following measures: (i) a medical team of four members are working in each upazila and providing medical services and continuing vaccination programme; (ii) a high ranked medical team of four members are supervising local activities in each division; (iii) 47 MT of livestock feed was distributed in 7 districts; (iv) up to second week of May 2008, more than 200 thousand of livestock and about 2,010 thousand poultry have been vaccinated; medical service was provided to about 195 thousand livestock and 803 thousand poultry; and (v) Bangladesh Army, BRAC, and other NGOs distributed 1,665 cows, 882 oxen, 2,581 calves, 13,115 goats and 6,564 chickens in 27 upazilas of Barisal and 2 upazilas of Khulna district. In addition, Tk. 17.94 lakh were distributed to reconstruct the damaged farms in these areas.

Poultry production in many areas faced bird flu (avian influenza). According to the Department of Livestock Services, bird flu was found in 219 poultry farms (commercial: 177 and family: 42) under 110 upazilas and 13 metro thanas of 47 districts. A recent study shows, during February 2007 to June 2008, 1.6 million chickens were culled and further 277,000 died in a total of 287 outbreaks and nearly 2.2 million eggs were destroyed by the concerned authority. Government distributed Tk. 11 crore 20 lakh to compensate for the affected farm owners. Each farm owner received Tk. 95 per domestic chicken, Tk. 90 per layer, Tk. 60 per broiler and Tk. 3 per egg as compensation. An analysis conducted by Bangladesh Livestock Research Institute (BLRI) showed that the poultry industry of Bangladesh had an estimated financial loss to the tune of Tk. 3,858 crore in 2007 and 2008. During the time of bird flu outbreak, prices of broiler and eggs declined by 28.0 and 26.5 per cent, respectively. As a result of death and culling of poultry, sharp price fall of poultry and eggs, price hike of poultry feed, bird flu panic and lack of insurance coverage, as many as 17,990 poultry farms were pushed out of business during July 2007 to February 2008. According to the Poultry Farm Owners' Associations of Bangladesh, estimated loss due to bird flu as Tk. 4,165 crore and around 5 lakh people became jobless due to the outbreak of the disease. Concerned agencies of the government had taken prompt actions such as active disease surveillance, culling of birds in affected farms, limiting human movement in affected farms and disinfecting the affected farms which are crucial to containing the situation. However, the threat is not yet over. According to news published in a number of national newspapers, a boy has been affected by bird flu in Bangladesh. We thus need to remain vigilant with regard to the spread of bird flu. To this end, effective implementation and continuation of the two projects on prevention of bird flu and development of poultry sector would be required.

Fisheries Production

In FY2007-08, total fish production was 2,592 thousand MT (about 6 per cent higher than that of FY2006-07), even though the sub-sector was affected by two consecutive floods and cyclone Sidr. During this period, marine fisheries grew by 20.4 per cent and inland fisheries grew by 2.7 per cent. According to the Department of Fisheries (DoF), two consecutive floods affected more than two lakh ponds and dighies in 259 upazilas under 39 districts. Total loss of fish production was 33.56 thousand metric tonnes which was worth of Tk. 196.49 crore. The government allocated Tk. 41 crore for rehabilitation of the fisheries sub-sector. During the flood, concerned agencies suspended planned disbursement and release of fingerlings (worth Tk. 3.03 crore). Following the flood these agencies distributed 1.2 crore fingerlings in the flood affected areas.

Sidr hit the coastal belt at a time when it was off-season for Bagda shrimp. However, loss incurred by fish farmers, who invested in ponds with prawn (galda) and various types of fresh water fish, were substantial. Fish farmers made fairly good investment, often financed by microcredit. Ponds were flooded and a large part of the fish stock escaped to creeks and canals. The water in the ponds was contaminated with fallen leaves and twigs and has become unfit for fish culture in the immediate future. According to the DoF, 11 districts (Khulna, Satkhira, Bagerhat, Barisal, Jhalokati, Pirojpur, Bhola, Barguna, Patuakhali, Gopalganj and Munshiganj) were severely affected by Sidr. More than 139 thousand ponds and dighies were affected by Sidr which together covered an area of about 44 thousand acres. As a result about 799 metric tonnes of shrimp, 5.7 thousand metric tonnes of fish, and 205 lakhs fingerlings were damaged. It is to be noted that fish farming is no longer a business of the rich people only. To sustain the growth of the fisheries sub-sector, a massive rehabilitation programme would be required in FY2008-09. Small farmers would require both technical (reclamation of damaged fish pond, fish fry) and financial support in the form of loan.

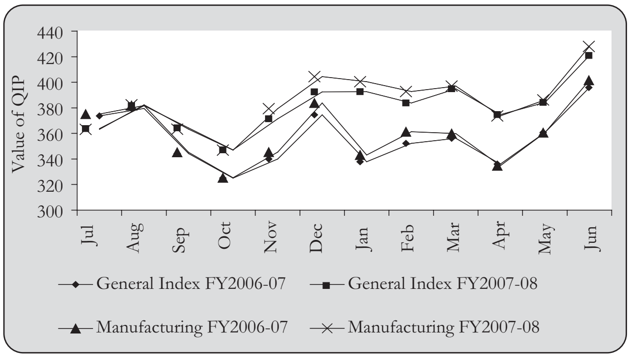
1.6.2 Industrial Sector

Industrial Production

Industrial production registered a modest growth of 6.9 per cent in FY2007-08; this growth was 2-

percentage point lower compared to what was achieved in FY2006-07 (Figure 1.32). This moderate level of industrial growth in FY2007-08 was mainly

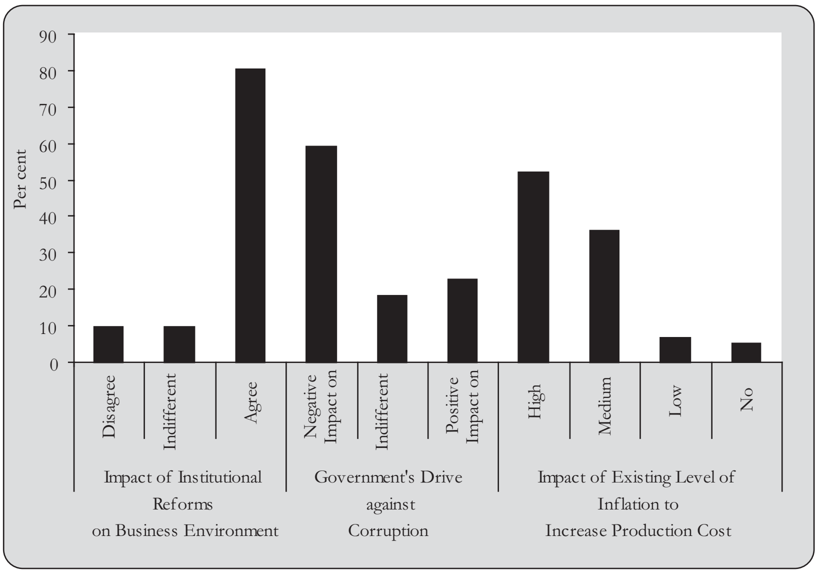
Figure 1.32: Movement of Quantum Index of Production (QIP) in FY2006-07 and FY2007-08



Source: CPD - IRBD database.

accounted for by the relatively low pace of growth of the manufacturing sector in FY2007-08. However, performance of some of the other sectors was relatively higher during the same period compared to the previous year, e.g. electricity (7.1 per cent *vis a vis* 6.7 per cent). Both large and medium scale units as well as small scale units registered relatively low levels of growth in FY2007-08 (6.8 per cent and 5.8 per cent respectively). Movement of general and manufacturing

Figure 1.33: Perception of Business Executives on Various Institutional Reforms with the Improvement of Business Environment of Bangladesh



Source: CPD Executive Opinion Survey, 2008.

indices indicated sluggish growth during the first quarter of FY2007-08; both the indices, particularly manufacturing sector index had picked up in the following quarters. The continuity of upward movement of the manufacturing sector in the next fiscal will largely depend on whether there is perceptible improvement in the business environment of the country.

Business confidence in the country appears to have improved in the latter half of FY2007-08 thanks to a number of initiatives taken by the CTG. These included, among others, relaxation/withdrawal of several stringent measures taken earlier for monitoring business practices, formation of Better Business Forum (BBF) headed by the Chief Advisor, establishment of Regulatory Reforms Commission (RRC). According to CPD's "Executive Opinion Survey 2008," which was conducted during February-April 2008, 80 per cent business executives were of the opinion that various institutional reform measures pursued by CTG in FY2007-08 have improved business environment in the country (Figure 1.33). On the contrary, government drives against improper business activities including corruption in 2007 were perceived to have had a negative impact (60 per cent). Besides, 52 per cent of business executives in FY2007-08 thought that the prevailing high inflation has increased cost of production by a "high" margin, when the corresponding figure for 2007 was only 19 per cent.

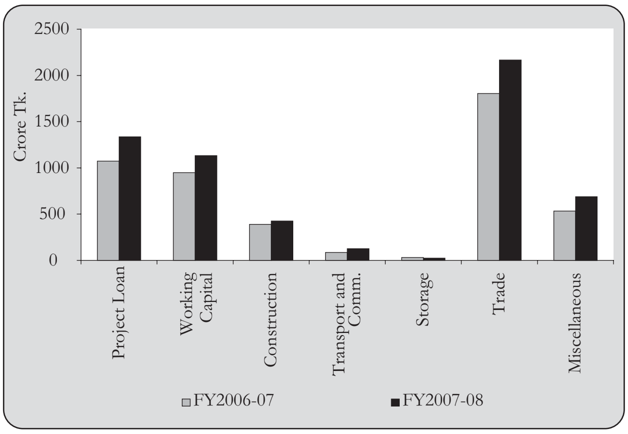
Major manufacturing sectors, such as apparels and leather, wood products, basic metals attained moderately high level of growth in FY2007-08. Production of various processed food products suffered during FY2007-08 mainly because of higher prices of imported raw materials. Indeed, with the fall in purchasing power due to high inflation, demand for some consumer goods declined which is clearly reflected in sluggish growth of production of perfume and cosmetics, rubber and footwear. Notwithstanding the rising demand for fertiliser in the domestic market, production of fertiliser was only 80 per cent in FY2007-08 (15,81,683 MT) compared to that in FY2006-07 (19,90,280 MT). One of the major reasons for the low level of fertiliser production was the decline in the supply of gas to fertiliser plants (24 per cent of total gas supply in FY2002-03, 17.4 per cent in FY2006-07 and 13.5 per cent in FY2007-08).

New opportunities for Bangladesh had been developed in building small-size ships. Entrepreneurs are taking initiatives to develop export oriented ship-building industry in the country in view of recent rise in the demand for small-size ships (capacity of less than 15,000 DWT) which traditional manufacturing countries such as Japan, China, South Korea and Vietnam are not interested to manufacture. During FY2007-08 production of ship-building sector was 4,266 MT, which was 3,705 MT for FY2006-07.

Disbursement of Industrial Term Loan and Bank Advances

A total of Tk. 20,151 crore has been disbursed by commercial banks as industrial term loan during FY2007-08, which was 62.5 per cent higher compared to that of the previous year. During the same period, a total of Tk. 13,625 crore was recovered, which was 50 per cent higher compared to the previous year; consequently, net disbursement of industrial term loan has increased: Tk. 6,525.6 crore in FY2007-08 *vis a vis* Tk. 3,326.3 crore in FY2006-07. According to Figure 1.34, net disbursement was highest in case of trade related activities (Tk. 2,167 crore) being 20 per cent higher than the previous year. Disbursements of project loan and working capital during the same period have increased by 24.5 per cent and 19.3 per cent respectively. Investment in the construction sector was not significant during the last fiscal.

Figure 1.34: Net Disbursement of Credit in Different Economic Activities



Source: Bangladesh Bank.

Financing SMEs

In order to strengthen the small and medium enterprise (SME) sector, Bangladesh Bank gave directives to commercial banks to expand their credit operation for the small and medium scale enterprises. During FY2007-08, bank advances have increased - outstanding position of SME loans at the end of June 2008 was more than one-fifth of the total outstanding credit for all types of industrial loans (Table 1.9). Although state-owned banks (SOBs) distributed one-third of their advances to the SMEs, PCBs in terms of absolute figure, distributed the highest amount (Tk. 19,890 crore). This trend has continued over all the four quarters in FY2007-08. PCBs' interest in SME financing is possibly coming from increased availability of funds which have been partially leveraged with the supply of soft loan from Bangladesh Bank for SME financing, as well as the very low provisioning requirement in case of SME financing.

Table 1.9: Outstanding Position of SME Loans

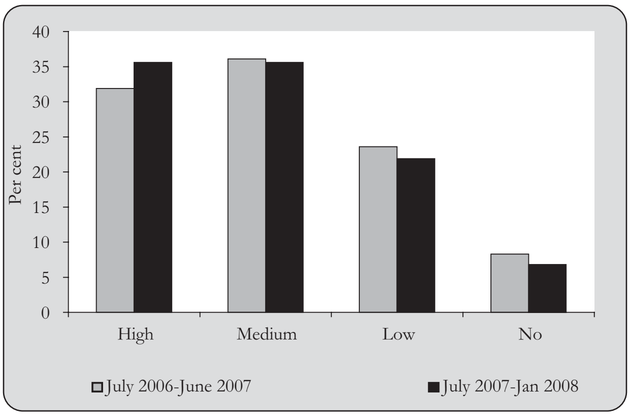
Loan	State-owned Banks	Private Banks	Foreign Banks	Specialised Banks	Non-financial Institutions	Total
Outstanding loan (in Crore Tk.) as of 30 June 2008	9918.9 (28.3)	19889.8 (56.77)	611.7 (1.75)	3249.1 (9.27)	1367.7 (3.90)	35037.1 (100.0)
SME loans as percentage of total loans	33.3	19.7	6.5	22.9	19.7	21.7

Source: Agricultural credit & special programmes department, Bangladesh Bank.

High rate of interest on term loan and working capital is considered to be a major constraint for businesses in Bangladesh, particularly for SMEs. According to the perception of leading business executives captured through CPD's "Executive Opinion Survey 2008," as many as 93.2 per cent business executives perceived that high rate of interest is a major cause for cost escalation; of these 36 per cent business executives considered the extent of cost escalation due to interest rate as "high" (Figure 1.35). In 2007, the comparable figures were 91 per cent and 32 per cent respectively.

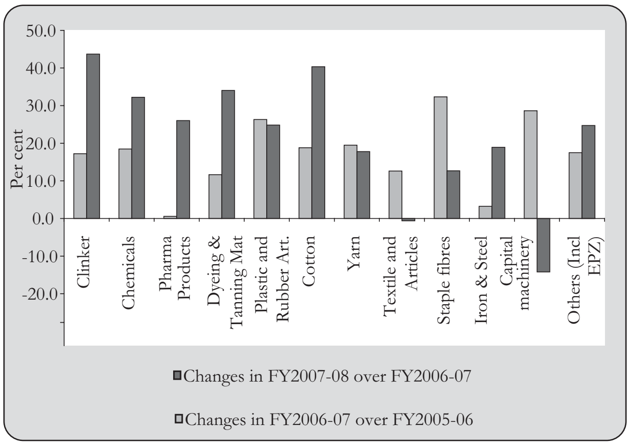
Recently, banks have decided to lower the lending rate of term loan and working capital, and fixed this at the maximum rate of 14 per cent. A total of 23 banks have decided to reduce their rates of lending from a maximum of 16 per cent to 14 per cent level (Table 1.10). In case of term loan, a good number of banks have decided to reduce the lending rate by about 1-2 per cent, while in case of working capital financing 11

Figure 1.35: Perception of Business Executives on Impact of Inflation on Cost of Production



Source: CPD Executive Opinion Survey, 2008.

Figure 1.36: Changes in Import of Intermediate Products, Raw Materials and Capital Machinery



Source: Bangladesh Bank.

banks have reduced the lending rate by less than 0.5 per cent. Reduction of interest rate on term loan and working capital was expected to somewhat reduce entrepreneur's cost of borrowing from the banking sector. Performance of industrial investment in FY2007-08 also reinforces the need for development of infrastructure and services, particularly energy services, in Bangladesh.

Table 1.10: Number of Banks having Lending Rate Higher than 14 Per cent

Range	Term Loan to Large & Medium Scale Industry	Term Loan to Small Industry	Working Capital to Industry
14< r* ?14.5	6	6	11
14.5 < r ? 14.75	5	2	2
14.75 < r ? 15	4	3	5
15 < r ?16	7	7	5
Total	22	18	23

Source: Calculated on the basis of the Bangladesh Bank Data.
Note: * r denotes the rate of interest.

Import of Intermediate Products, Raw Materials and Capital Machineries

Import of various types of intermediate products and raw materials posted higher level of growth in FY2007-08 compared to FY2006-07 (Figure 1.36). Although import of cotton, yarn and staple fibres registered growth rates higher than 10 per cent (with a range of 12.7 per cent to 40.3 per cent) in the last fiscal, import of textiles and articles recorded negative growth over the same period (-0.6 per cent). More importantly, import growth of these items except cotton was lower than the previous year. Import of dyeing and tanning materials substantially increased in the last year. However, import of capital machineries registered a negative growth in FY2007-08 (-14 per cent). Analysis of different types of capital machineries in terms of fresh opening and settlement of letter of credits (L/Cs) indicates that although fresh opening of L/Cs for import of textile machinery was 27 per cent higher compared to the previous year, settlement of L/Cs for import of such machineries was 17 per cent lower for the corresponding period (Table 1.11). The comparable figures for other industries were both ways: garment industry (16.9 per cent and 1.8 per cent), leather industry (-11.2 per cent and 40.9 per cent) and pharmaceuticals (19.5 per cent and -19.4 per cent). A positive change in import of raw materials and intermediate products for most of the industries, on the one hand, and a negative growth of import of capital machineries (both opening and settlement of L/Cs) on the other, indicate a mixed picture. Entrepreneurs were using working capital to run existing production lines and businesses; with regard to expansion and new investments, they tended to be

Table 1.11: Changes in Fresh Opening and Settlement of L/Cs for Capital Machineries

Industry	Fresh L/Cs Opening	Settlements of L/Cs
Capital machinery	15.9	-8.4
Textile machinery	27.2	-17.1
Leather / tannery	-11.2	40.9
Jute industry	16.6	-26.5
Garment industry	16.9	1.8
Pharmaceutical industry	19.5	-19.4
Plastic industry	-23.9	23.0
Packing industry	9.1	-7.2

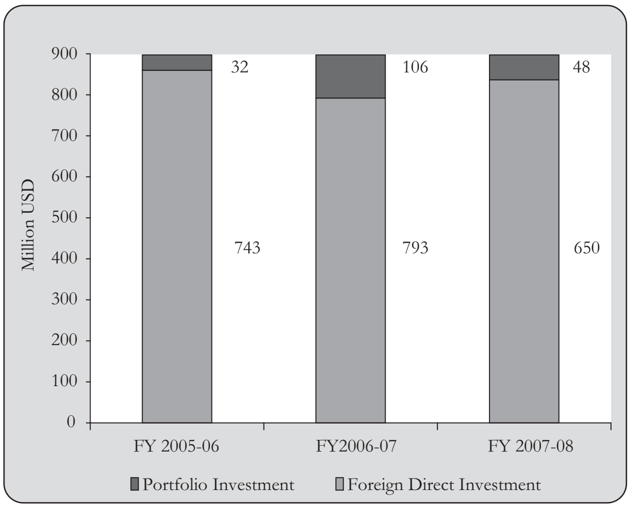
Source: Bangladesh Bank.

cautious perhaps in view of the various domestic and external risks and challenges.

FDI in Bangladesh

Inflow of FDI to Bangladesh has not been encouraging particularly in the backdrop of the high FDI flow to some of the other developing countries including Vietnam, Cambodia and India. FDI is yet to touch the USD 1 billion mark which was set for the year 2006. In FY2007-08 FDI flow to Bangladesh was USD 698 million, which was 22.4 per cent lower compared to the previous year (Figure 1.37). Both direct investment (-18 per cent) and portfolio investment (-55 per cent) registered negative growth in FY2007-08 *vis a vis* the previous year. It is reckoned that, in view of the ongoing global financial crisis and the consequent economic slow down, multinational companies would be more careful when considering investment in countries such as Bangladesh. It is to be noted in this context that according to United Nations Conference on Trade and Development (UNCTAD) World Investment Report 2008, Bangladesh's rank in terms of FDI performance index in 2007 has slipped down by 1 position from 120 to 121.

Figure 1.37: FDI and Portfolio Investment in Bangladesh



Source: CPD - IRBD database.

In fact, net FDI flow to the country (measured by subtracting outward transfers from inward FDI), indicates a gloomy picture (Table 1.12). Taking into account - the large amount of outward transfers of FDI related income in the form of profit, dividend, royalties, license fees (most importantly those that relate to power, oil and gas companies), it is found that net FDI flow in FY2007-08 was as low as USD 44 million since about USD 653 million was transferred abroad on account of the aforesaid forms of outflow during the said period. Transfer of FDI related income has increased by 13.6 per cent in FY2007-08 over the previous year. Net FDI flow in FY2006-07 was only USD 320 million. Reinvestment of foreign companies needs to be encouraged. Credit availability from local banks should also be made easier. Indeed, conducive business environment in the country is the key factor that FDI entities consider whilst making reinvestment decisions.

Table 1.12: Net Inflow of FDI

(in Million USD)

Items	2006-07 July-June	2007-08 July-June	% Change in FY08 over FY07
A. FDI Inflow	899.00	698.00	-22.36
B. Transfer of FDI related income	574.93	653.04	13.59
Royalties	5.56	7.89	41.91
Profit and dividends	165.42	173.33	4.78
Earnings of oil, gas & power	403.95	471.82	16.80
C. Net FDI inflow (A-B)	324.07	44.96	-86.13

Source: Bangladesh Bank.

Registration of new foreign investment has declined during January-December 2007 over 2006 - about USD 318 million worth of investment projects were registered in 2007, which was 78.7 per cent lower compared the previous year (Table 1.13). Investment proposals for manufacturing and textiles units were high in value (worth about USD 113 million and USD 169 million respectively), while in the other sectors particularly power and gas, the number of new investment proposals was small. Bangladesh Export Processing Zones Authority (BEPZA), on the

Table 1.13: FDI Registered at Board of Investment (BOI) in 2006 and 2007

(in Million USD)

Sector	2006	2007	% Change
Agriculture & food	8.6	3.1	-63.3
Manufacturing (other than textile)	62.7	113.8	81.5
Textile & wearing	128.9	169.1	31.2
Power, gas, petroleum	17.9	17.0	-5.1
Service	45.9	5.8	-87.3
Telecommunication	1116.1	0.3	-100.0
Transport, storage & comm.	115.6	8.7	-92.5
Total	1495.6	317.8	-78.7

Source: Board of Investment (BOI).

Table 1.14: Proposed Investment in EPZs *(in Million USD)*

Sector	FY2006-07	FY2007-08*
Textile	9	133
Terry towel	0	7
Metal products	0	10
Electronics & electrical goods	0.1	5
Garments	211	73
Plastic goods	12	41
Footwear & leather goods	7	68
Knitting & other textile dept.	43	14
Agro products	1	6
Garment accessories	21	110
Power	64	163
Chemical & fertiliser	0	14
Furniture	0	173
Sports goods	0	3
Service oriented industries	0	59
Tent	0	49
Miscellaneous	3	15
Total	370	943

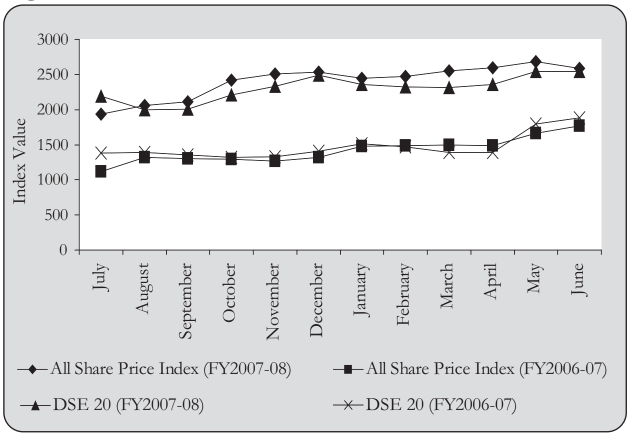
Source: Bangladesh Export Processing Zones Authority (BEPZA).
Note: * Up to 21 May 2008.

other hand, has received substantially large number of investment proposals (USD 943 million) during July 2007 - May 2008 compared to that in FY2006-07 (Table 1.14). This was mainly because of new investment opportunities created in the two recently opened export processing zones (EPZs) - Karnaphuli and Adamjee EPZs. Major investment proposals were for furniture (USD 173 million), power generation (USD 163 million), and garment accessories (USD 110 million). If realised, investment proposed for such industries as terry towel, metal products, chemical, sports goods, tent, and services would contribute to the diversification of production and export base of the manufacturing sector of the country. However, there is a long way between proposing something and getting those off the ground. A renewed effort will be required to ensure that the memorandum of understandings (MoUs) turn into real investments.

Capital Market

Buoyancy in the capital market was visible from the beginning of the early months of FY2007-08 sustaining over the subsequent months, despite the sluggish trends both in industrial growth and long-term investments. All share price index, general index and top 20 index in the Dhaka Stock Exchange (DSE) have registered a significant rise in FY2007-08 compared to that in FY2006-07 (Figure 1.38). Movement of the various share prices in the DSE

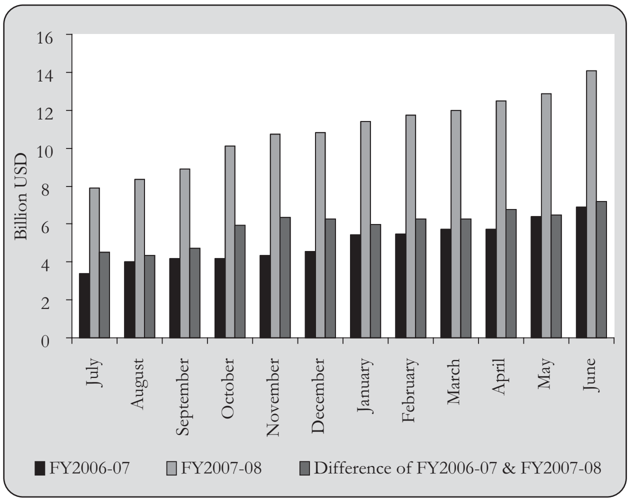
Figure 1.38: Trend of Share Price Index of DSE



Source: Monthely Reviews, DSE, various issues.

(also in Chittagong Stock Exchange (CSE)) reveals that prices of all types of shares have increased including 'Z' category shares in FY2007-08. Indeed prices of blue chips have increased at relatively slower pace compared to all share price index and the general index (which includes 'Z' category shares). It appears that a large number of small investors are possibly unaware of, or do not appreciate appropriately, the state of current performance and future plans of enlisted companies. Many of these investors are currently buying shares at high prices in anticipation of further rise in prices. Consequently their exposure to risks could be high. Adequate monitoring of the performance of the country's stock markets by the Securities and Exchange Commission (SEC) will be required to avoid any possibility of repetition of the 1996 boom and bust.

Figure 1.39: Market Capitalisation of DSE



Source: Monthely Reviews, DSE, various issues.

In July 2007, market capitalisation of DSE was USD 7.9 billion, which surged in the following months and reached USD 14.1 billion in June 2008; the corresponding figures for FY2006-07 were USD 3.4 billion and USD 6.9 billion respectively (Figure 1.39).

Table 1.15: IPOs Floated in the DSE during 2007 and 2008

IPOs	FY2006-07	FY2007-08	% Change of FY08 and FY07
No. of IPOs	10	12	20.00
Total issued shares (after IPO)	143310876	76127314	-46.88
Sponsors portion (share)	90153081	45245264	-49.81
Public offer (share)	53157795	30882050	-41.90
Public offer as percentage of total issued shares (after IPO)	37.09	40.57	9.36
Total paid up capital (after IPO) (in crore Tk.)	651.54	749.68	15.06
Over subscription as % of total public offer	734.30	378.44	-48.46

Source: Calculated based on information collected from the DSE website.

Growth of market capitalisation of DSE by more than 100 per cent in the span of a single year does indicate bullish trend in the market. Similarly, market capitalisation of CSE was USD 11.35 billion in June, 2008, which was 74.6 per cent higher compared to that in July 2007. Small investors took interest to invest in the capital market possibly because of incentive in the form of capital gains tax waiver on investment. One will need to closely monitor how the capital market makes necessary adjustments in the coming months in view of the relatively slow pace of growth of the industrial sector. It is important to note that during FY2007-08 USD 48 million worth of portfolio investment had entered into the capital market of Bangladesh, which was 54.7 per cent lower compared to the corresponding period of the previous year.

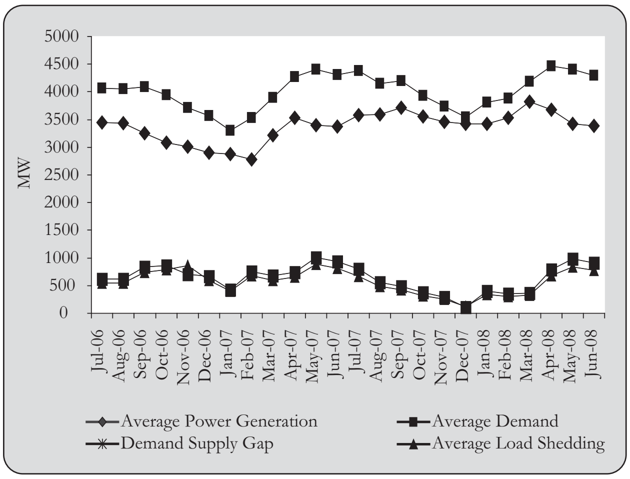
New Initial Public Offerings (IPOs) in the capital market in FY2007-08 was only 12; the number of IPOs in the previous year was also lower (10) (Table 1.15). All new IPOs in FY2007-08 were related to financial sector including banks, insurance and mutual funds. The amount of over subscriptions (though reduced by 48 per cent in FY2007-08) does indicate that a large number of investors are ready to invest in country's capital markets if more good IPOs are floated in the market. The government has given tax incentive to companies (to the tune of 10 per cent of company tax) to encourage them to participate in the share market. Government's initiative to attract large companies to the capital market including the telecom companies is yet to produce results (the Grameenphone is expected to off-load 9.4 per cent of its share in the coming months). Off-loading the shares of a number of public limited companies (PLCs) including those of Meghna Petroleum and Jamuna Oil were completed in FY2007-08; however, off-loading shares of other public sector companies under the power and telecommunication sectors is yet to take place. Off-loading of shares of large companies in the capital market is likely to attract more local and foreign portfolio investment in the country.

1.6.3 Power Sector

Generation and Distribution

Inadequate power supply has been a major bottleneck which has severely constrained investment and business activities in Bangladesh. New investments in trade and industries are discouraged because of absence of reliable and adequate power supply; even the existing ones suffer from frequent outages, leading to damage of equipments, production disruption and the cost escalation originating from more costly alternative sources. Demand for power in the country ranged between 3,500 mega watt (MW) - 3,900 MW during the winter season and between 4,000 MW - 4,500 MW during the summer season. However, current level of power generation is unable to meet the requirements. Power generation in FY2007-08 was 23,406 mkwh, which was 7.3 per cent higher

Figure 1.40: Power Demand, Generation and Load Shedding of Electricity

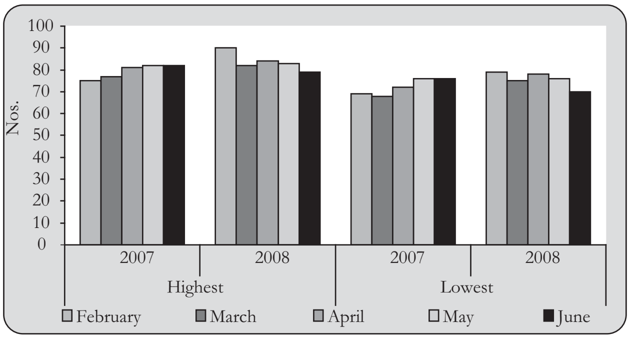


Source: BPDB.

compared to the previous year. Owing to high demand for electricity, this additional power generation is considered to be inadequate. The gap between demand and generation of power was as high as 980 MW in April 2008 (Figure 1.40).

Protracted load shedding has come to be a regular feature in Bangladesh. In FY2007-08, the highest level of load shedding was in May 2008 (839 MW), while the lowest level of was in December 2007 (116 MW). According to Bangladesh Power Development Board (BPDB) major reasons for the generation shortfall are repair and maintenance works of plants and forced stoppage, and very recently shortage of gas (Figure 1.41). Power generation was hampered in recent

Figure 1.41: Highest and Lowest Number of Power Plants in Operation during FY2006-07 and FY2007-08 (February-June)



Source: Power Division.

months due to shortages of gas to the tune of 939 MW in February 2008, 728 MW in March 2008, 720 MW in April 2008 and 780 MW in June 2008. Because of frequent power outages, industries and businesses are becoming increasingly dependent on captive power in order to ensure uninterrupted power supply to factories and business premises. This has escalated their costs and undermined their competitiveness.

There is no alternative to generating electricity through new power plants in order to meet the increasing demand for electricity. During FY2007-08 four new power plants with a capacity of 231 MW were established under the rental power plants (RPPs) contract (Table 1.16). All these are small scale power plants with a capacity in the range of 24-105 MW; two of these plants are gas operated, while other two are oil operated and combined cycle. However, most of these plants operated below their installed capacity.

According to BPDB, a total of 30 power plants are to be set up in the country by 2012, of which 17 power

Table 1.16: New Power Plants Operated in FY2007-08

Power Plant	Date of Power Generation	Fuel Type	Capacity (MW)	Available Generated Electricity (MW)
Khulna RPP	6 June 2008	Oil	50	40
Sylhet RPP	23 June 2008	Gas	52	45
Bogra RPP	16 June 2008	Gas	24	24
Fenchuganj	FY2007-08	Combined	105	75
Total Amount (MW)			231	184

Source: Power Grid Company of Bangladesh (PGCB), BPDB.

plants are now under construction phase which are expected to be commissioned by 2009, and another 13 power plants are under processing which are planned to be commissioned by 2010 to 2012. If all these power plants are constructed in time, a maximum of 4,445 MW additional power supply could be added to the national grid. A total of 12 power plants with a production capacity of 694 MW is planned to be built during 2008. However, only one has been set up as of now and others are still under construction. Out of this, 11 power plants will be constructed on rental terms for 3 years to 15 years. Since the majority of these constructed or proposed power plants are gas-based, supply of the required gas to the power plants will be a critical factor. According to an estimate of generation of electricity in a large scale combined cycle power plant, a total of 0.16-0.19 mmscf gas is required for generation of 1 MW of electricity. Taking this into account, an amount of 711.2-844.55 million standard cubic feet (mmscf) gas will be required for generating 4,445 MW of electricity. It will be a challenge for Petrobangla to make available the required quantity of gas to the power plants from its limited reserves, over a prolonged period of time, unless exploration to find new sources of gas is carried out in all earnest and new gas fields are discovered.

To take pressure off gas resources (almost 87 per cent of the total electricity production now depends on gas), alternative inputs for electricity generation such as coal will need to be made use of. About 3,300 million tonnes of country's coal reserves could generate more than 80 trillion cubic feet (TCF) equivalent of energy. A priority for the new government, therefore, will be to come up with a "National Coal Policy," which addresses both investment and environmental concerns and ensures required investment in the sector.

Gas Production

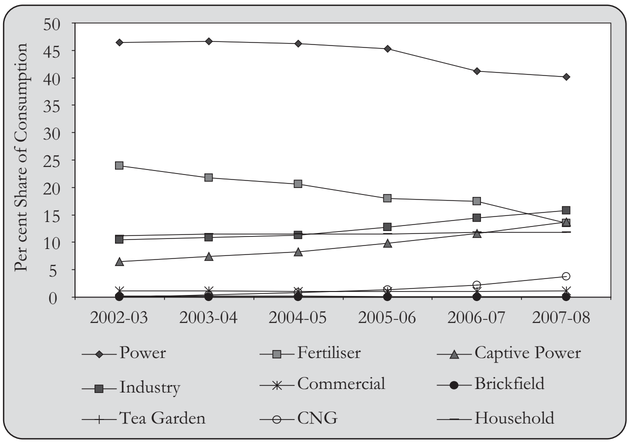
As is known, Bangladesh's gas reserves are estimated to be lower than what was earlier projected. According to some estimates, proven reserves of natural gas are about 8.3 TCF and probable reserves are another 5.5 TCF. Gas generation has increased at a rate of 6 to 8 per cent per year in the recent past. In FY2007-08 as well, 6.9 per cent growth was achieved with a total production of 17,015 million cubic feet (mmcf) (Table 1.17). However, this was 94.4 per cent of the target set for FY2007-08 (18,025 mmcf). Though more than 50 per cent of gas currently generated in the country is being used for power generation and fertiliser production, its use for other purposes has been on the increase over time, including for industrial and commercial use and for conversion into compressed natural gas (CNG) (Figure 1.42). However, due to shortage of gas, government has delimited/controlled the supply of gas to various economic activities, especially in industrial units, particularly yarn and textile manufacturing units during the evening hours. As is known, gas supply to industrial units in Chittagong has been rationed in recent times. Appropriate initiatives will have to be taken to put in place additional power for meeting the increasing demand of consumers and entrepreneurs.

Table 1.17: Gas Production in Different Years *(mmcf)*

Financial Year	Petrobangla	International Oil Company (IOC)	Total	Growth Rate (%)
FY2002-03	9449.1	2476.7	11925.9	
FY2003-04	9715.1	3106.0	12821.1	7.5
FY2004-05	10086.5	3696.9	13783.4	7.5
FY2005-06	10116.6	4804.3	14920.8	8.3
FY2006-07	10148.5	5771.7	15920.1	6.7
FY2007-08	9282.0	7732.5	17014.5	6.9

Source: Management Information System (MIS) Report, Petrobangla.

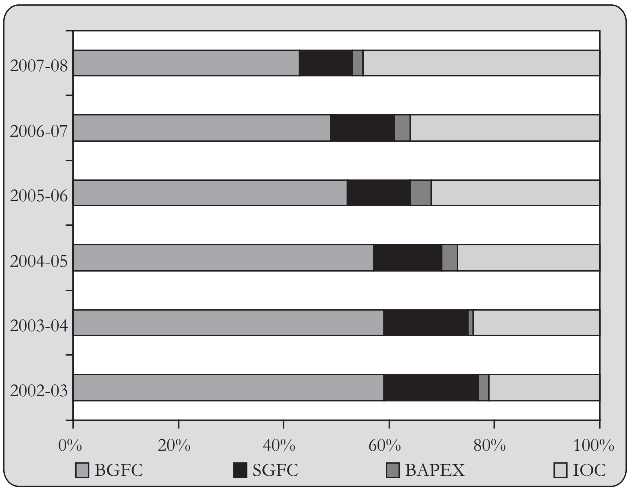
Figure 1.42: Consumption of Gas in Different Sectors



Source: Management Information System (MIS) Report, Petrobangla.

The share of private companies in overall gas distribution has been increasing over time. Over the last 5 years, this share has doubled from 21 per cent in FY2002-03 to 45 per cent in FY2007-08 (Figure 1.43).

Figure 1.43: Gas Production by Public and Private Companies



Source: Management Information System (MIS) Report, Petrobangla.

Petrobangla's share of production of gas was 64 per cent in FY2006-07 which came down to 55 per cent in FY2007-08. To consolidate domestic presence in the energy sector and ensure command over potential benefits, further strengthening of Bangladesh Petroleum Exploration & Production Company (BAPEX) has assumed critical importance from Bangladesh's long-term growth perspective.

According to energy experts, current gas reserves, estimated to be about 8.0 TCF, will not be able to meet the demand of the country beyond 2015; about 24 TCF gas will be required to meet the energy demand up to 2025, with an estimated investment requirement of USD 8 billion in the energy sector. As is known, Petrobangla floated international tender on 15 February 2008 to lease out 28 offshore gas blocks, divided into two categories-shallow blocks and deep water blocks. As reported in the newspaper, a United Kingdom (UK)-based consulting firm has recently mentioned that 12 out of 28 gas blocks offered under the latest offshore bidding round have been wholly or partly licensed by neighbouring countries. One shallow water block and eleven deepwater blocks have been wholly or partly licensed by India and Myanmar. It is reported that of the 12 blocks, India has already licensed five of the offshore gas blocks, while Myanmar has licensed seven blocks in the prospective Bay of Bengal zone. Taking into cognisance the possible disputes with Myanmar and India, the President has recently formed a Committee to discuss these issues with neighbouring countries. A coordinated and strengthened effort is needed in this regard, along with resolving territorial issues with Myanmar and India over offshore gas blocks. This issue ought to be given priority by Bangladesh's policymakers in view of the critical importance of gas for energy security, prospects of FDI inflow, need to meet domestic consumption and overall economic development of the country in near and medium-term future.

Petroleum Subsidy

Government has been providing substantial amount of subsidy to the Bangladesh Petroleum Corporation (BPC), over a long period of time, because administered prices of various types of fuels were kept at consistently lower levels compared to global prices. In April 2007, prices of petroleum products were increased from Tk. 33.00 to Tk. 40.00 for per litre of kerosene and diesel, from Tk. 56.00 to Tk. 65.00 for per litre of petroleum, and from Tk. 58.00 to Tk. 67.00 for per litre of octane, to adjust to the rising global prices. In the budget FY2007-08, the government had taken the liabilities of BPC worth Tk. 7,523 crore which was financed through issuance of Bonds. It was expected that this support will help bring BPC out of red and it would be able to start working with a clean slate.

International price of crude and refined petroleum products increased quite considerably since the last adjustment of prices. Between June 2007 (budget announcement) and June 2008, price of crude oil had doubled from USD 65.37 per barrel to USD 131.47 per barrel (according to Commodity Price Data, World Bank). As mentioned earlier, this sky-rocketing price of fuel also had an adverse impact on the subsidy for fuel. During the last week of May 2008, cost of refined products was as follows: diesel and kerosene: Tk. 97.40 per litre, octane: Tk. 80.35 per litre, jet fuel: Tk. 97.57 per litre (according to report published in the Prothom-Alo). On the other hand, per litre administered price of diesel and kerosene was Tk. 40.00, octane Tk. 67.00, and jet fuel Tk. 72.00. Thus, subsidy provided to per litre of diesel and kerosene was Tk. 57.40, octane Tk. 13.35 and for jet fuel this was Tk. 25.57. Consequently the burden on the government in the form of subsidy was quite high.

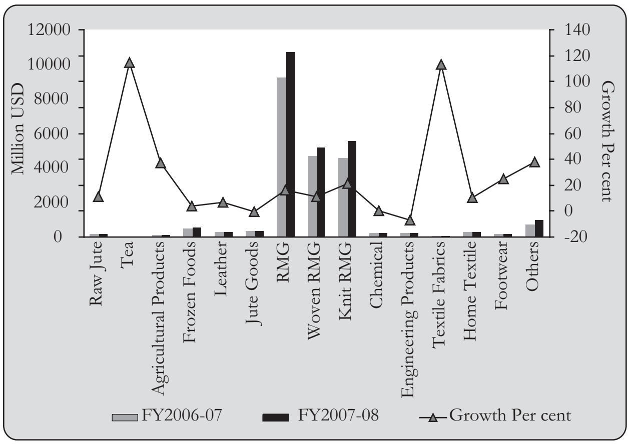
1.7 EXTERNAL SECTOR

1.7.1 Export Sector Performance

Robust performance that was demonstrated by Bangladesh's export sector over the recent past has continued in FY2007-08, despite suffering from two consecutive floods and the cyclone Sidr in the first half of FY2007-08. Bangladesh's total export earnings during FY2007-08 stood at USD 14,088.27 million, registering a double-digit growth of 15.9 per cent over FY2007-08. The sector was able to recover from the debacle suffered in the first quarter of FY2007-08 (July-September 2007) when export earnings registered a negative growth of (-)5.4 per cent. The growth rate posted in FY2007-08 is all the more impressive since it comes in the backdrop of the high growth rates of 24.7 per cent and 15.6 per cent attained in FY2005-06 and FY2006-07. Although exports fell just short of the target of USD 14.5 billion set in the beginning of the fiscal, this record stands out given the challenges Bangladesh faced in FY2007-08.

As Figure 1.44 shows, Bangladesh's foremost export

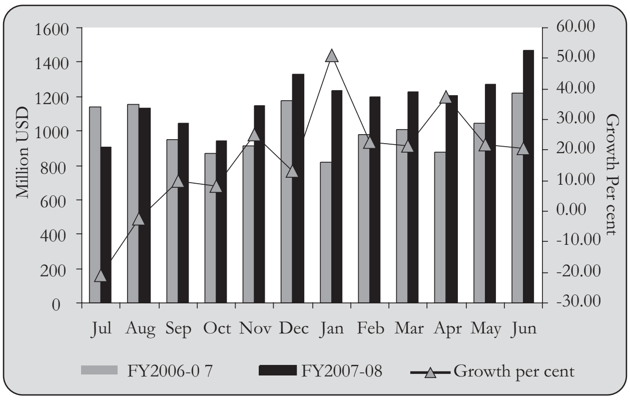
Figure 1.44: Export of Major Commodities: FY2006-07 and FY2007-08



Source: CPD-Trade database, 2008.

item, RMG, posted a high growth of 16.2 per cent during FY2007-08. Bangladesh earned USD 10.7 billion from export of apparels in FY2007-08, compared to the USD 9.21 billion earned in FY2007-08. This was 76 per cent of Bangladesh's total export earnings. It is of interest to note that, Bangladesh's export earnings from the RMG sector crossed the USD 10 billion threshold for the first time ever in this fiscal. During the period under review (FY2007-08), an additional amount of USD 1.49 billion was earned by the sector compared to FY2006-07, major share in this originating from the increasing export of knit-RMG (amounting to USD 978.20 million or 65.7 per cent). A decomposition of the RMG export indicates robust growth rates for both woven-RMG (11.0 per cent) and knit-RMG (21.5 per cent). Thanks to the consistently high growth rates of knitwear in recent years, share of this sub-sector in the total RMG export now exceeds that of the woven-wear. Since domestic value retention of knitwear (55-60 per cent) was substantially higher than woven wear (25-30 per cent when the fabric is imported, and about 60 per cent when the fabric is locally sourced), this structural shift within the RMG must be viewed as a remarkable achievement that has contributed to intra-RMG diversification. Indeed estimates of net export carried out by the CPD illustrates that during FY2007-08, value retention in knit-RMG was about USD 3,042.99 million compared to USD 1,744.05 million for the woven-RMG (or about 1.74 times more). RMG's performance needs to be seen as Bangladesh's ability to realise her competitive strength in the context of the quota-derestricted regime of the post Multi-fibre Arrangement (MFA) global market. The quota imposed on the Chinese export of apparels by both the USA (2003) and the EU (2005) had also worked in favour of Bangladesh in FY2007-08.

Figure 1.45: Monthly Trends in Export: FY2007 Vs. FY2008

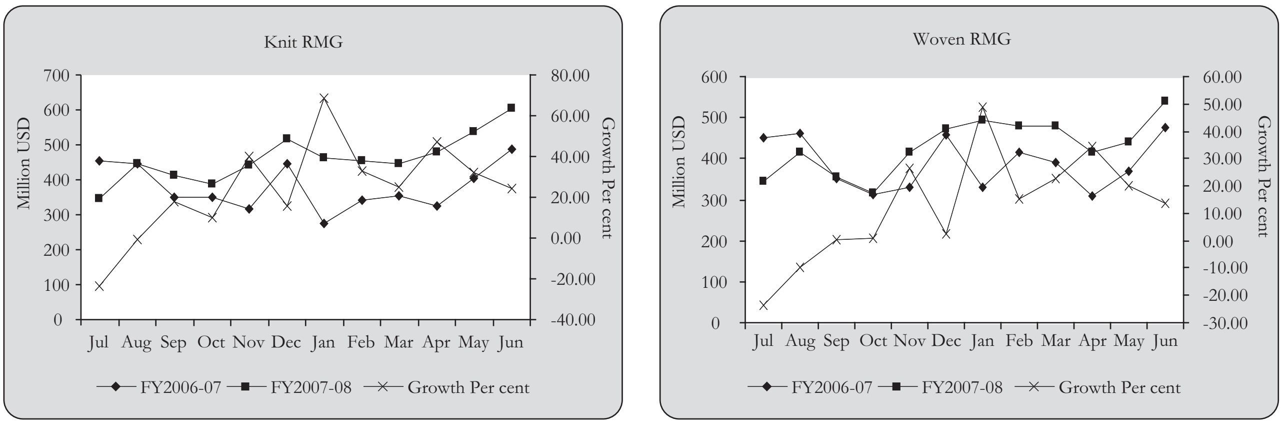


Source: CPD-Trade database, 2008.

Of the other major items of export, home textile (10.3 per cent), textile fabrics (113.5 per cent), footwear (24.7 per cent), frozen food (3.6 per cent) and leather (6.9 per cent) demonstrated high growth rates. On the other hand, earnings from Bangladesh's traditional export items such as jute goods failed to register an upturn and posted negative growth (-0.8 per cent) during FY2007-08.

Month-by-month export earnings during FY2007-08 exceeded that of the corresponding period of FY2006-07 for all months except July and August 2007 (which is evident from Figure 1.45). There was some cause for concerns when export dipped during these two months, posting negative growth rates of (-)21.1 per cent and (-)2.3 per cent respectively (in large measure caused by domestic political uncertainties following take over by the CTG in January 2007 and labour unrest during May, which resulted in low export orders from major buyers). Export earnings, however, started to rise in the subsequent months and maintained the momentum till the end of FY2007-08 helping to achieve the aforesaid robust growth of 15.9 per cent. Indeed, the fall in exports in

Figure 1.46: Monthly Trends in RMG Export: FY2007 Vs. FY2008



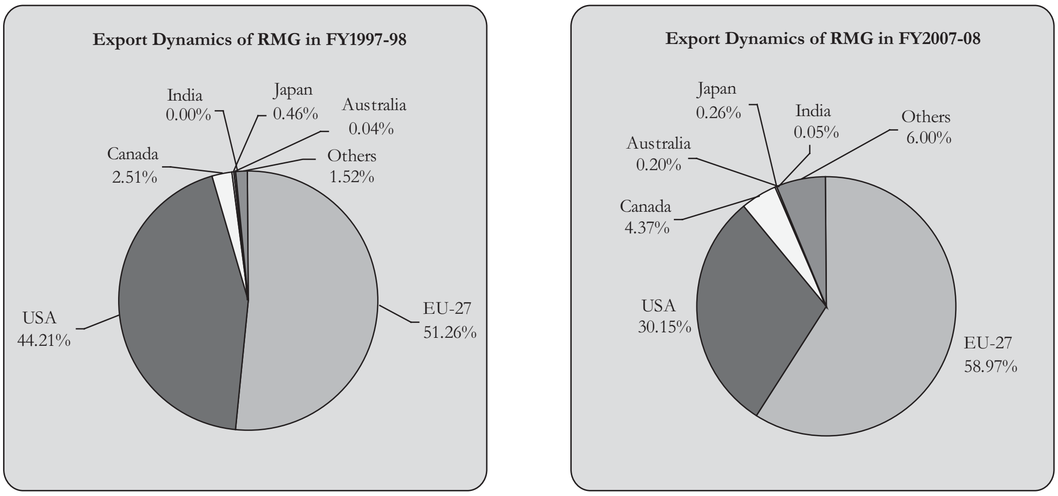
Source: CPD-Trade database, 2008.

July and August 2007 reflected falling export earnings for both knit and woven wear which declined by (-)23.6 per cent and (-)9.7 per cent for woven wear, and (-)23.5 per cent and (-)0.4 per cent for knitwear respectively. During the following ten months, export of both knitwear and woven wear had gradually picked up, which resulted in high growth rates for the overall RMG exports in FY2007-08 (Figure 1.46).

In terms of markets for Bangladesh's export, there was no visible deviation in FY2007-08 from the traditional destinations. The EU-27 and the US continued to be the major earning sources for Bangladesh, contributing around 77.3 per cent of total export earnings in FY2007-08, followed by Canada and India, whose contribution to the export basket is way behind the leaders. The EU-27's contribution to the export basket amounted to USD 7.31 billion - exports to the EU rose by nearly 14.3 per cent, (which meant an additional earning of USD 917.20 million); to compare, the performance of the US market was rather discouraging, with exports increasing by about 4.4 per cent (to USD 3,590.56 million), perhaps because of depressed demand following the recent economic downturn. A steady BDT-USD exchange rate could also have contributed to this. During FY2007-08, Bangladesh was able to register an increase in export of only USD 149.54 million to the USA. The lion's share of export earnings came from exports of apparels from the EU and USA. Over the years EU has consolidated its share in the export basket of Bangladesh; the reverse is the case for US market. Figure 1.47 clearly illustrates this structural shift. While in FY1997-98, the EU-27's contribution to Bangladesh's total apparels export was 51.3 per cent, in FY2007-08 it has increased to about 59 per cent. To compare, the market share in the US was around 44.2 per cent in FY1997-98, which had decreased considerably over the last 10 years with the market share currently standing at about 30.2 per cent. Apparels export growth to the US had been, about 9.3 per cent on an annual basis, over this last decade. However, this pace of growth lags way behind that of the EU-27 for which the average apparels growth has been close to 23 per cent (10-year average).

Over the last decade, Bangladesh has also been able to increase her apparels market share in Canada (from 2.5 per cent to 4.4 per cent, thanks mainly to the least developed country (LDC)-friendly rules of origin (RoO) of 25 per cent domestic value addition), Australia (from 0.04 per cent to 0.3 per cent) and India (from 0 per cent to 0.1 per cent). However, there is a growing concern for Bangladesh in terms of expanding her apparels share to the US market in the near future in view of the US sanctions on China to be withdrawn in January 2009. Phase-out of quota on 21 categories of apparels from China (which together accounted for about 70 per cent of Bangladesh's total export to USA in 2006) is likely to put Bangladesh's export of apparels to US under more competitive pressure in 2009.

Figure 1.47: Structural Shift in Market Share in Export of Apparels



Source: CPD-Trade database, 2008.

It is a matter of interest to note that Bangladesh's export to India has been on the rise in recent years. In FY2002-03 export to India was USD 84.08 million which increased to USD 241.96 million in FY2005-06 and USD 289.42 million in FY2006-07. Export growth in FY2007-08 matched those of FY2006-07, registering a growth of 23.7 per cent (taking the tally to USD 358.08 million from USD 289.42 million between FY2006-07 and FY2007-08). It is important to identify the new products of export to India (ceramic, cement, melamine) and build on this. It is a good sign that the zero-duty offer by India for 8 million prices of garments export from Bangladesh (worth about USD 30-35 millions export) has now been operationalised. Bangladeshi exporters should make every effort to realise this offer on the ground. A comprehensive strategy is required to take advantage of the bringing forward of the time line for duty-free (DF) access under the South Asian Free Trade Area (SAFTA) and reduction of the negative list. Although intra-developing country trade is on the rise globally, Bangladesh is yet to take advantage of the expanding demand for imports developing and emerging markets.

Table 1.19: Falling Purchasing Power of Exports

Selected Import Items	Dozens of RMG		Rise (in Times)	Tonnes of Jute Goods		Rise (in Times)
	2006	2008		2006	2008	
1 barrel of oil (fuel)	2.34	4.72	2.0	0.11	0.23	2.1
1 ton of rice	10.97	34.59	3.2	0.52	1.70	3.3
1 ton of wheat	6.23	17.25	2.8	0.30	0.85	2.9
1 MT soybean oil	21.19	48.46	2.3	1.00	2.38	2.4
1 MT whole milk powder	77.87	154.68	2.0	3.69	7.61	2.1

Source: CPD-Trade database, 2008.

Product and market diversification along with the increase of local value addition, continue to remain major obstacles facing Bangladesh's export sector in its quest for higher growth. Export growth, whilst impressive, have continued to be driven in large measure in terms of volume growth rather than rise in prices. A decomposition of the growth dynamics of Bangladesh's exports reveals the rise in export (15.1 per cent) was, to a large extent, accounted for by the rise in volume (14.1 per cent); only an insignificant share was contributed by rise in average prices (1.8 per cent). This particular issue also needs to be considered in relation to the considerable deterioration of Bangladesh's terms of trade (ToT) experienced in recent years. As is evident from Table 1.18, if export prices of FY1999-00 are taken as the base year, ToT declines significantly to 88.0 by FY2007-08. A CPD analysis of export and import of selected items vividly illustrates the deteriorating ToT situation (Table 1.19). While in 2006, to import a barrel of crude petroleum Bangladesh had to export 2.34 dozens of RMG, in 2008 this has increased to 4.72 dozens. Similarly, to import one ton of rice, in 2006 Bangladesh had to export 0.52 tonnes of jute goods; in 2008, to import the same amount of rice Bangladesh had to export 1.70 tonnes of jute goods.

Table 1.18: Deteriorating Terms of Trade

(Base: FY1999-00= 100)

Financial Year	Export Price Index	Import Price Index	Terms of Trade
FY1999-00	100.00	100.00	100.00
FY2000-01	102.40	107.53	95.24
FY2001-02	104.82	115.61	90.67
FY2002-03	107.44	124.57	86.25
FY2003-04	115.07	129.62	88.78
FY2004-05	118.82	134.21	88.54
FY2005-06	121.18	139.50	86.88
FY2006-07	127.06	144.58	87.88
FY2007-08	131.53	149.55	87.96

Source: CPD estimates based on the Bangladesh Bank ToT.

Bangladesh's narrow export base is one of the reasons for the sector's vulnerability in the global market. There is a need for both intra-RMG and extra-RMG diversification. Special attention ought to be given to stimulate new non-traditional exports such as home textile, light engineering and ship-building. The prospects of ship-building industry call for special mention. Recently, Bangladesh has started to gain a foothold in this lucrative market with the first export having been made in May 2008. A number of Bangladeshi companies have received orders for small-size ship (of less than 10 thousand DWT). It is widely believed that Bangladesh has the maritime tradition and skilled manpower and entrepreneurial expertise to emerge as a major player in the global market for smaller vessels. To realise the potentials, the sector will need support in such areas as (a) bonded warehouse facilities, (b) availability of bank guarantee, (c) duty rebate for import of capital machineries, (d) special zoning policy to facilitate setting up of shipyards. The global market for ships of various sizes is worth USD 800 billion; if Bangladesh is able to capture a mere 1 per cent share, this could amount to an export of about USD 8 billion!

The ongoing negotiations in the WTO also pose formidable challenges for Bangladesh. In recent months, Bangladesh has been lobbying the US for an LDC-friendly design of the duty-free quota-free (DF-QF) (97 per cent) list. Besides, the New Partnership for Development Act of 2007 (NPDA 2007), which has been tabled in the US Congress, is also being debated at present. These issues ought to get priority attention of policymakers. In view of ongoing WTO negotiations on sanitary and phytosanitary (SPS), technical barriers to trade (TBT), environmental issues, Bangladesh (and also other LDCs) is likely to be confronted with new challenges in terms of complying with the various standards. Agricultural exports (SPS-TBT), knitwear (affluent facilities) and other sectors will need to considerably strengthen their compliance strength in view of the likely stringent demands stemming from the current round of trade negotiations. Bangladesh's export policies and incentive structure will need to be geared towards addressing the attendant issues. Bangladesh will need to jointly fight with other LDCs for getting market access in Mode 4 under General Agreement on Trade in Services (GATS) negotiations, which is being discussed as part of the WTO's Doha Work Programme. It is also important that Bangladesh receives her due share under the proposed Aid for Trade initiative (AfT) of the WTO to strengthen her trade related supply side capacities. Appropriate proposals will need to be developed to claim Bangladesh's stake in the proposed funds. Bangladesh should make every effort to get a fair share of this financial support of the WTO. The envisaged change in the RoO for apparels under the Everything but Arms (EBA) and the phase-out of quota on Chinese apparels export in the USA should be kept in mind whilst designing policies to stimulate Bangladesh's export sector in the coming days.

Box 1.1: Export Diversification: Emergence of Ship-building as an Expression of Interest (EOI)

Bangladeshi ship-builders have been in the export business since the year 2000 when they started to build and export fishing vessels. Recently, in May 2008, Ananda Shipyard exported the first seagoing vessel from Bangladesh (HS8901.90.10, 2900 DWT to Denmark worth USD 6.2 million); it has also received orders for building another 19 ships worth about USD 209 million to be delivered by 2012. Two other private sector shipyards have also signed similar export contracts with a total contract value of about USD 137 million. These are indeed encouraging developments.

As is known, ships come in various shapes and sizes: tankers, bulk carriers and containers which make up by far the largest part of the fleet and a significant part of the output of the ship-building industry. Bangladesh's comparative advantage lies with the third type of ship, where the tonnage ranged between 2,000 to 10,000 DWT (cargo vessels for the transport of both people and goods). Current market for the global small ship-building industry is worth about USD 76 billion (HS Chapter 89; data analysed at the CPD on HS6 digit level based on the Trade Map dataset). The category of ships that Bangladesh is exporting (8901.90) is worth about USD 44.0 billion. Bangladesh has the potential to capture a significant share of the market and eventually become a major destination for companies seeking construction of small ocean going vessels. It is to be noted that traditional ship-building countries such as South Korea and China are now focusing on building large size ships. Even, relatively new ship-building countries such as Vietnam is becoming less interested to build small ships weighing up to 2,500 DWT. As a result, a new window of export opportunities is opening up for Bangladesh. Bangladesh has a strong maritime tradition with skilled manpower and a history of building small scale ocean and river going vessels. Indeed USD 3.57 million worth of ship related products including life boats, fishing boats, scraps, etc. was exported by Bangladesh to Netherlands, Maldives, India, etc. during July-March

(Box 1.1 contd.)

(Box 1.1 contd.)

of FY2007-08. Apart from the cargo vessel, Bangladesh could also gradually make inroads into export market for cruise ships, excursion boats, dredgers, floating or submersible drilling or production platforms, warships, lifeboats and hospital ships through sealing up (above 10,000 DWT).

With regard to the growth of supply and demand for container shipping, it is to be noted that for the first time in 2006 since 2001, the growth of fleet again outstripped the growth of containerised trade. For 2007, it was estimated that that world container carrying capacity grew at an annual rate of 13.4 per cent, which was 2.4 per cent higher than the estimated growth in demand. In September 2007, the order book of containerships stood at 6.2 million TEUs[1] representing 60 per cent of the existing fleet.

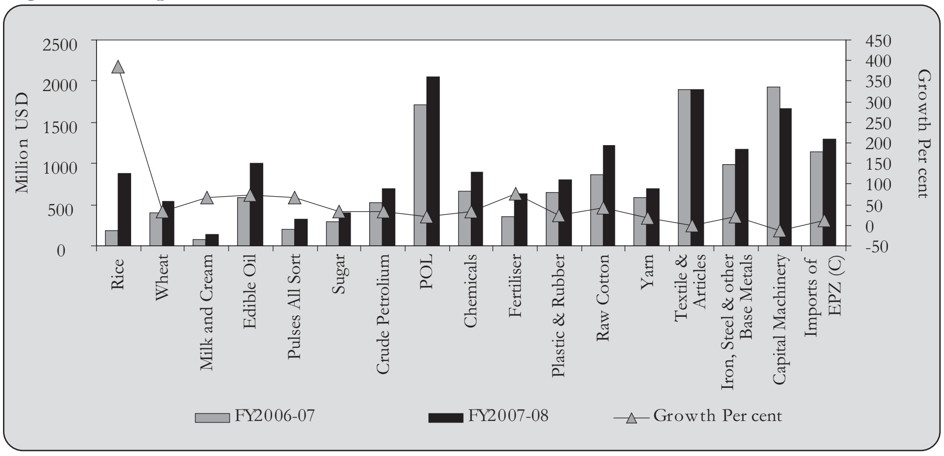
In view of the emerging opportunities, there is a need to provide strategic support to this industry, which has been declared as a thrust sector, through fiscal, banking and infrastructure development support.

[1]TEU refers to twenty-foot equivalent unit.

1.7.2 Key Features of the Import Sector

As evidence suggests, import growth has been quite high for the last few years. Total merchandise imports to Bangladesh during FY2007-08 amounted to USD 21.63 billion, registering a growth of 26.1 per cent compared to the corresponding period of FY2006-07. Imports to the EPZs also registered a positive growth of 13.1 per cent. Import share of petrolium, oil and lubricant (POL) was the highest, around 9.5 per cent of total import. The second highest import share (in value terms) was of textiles and related articles, accounting for about 8.8 per cent of total import. This was followed by capital machineries accounting for about a 7.7 per cent of total import. Imports of foodgrains posted a staggering growth of 142.6 per cent (6.5 per cent of total import), with rice registering a high increase of 4.9 times and wheat 1.3 times compared to FY2006-07. The huge rise in imports of foodgrains, particularly rice and wheat, as is well known by now, was necessary to address the shortfall caused by the two consecutive floods and cyclone Sidr in 2007.

Figure 1.48: Import of Some Selected Commodities

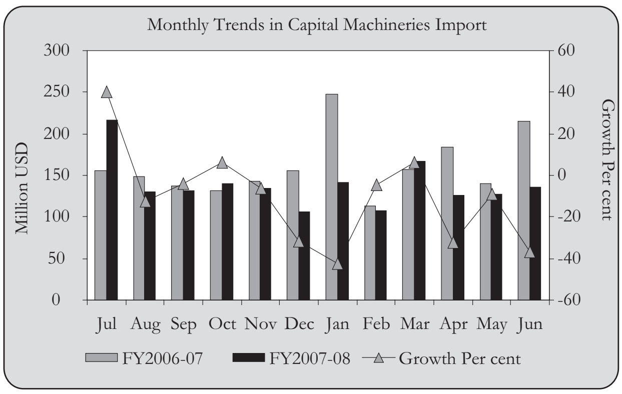


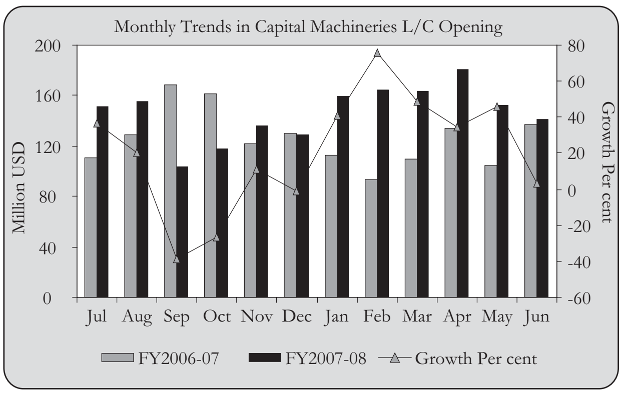
Source: CPD-Trade database, 2008.

Import growth was high to moderate for all major non-food items excluding capital machineries, which posted negative growth rate of (-)13.7 per cent. Import growth of textiles and articles were very low (at 0.01 per cent only)! Import growth of crude petroleum was high at 32.7 per cent, fuelled by the rise in global oil prices. By the end of June 2008, crude oil price/barrel has already hit USD 136. Import of POL also posted a positive growth of 20.4 per cent. The bill for this was to the tune of USD 2,058 million in FY2007-08. High import growth of intermediate inputs, such as raw cotton (41.1 per cent) and yarn (18.7 per cent) would indicate strengthened backward linkage activities; import of iron, steel and other base metals, also posted significant increase (19.7 per cent) (Figure 1.48).

As mentioned earlier, import of capital machineries fell by (-)13.7 per cent during FY2007-08 compared to FY2006-07. Except for the month of July, October and March (growth of 24.9 per cent, 6.1 per cent and 6.2 per cent respectively), in all the other months (compared on a monthly basis with FY2006-07), import of capital machineries maintained a declining trend. Interestingly, opening of L/C in case of capital machineries for FY2007-08 showed a positive trend of over 15.9 per cent, whereas settlement of L/C for capital machineries revealed a negative growth of (-)8.4 per cent when compared against FY2006-07 (Figure 1.49). The fact of declining import of capital

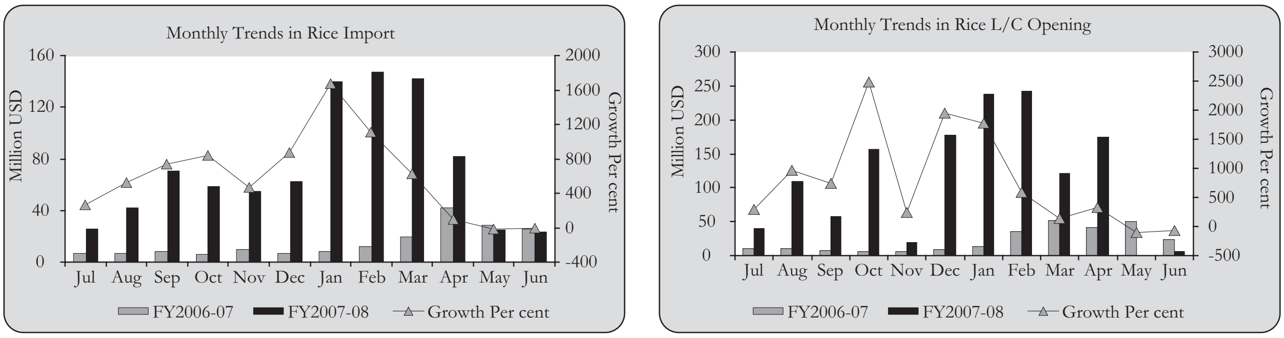
Figure 1.49: Monthly Trends in Capital Machineries Imports, in Value Terms





Source: CPD-Trade database, 2008.

Figure 1.50: Monthly Trends in Rice Imports, in Value Terms

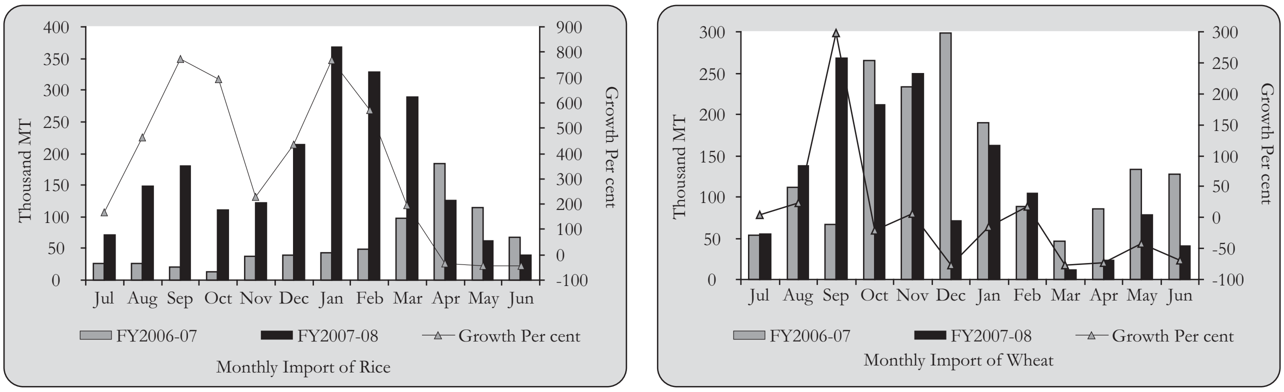


Source: CPD-Trade database, 2008.

machineries is disturbing since this was likely to have negative implications for investment. However, double-digit growth of L/C openings for capital machineries transmits positive signals as to future demand with likely positive impact on investment over the subsequent period.

In view of the crop losses caused by two successive floods and cyclone Sidr, high import of rice was expected to be a salient feature of FY2007-08. Import of rice rose from USD 179.90 million to USD 873.60 million, by 4.9 times in value terms. Import of rice in FY2007-08 picked up from the very beginning of the fiscal year and continued to be on the rise till April 2008 - not only in value terms, but also in volume terms. During FY2007-08 import of rice was 2,058.63 thousand metric tonnes, 185.7 per cent higher than the previous fiscal (Figure 1.51).

Figure 1.51: Monthly Trends in Rice and Wheat Imports, in Volume Terms



Source: Analysis from information collected from Food Directorate, Ministry of Food and Disaster Management.

Relatively higher growth rate in value terms indicate the effect of rising prices of rice in the international market. Whereas on average import price of rice was USD 320.06 per ton during FY2006-07, it stood at USD 541.30 per ton in FY2007-08 (an increase of 69.1 per cent in unit price). High global prices combined with export ban on rice by major rice producing countries (India, Thailand, Vietnam) contributed to this. Bangladesh imported rice at a cost of USD 342 per ton in July 2007 whereas she had to pay USD 934 per ton in June 2008, a rise of 2.7 times (172.8 per cent rise).

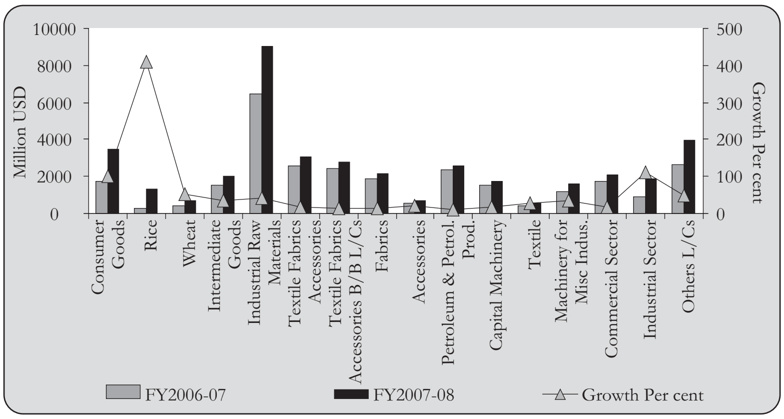
Thailand, world's largest rice exporter, was quoting export price of rice well beyond USD 1,000 per ton by June 2008. Vietnam, the world's second largest rice exporter, experienced a downturn in her domestic production which resulted in low availability of rice for export. The Chinese government, following the removal of VAT export rebate on rice (coupled with some other agricultural products in December 2007), introduced 5 per cent export duties on rice beginning from 2008. India initially imposed a ban on rice export; later on the government withdrew the restriction while increasing the MEP of rice to USD 400, USD 500, USD 650 and finally USD 1,000 per ton, at which point excepting the basmati variety export of all other types of rice was banned.

Increasing global population, higher demand in India and China, soaring demand for bio-fuels and animal feed, and unfavourable weather conditions are considered to be major reasons contributing to the rapid hike in global rice prices. It is reckoned that, use of corn for ethanol and bio-fuels became economically viable once fuel prices went beyond USD 80-90 per barrel. The tension between fuel and food, factory and farm is likely to be a feature in the future global scenario with major implications for net food importing countries such as Bangladesh.

1.7.3 L/C Opening and Settlement

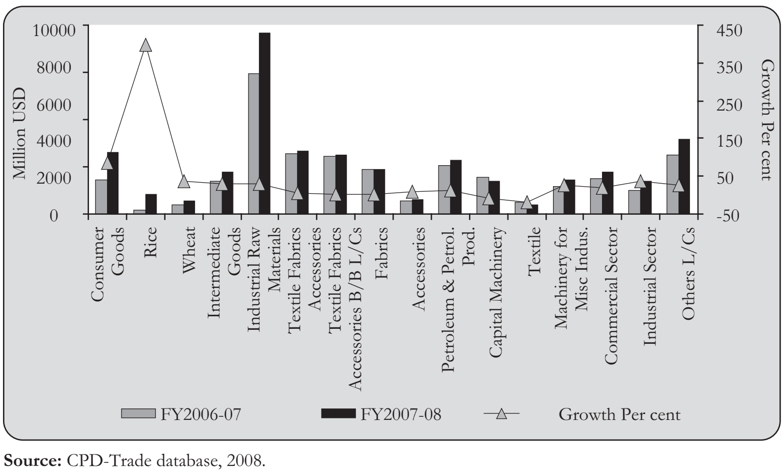
L/Cs opened during FY2007-08 were worth USD 24.43 billion, which was 40.0 per cent higher compared to L/Cs opened during FY2006-07. To compare, L/Cs settled in this period amounted to USD 20.37 billion which was 27.5 per cent higher than in FY2006-07. Indeed, as Figure 1.52 indicates, for FY2007-08, L/Cs opened for all major commodities registered high positive growth rates ranging from 8-50 per cent. For some items including capital machinery, there was a decline in terms of L/C settlement (-8.4 per cent). Settlement of L/Cs for textile also suffered a serious setback, registering a negative growth of (-)17.1 per cent (Figure 1.53).

Figure 1.52: Opening of L/C



Source: CPD-Trade database, 2008.

Figure 1.53: Settlement of L/C



Source: CPD-Trade database, 2008.

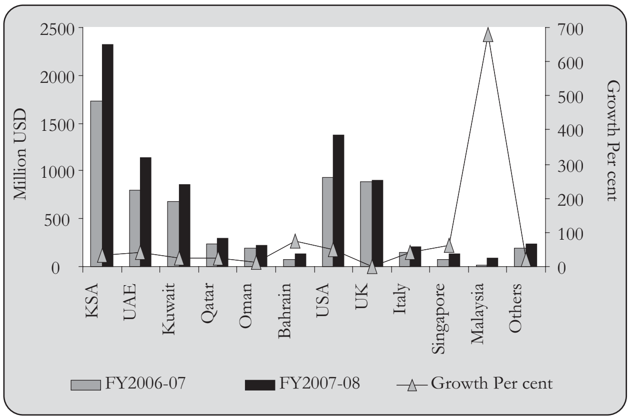
On the other hand, L/C opening for consumer goods has been exceptionally high (99.2 per cent), driven by import of cereals, particularly rice, and also wheat, soybean, vegetable oil etc. As Figure 1.50 bears out, following comparatively lower levels of L/Cs opened for rice in the months of May and June, the number of import L/Cs opened in other months demonstrated quite high growth (with overall FY2007-08 growth of 411.3 per cent). In case of wheat, the trend in L/C opening was somewhat inconsistent, with ups and down all through FY2007-08, overall growth in FY2007-08 was 51.7 per cent compared to FY2006-07.

1.7.4 Remittance Flow

In recent years, remittance flow to Bangladesh was able to record quite remarkable growth. From under two billion dollars in FY1999-2000 (USD 1.95 billion), remittance rose to USD 5.98 billion in FY2006-07. During FY2007-08, earnings from remittance was to the tune of USD 7.91 billion which was about USD 1.92 billion more than that of FY2006-07 (32.0 per cent growth). CPD estimates indicate that remittance earnings was equivalent to more than half of Bangladesh's gross export (56.2 per cent), and was equivalent to the figure of net export (101.0 per cent).

From Figure 1.54 it is seen that, Saudi Arabia (KSA) continued to rank as the major source for remittance, accounting for 29.4 per cent of all remittance flow in FY2007-08, recording a growth of 34.0 per cent compared to FY2006-07. Of the other major sources, growth rates of remittance from United Arab Emirates (UAE) (41.0 per cent), Kuwait (26.9 per cent) and USA (48.3 per cent) have been significantly high. Significant growth of remittance earnings has been observed from countries such as Malaysia. During FY2006-07 remittance earnings from Malaysia was only USD 11.84 million, which increased to USD 92.44 million, posting an

Figure 1.54: Country-wise Flow of Remittances



Source: CPD-Trade database, 2008.

impressive growth of 680.7 per cent as compared to the last fiscal. Though in terms of aggregate remittance earnings this value does not hold much significance considering the earnings from KSA, UAE, USA and Kuwait, it has important policy implications. Contracts signed in FY2006-07 with the UAE, Malaysia and South Korea has contributed importantly to the growth in remittances. Recent market opening in Oman also created a favourable environment for Bangladesh in terms of boosting her manpower export. In very recent times, some skilled Bangladeshi textile workers have been invited to work in Russia. In the course of 2007 some 832 thousand workers went abroad. By the end of 2007, a total of 5,390,854 Bangladeshis have gone overseas as migrant workers (from 1976 till 2007). Among them, the number of professional workers was 166,413 (3.1 per cent), skilled 1,614,762 (29.9 per cent), semi-skilled 859,054 (15.9 per cent) and unskilled 2,750,625 (51.0 per cent). In the first 10 months of 2008, a record 763 thousand workers have gone abroad. Although the skill composition of workers leaving for overseas employment has shown some positive change in the past years (favouring skilled labour as against unskilled and semi-skilled), percentage of skilled workers in the total migrant labour force of Bangladesh has, however, come down in the recent past. Bangladesh is expected to send around 900 thousand workers abroad in 2008. A total of more than 352 thousand workers have already received permission to go abroad (till May 20), which is 56 per cent more than the comparable period of last year.

Box 1.2: Exploring New Markets for Manpower Export

CPD study shows that in order to stabilise the size of the working population in the European Union (EU-15), an annual net gain of some 550,000 foreign workers and professionals would be necessary up to 2010 and a further 1.6 million per annum between 2010 and 2050, totaling a net inflow of 68 million people between 2003 and 2050. This is the likely scenario that would emerge because of ageing, low fertility rate and limited manpower. This will create new export opportunities for developing countries such as Bangladesh. CPD study further highlighted that the potential benefit from exporting 2 lakhs professionals from Bangladesh would be USD 11.57 billion, and an increase of 2 lakhs unskilled workers would bring an additional USD 3.5 billion to the county.

There is an urgent need to design a comprehensive policy with a view to make Bangladesh capable of taking advantage of the rising demand for workers in the global labour market. More effort needs to be taken to train up workers who plan to travel abroad for work related purposes. Bangladesh should also be well-prepared to take advantage of any possible market opportunities in Mode 4 in the WTO, particularly in health and caring services. Such opportunities could open up in the coming years either as a result of multilateral negotiations under WTO-GATS, or through bilateral initiatives of developed countries.

1.7.5 Balance of Payments (BOP)

Trade balance recorded a high deficit of USD 5,541 million in FY2007-08 compared to that of USD 3,458 million in FY2006-07. Services also posted a higher negative balance (-)USD 1,525 million in FY2007-08 against (-)USD 1,255 million in FY2006-07. Despite larger deficit in the trade balance, current account balance recorded a surplus of USD 672 million in FY2007-08 against the surplus of USD 936 million during FY2006-07, mainly thanks to a larger current transfer of USD 8,743 million (Table 1.20).

Overall trade balances of FY2007-08 indicate some deterioration, although robust remittance flows have eased the situation. Export earnings and import payments during FY2006-07 were USD 12,053 million and USD (-)15,511 million respectively. Although export earnings increased to USD 13,945 million, import payments have outstripped this totaling about USD (-)19,486 million in FY2007-08 (indeed trade balance deteriorated further in FY2007-08 and reached USD 5.54 billion). However, this large deficit in the trade balance was offset by the surplus in the current transfers (mainly private transfers in the form of worker's remittances which recorded an earning of USD 7,915 million). On the financial account side, BOP experienced a net deficit of USD 431 million in FY2007-08, against a surplus of USD 762 million during FY2006-07. The overall balance also showed a modest surplus of USD 604 million in FY2007-08 against a surplus of USD 1,493 million in FY2006-07, thanks to surplus in the capital and current accounts of USD 576 million and USD 672 million respectively. Overall, the current account balance fell from USD 936 million in FY2006-07 to USD 672 million in FY2007-08, whereas capital account balance increased from USD 490 million in FY2006-07 to USD 576 million in FY2007-08 (Table 1.20).

Table 1.20: Balance of Payment

(in Million USD)

Components	FY2006-07	FY2007-08
Trade balance	-3458	-5541
Services	-1255	-1525
Income	-905	-1005
Current transfers	6554	8743
Official transfers	97	127
Private transfers	6457	8616
of which : Workers' remittances	5979	7915
Current account balance	936	672
Capital account	490	576
Financial account	762	-431
Errors and omissions	-695	-213
Overall balance	1493	604
Reserve assets	-1493	-604

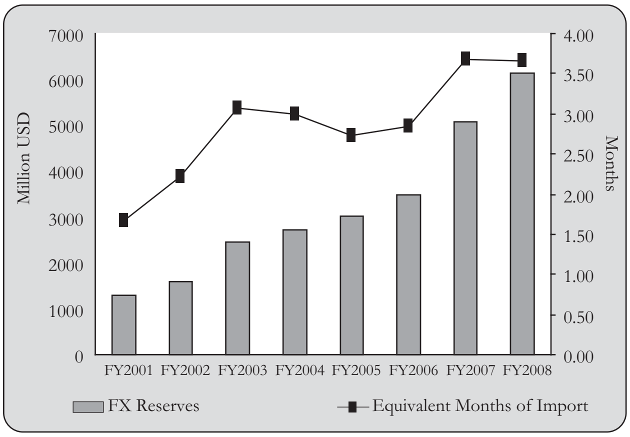
Source: CPD-Trade database, 2008.

As observed earlier, balance of current transfer responded positively to robust remittance flow, which increased by 32.4 per cent (from USD 5,979 million in FY2006-07 to USD 7,915 million FY2007-08), somewhat compensating for the negative trends in balances on account of trade and services. Although remittance is expected to continue with its high flow in the coming months, anticipated higher import payments combined with modest exports is likely to create further pressure on the BOP position in the near future

1.7.6 Foreign Exchange Reserves

In the backdrop of high export and remittance earnings, the foreign exchange (FX) reserves stood at USD 6,148.82 million at the end of June 2008 (following two Asian Clearing Union (ACU), payment of USD 462.3 million made in mid-November 2007 and USD 733.17 million on 6 March 2008). This was 21.11 per cent higher than the comparable figure of June 2007. The current FX reserve is equivalent to about 3.7 months of import payment (Figure 1.55). Whilst comfortable, given the pressure from the import side in the wake of the pick-up of the economy in recent months, the reserve position will need to be carefully monitored.

Figure 1.55: FX Reserves and Equivalent Months of Import



Source: CPD-Trade database, 2008.

Bangladesh has been pursuing floating exchange rate regime since May 2003. However, the Bangladesh Bank has in all practicality been implementing a managed float policy. In the early part of FY2007-08 Bangladesh Bank has intervened in the FX market directly to keep the BDT appreciated against the USD, by injecting (selling) about USD 500 million in the FX market. This was perhaps done to contain the negative implications of imported inflation on the economy. As is known, BDT has been quite steady against USD (at around 68.00 Tk./USD) in recent times. The Bangladesh Bank has also stopped intervening in the FX market in the past few months. The challenge for the Bangladesh Bank will be to ensure that the exchange rate of Taka against major currencies is kept at a level that provides incentive to exports but at the same time acts as a cushion against imported inflation. Whilst under a floating exchange regime the market should take care of the exchange rate, some type of market monitoring and selective intervention will be required on the part of the Bangladesh Bank given the volatility of the external sector observed in recent times. The other issue relates to the composition of Bangladesh's reserves. Given the depreciation of USD against all foreign currencies, particularly Euro, and given that a large part of Bangladesh's import is from Euro-denominated area, it appears that keeping a higher share of reserves in Euro could serve Bangladesh's interest better. It is interesting to note the rise of Euro as a hard-currency for foreign exchange reserves - from 2000 to 2006, the share of USD official holdings of FX worldwide declined from 71 per cent to nearly 65 per cent, while during the same period, the share of Euro official holding of FX increased from 18 per cent to almost 26 per cent. The Deutsche Bank Research Group predicts that the Euro share of global FX reserves will rise to 30- 40 per cent by 2010. In recent years, both Russia and China have opted for basket of currencies rather than pegging those to USD. In view of the increasing worldwide rapid use of Euro as an anchor currency, the Bangladesh Bank may need to rethink about currency composition of its FX reserves, which is to a large extent, USD denominated (although a significant part is also kept in Euro and Pound Sterling). Possible routes to hedge against further depreciation of USD need to be given careful examination.

1.7.7 Foreign Aid

Flow of foreign aid during FY2007-08 increased significantly compared to the inflow during the corresponding period of FY2006-07. Total aid disbursements during FY2007-08 were higher at USD 1,956.70 million, compared to USD 1,624.62 million during FY2006-07. Net receipts of foreign aid in FY2007-08 also stood markedly higher at USD 1,376.54 million, against USD 1,099.52 million in FY2006-07; with payment (principle) also registering a modest growth (10.5 per cent growth). USD 83.31 million arrived as food aid (provided by the United Nations World Food Programme (WFP)) in FY2007-08 following two consecutive floods in September and the cyclone-Sidr in December 2007, against USD 59.89 million of food aid in FY2006-07.

Apart from the food aid disbursed for the cyclone-Sidr, a sum of USD 634.00 million was also committed in view of the natural disasters. A large part of this aid commitment intended for the cyclone Sidr was made by the World Bank (USD 325 million) of which USD 100 million has already been disbursed (in January 2008) as a budgetary support under the World Bank DSC IV-Supplemental Financing II. It is to be noted that, the government has chalked out a 15-year long plan designed by the joint Damage Loss and Needs Assessment mission, made up of 11 donors including the World Bank. These donors have pledged to release USD 1.5 billion in 2008-12, another USD 1.4 billion in 2013-17 and a further USD 1.1 billion in 2008-22 towards strengthening the country's preparedness for natural disasters.

1.8 SOCIAL SECTOR

1.8.1 Health

Compared to some of the other sub-sectors, the record of the MoHFW has been somewhat better in terms of utilisation of allocated funds in FY2007-08 (Table 1.21). However, there appears to be little opportunity for enthusiasm. Budgetary allocation for FY2007-08 was higher than that of the previous year, actual expenditure in FY2007-08 (76.29 per cent) was lower than that of FY2006-07 (80.5 per cent). Even though development expenditure posted a marginally high utilisation rate in FY2007-08, ensuring effective and timely completion of health related projects would require further strengthening of proactive intervention by the government.

Table 1.21: Expenditure for Health and Family Planning in FY2007-08

(in Crore Tk.)

Item	Revised Budget FY2006-07	Budget FY2007-08	Revised Budget FY2007-08	Actual Expenditure		Actual Expenditure in FY2006-07 as % of Budget FY2006-07	Actual Expenditure in FY2007-08 as % of Budget FY2007-08
				FY2006-07	FY2007-08		
Revenue Expenditure	2682.4	2863.2	2888	2488.1	2586.3	92.77	89.6
Development Expenditure	2275.2	2606.3	2363	1502.6	1586.3	66	67.1
Total	4957.6	5469.5	5251	3990.7	4172.6	80.5	76.29

Source: Ministry of Finance (MoF).

The Health, Nutrition and Population Sector Programme (HNPSP), initiated in 2004, is a programme with highest allocation under the Health Ministry. The programme encompasses such critical areas as reducing malnutrition and mortality, promoting healthy life styles, and reducing risk factors to human health from environmental, economic and social and behavioural causes. The programme also focuses on providing adequate healthcare services for the vulnerable section of the society and the elderly people. While 84 per cent of the allocated budget for the programme has been utilised during FY2007-08, this certainly is not a significant achievement given the size of the programme itself (Table 1.22).

Table 1.22: Planned, Budgeted and Actual Expenditure of the HNPSP

(in Crore Tk.)

Item	2005-06	2006-07	2007-08
Revised Programme Implementation Plan (RPIP)	3173.00	3047.30	3234.10
Budget	1693.90	2119.50	2362.97
Expenditure	1453.40	1402.10	1988.68
Utilisation of budget (%)	86.00	66.00	84.00

Source: Bangladesh Health, Nutrition and Population Sector Programme (HNPSP): Mid Term Review, 2008, and Ministry of Health and Family Welfare (MoHFW).

With the initially approved project life being up to 2010, a target was set to utilise about 50 per cent of the total approved cost by the end of FY2007-08. However, at the end of June 2008, total utilisation stood at about only 29 per cent. In view of this, the Revised Project Implementation Plan (RPIP) proposed extension of the project by another year, i.e. 2003-2011 (Table 1.23). However, with 71 per cent still remaining in reserve, the government will need to put in place comprehensive policy measures to ensure effective utilisation within the revised time frame.

Table 1.23: Summary of Estimated Budget for HNPSP (2003-2011) by Sources of Financing

Area of Expenditure	2003-2008	2008-2011	Total	% of Total
GoB Revenue	977395.00	1104369.52	2081764.52	55.69
GoB Development	257721.82	372190.00	629911.82	16.85
Sub-Total of GoB	1235116.82	1476559.52	2711676.34	72.54
Project Aid (PA)	407497.23	619237.48	1026734.71	27.46
Sub-Total of Dev (GoB+PA)	665219.05	991427.48	1656646.53	44.31
Total (Rev+Dev)	1642614.05	2095797	3738411.05	100.00

Source: Ministry of Health and Family Welfare (MoHFW).

With a view to reducing maternal mortality, ensuring safe motherhood, and better health and nutrition of hardcore poor mothers as well as ensuring safe birth and sound upbringing of infants, the government initiated a pilot programme in FY2007-08 titled "Maternity Allowance for the Poor Lactating Mothers." While Tk. 16.6 crore was disbursed from the allocated Tk. 17 crore, at the end of FY2007-08 total distribution among 45 thousand expecting mothers from 3 thousand unions stood at Tk. 16.2 crore. Another Tk. 6 lakh was spent as operational expenditure (Table 1.28). The remaining amount (Tk. 34 lakh) has been reimbursed to the government exchequer. However, the fact that basic health status indicators such as infant mortality rate (IMR), mortality of children under-five years, and total fertility rate (TFR) had declined between FY2004-05 and FY2007-08 (Table 1.24) calls for urgent policy and strategic intervention by the government.

Table 1.24: Basic Indicators of the Health Status

Indicator	Baseline Condition in FY2004-05	Target in FY2007-08	Condition in FY2007-08
Infant Mortality Rate (IMR)	65.0	45.0	52.0
Under-Five Mortality Rate (UFMR)	88.0	64.0	65.0
Maternal Mortality Ratio (MMR)	320.0	264.0	n.a
% U5 underweight (6-59 ms)	47.5	42.0	46.0
% U5 severely underweight	12.8	<5.0	11.8
% U5 severely stunted (24-59 ms)	16.1	n.a	16.1
Total Fertility Rate (TFR)	3.0	2.6	2.7
Contraceptive Prevalence Rate (CPR) (modern methods)	15.0	29.5	18.2

Source: Bangladesh Health, Nutrition and Population Sector Programme (HNPSP): Mid Term Review (2008).

1.8.2 Education and Technology

Ensuring quality education for all had traditionally been a top priority of all successive governments. However, available data show that full utilisation of allocated resources is hardly attained. As is seen in Table 1.25, while 88 per cent utilisation in FY2007-08 is certainly a not so pessimistic outcome, it still lags behind the corresponding figures for the previous year

Table 1.25: Budget (Revenue and Development) and Actual Expenditure in Education in FY2007-08

(in Crore Tk.)

Line Item	Sub-sector	Revised Budget FY2006-07	Budget FY2007-08	Revised Budget FY2007-08	Actual Expenditure in		Expenditure in FY2006-07 as % of Revised Budget FY2006-07	Expenditure in FY2007-08 as % of Revised Budget FY2007-08
					FY2006-07	FY2007-08		
Revenue Expenditure	Education Sector	8020.60	8659.10	8658.80	7524.10	8145.30	93.81	94.10
	Ministry of Primary and Mass Education	3201.70	3371.10	3386.30	2817.00	2987.70	87.98	88.20
	Ministry of Education	4706.60	5172.60	5172.60	4615.30	5052.80	98.10	97.90
	Ministry of Science and Technology	112.40	115.40	111.40	91.90	104.80	81.76	94.08
Development Expenditure	Education Sector	2874.90	3710.20	2995.80	2512.60	2754.00	87.40	91.90
	Ministry of Primary and Mass Education	1796.60	2279.90	1886.60	1519.10	1742.70	84.60	92.40
	Ministry of Education	1002.70	1315.90	1000.50	927.30	909.20	92.50	90.90
	Ministry of Science and Technology	75.60	114.40	108.80	66.20	102.10	87.57	93.84
Total (=Rev.+Dev.)	For all Ministries	10895.50	12369.30	11654.60	10036.70	10899.30	92.12	88.12

Source: Ministry of Finance (MoF).

(92 per cent). This again sets a cautionary alarm as the revised allocation for FY2007-08 was about Tk. 750 crore higher than the amount allocated under the revised budget for FY2006-07.

During July-June of FY2007-08, actual expenditure of the revenue budget was 94.1 per cent, compared to 93.81 per cent in FY2006-07. On the other hand, spending under development budget in FY2007-08 was 91.9 per cent, against 87.4 per cent for the comparable months of FY2006-07. Strengthening of the line Ministries' ability to ensure higher utilisation of budget allocations will be of utmost importance for the government in the next fiscal. This is essential for realising the goal of adequate human capital development through providing quality education.

Female Stipend Programmes

Mainstreaming women into development process is a target set by the government in line with both the PRSP and the millennium development goals (MDGs). It is in this context that there are currently three ongoing stipend programmes for female students at the secondary and one programme at the higher secondary level. These are: Female Secondary Stipend Project Phase 2 (FSSP2), Female Secondary School Assistance Project Phase 2 (FSSAP2), Secondary Education Sector Development Project (SESDP), and Higher Secondary Female Stipend Project 3rd Phase (HSFSP3). In order to receive the stipend, one has to fulfill three conditions: (i) obtain at least 45 per cent marks in the final examination, (ii) have at least 75 per cent attendance in class, and (iii) be unmarried. It needs to be mentioned here that SESDP is the only programme that covers poor male students under the stipend

Table 1.26: Female Stipend Programmes in Bangladesh

(in Crore Tk.)

Project	Project Period	Project Fund	Covered Upazila	Allocation for FY2008		Expenditure in FY2008		Expenditure in FY2008 as % of RADP		Stipend Recipient (End June, 2008) (in Lakh)
				ADP	RADP	Total	Stipend	Total	Stipend	
FSSP2	July 2005 - December 2008	502.98	302	183.43	123.00	117.00	110.00	95.12	89.43	16.01
FSSAP2	July 2001- June 2008	766.27	119	33.00	65.00	57.62	53.60	88.65	82.46	7.24
SESDP	January 2007 - June 2013	793.33	53	110.00	83.13	67.27	30.00	80.92	36.09	3.12
HSFSP3	July 2005 - June 2008	184.86	All over the country	70.24	72.00	70.24	65.65	97.56	91.18	3.27
All Projects				396.67	343.13	312.13	259.25	90.97	75.56	29.64

Source: Directorate of Secondary and Higher Education.

programme. Out of the total enrolled students, 30 per cent female and 10 male poor students are selected for the stipend. During July-June of FY2007-08, total expenditure for all the four programmes was Tk. 312.13 crore which is 90.97 per cent of the RADP. It may also be noted that a total of 29.64 lakh female students received stipend and Tk. 259.25 crore was spent, which is 75.56 per cent of allocation under RADP (Table 1.26).

Available data indicate that the number of stipend recipients was in most cases less than 50 per cent of the enrolled female students. This largely owes to the inability of potential to meet all the three aforesaid conditions. In view of this, a review of the selection criteria should be undertaken so that larger share of the targeted poor female students receive the stipend.

Primary Education

Steps towards ensuring universal primary education for all has long been a priority development agenda for successive governments. To this end, three programmes for children at the primary level are currently in operation. These are: (i) Second Primary Education Development Programme (PEDP-II), (ii) Primary Education Stipend Project (Phase I), and (iii) Reaching Out of School Children (ROSC). PEDP is the largest programme under the Ministry of Primary

Table 1.27: Primary Education Stipend Programmes in Bangladesh *(in Crore Tk)*

Project	Project Period	Covered Upazila	Allocation for FY2007-08		Expenditure in FY2007-08		Amount Surrendered	Expenditure in FY2007-08 as % of RADP		Stipend Recipient (End June 2008) (in Lakh)
			ADP	RADP	Total	Stipend		Total	Stipend	
Second Primary Education Development Programme (PEDP-II)	July 2003 - June 2010	All over the country	1484.00	1114.35	1058.00	-	56.35	94.94	-	-
Primary Education Stipend Project (Phase I)	July 2002 to June 2008	477	468.00	468.00	467.93	446.96	0.07	99.99	95.50	48.16
Reaching Out of School Children (ROSC)	July 2004 to June 2010	60	101.54	84.30	76.64	25.31	7.66	90.91	30.02	4.90
All Projects			2053.54	1666.65	1602.57		64.08	96.12		

Source: Ministry of Primary and Mass Education.

and Mass Education. It aims at increasing enrolment and improving school infrastructure. The Innovation Grants programme under the PEDP-II was initiated in FY2007-08 to finance some novel education project targeted for special community or to the special type of children who have little or no access to receive education under the traditional education system. On the other hand, ROSC programme has three broad objectives: (i) improving access to primary education for the disadvantaged out-of-school children; (ii) improving quality of education in the ROSC learning centres and Shishu Kalyan Primary Education; and (iii) building capacity of related institutions.

Under the three projects for primary students, a total of Tk. 2,053.54 crore was allocated in the ADP of FY2007-08, which was reduced to Tk. 1,666.65 crore in the RADP (Table 1.27). During July-June of FY2007-08, actual expenditure of the primary education stipend project was about an impressive 99.99 per cent of the RADP allocation, while it was 94.94 percent of the allocated amount under the PEDP-II. For the ROSC project, 96.12 per cent was spent during July-June of FY2007-08.

1.8.3 Social Safety Net

For social empowerment, social safety net, poverty reduction, and employment generation (including microcredit support scheme) programmes, total allocation in the budget for FY2007-08 was Tk. 3,893 crore. It was targeted that 20 lakh people would be directly benefited through these programmes. These programmes are administered by a diverse group of Ministries, departments and organisations. A large group of NGOs are also involved in the implementation of some of these schemes.

Programmes under the social safety net include old-age allowance; allowance programme for the widowed, deserted and destitute women; capitation grant for public and private orphanage; honorarium programme

Table 1.28: Utilisation of Funds Allocated for Social Safety Net Programmes

(in Crore Tk.)

Programme	FY2007 -08 (RB)	Target Number of Beneficiaries (Thousand)	Achievement in FY2007-08			Achievement as % of Target	
			Disbursed	Distributed	Number of Beneficiaries (Thousand)	Distribution with Respect to FY2007 -08 (B)	Beneficiary
Old-age allowance	448.80	1700.00	448.80	448.80	1700.00	100.00	100.00
Allowance programme to the widowed, deserted and destitute women	198.00	750.00	198.00	198.00	750.00	100.00	100.00
Capitation grant for public orphanage	14.94	10.375	14.94	14.94	10.375	100.00	100.00
Capitation grant for private orphanage	30.74	42.70	30.74	30.74	42.70	100.00	100.00
Honorarium programme for insolvent freedom fighters	72.00	100.00	72.00	72.00	100.00	100.00	100.00
Programme for the assistance to the fully retarded	52.80	200.00	52.80	52.80	200.00	100.00	100.00
Fund for mitigating risk due to natural disaster	20.00	n.a.	20.00.	10+10 (Distributed in Sidr affected area)	n.a.	100.00	n.a.
Fund for rehabilitation of the acid burnt women and the physically handicapped	10.00	6.00	9.69	8.00	8.19	80.00	136.50
Maternity allowance for the poor lactating mother	17.00	45.00	16.60	16.26	45.00	95.65	100.00

Source: Budget documents.

for insolvent freedom fighters; programme for the assistance to the fully retarded; fund for mitigating risk due to natural disaster; fund for rehabilitation of the acid burnt women and the physically handicapped; seasonal unemployment reduction fund; development fund for the RMG workers; maternity allowance for the poor lactating mother; vulnerable group development (VGD), VGF, test relief (TR) and gratuitous relief (GR).

An allowance of Tk. 220 per person is provided to the beneficiaries of the *old-age allowance*, and *allowance programme to the widowed, deserted and destitute women.* Tk. 300 per month is provided to the beneficiaries of the *maternity allowance for the poor lactating mother* programme. Tk. 600 per month is provided to the public and private orphanage for each orphan. The *programme for the assistance to the fully retarded* provides a monthly allowance of Tk. 200 for disabled students at the primary level, Tk. 300 for secondary level, Tk. 400 for higher secondary level and Tk. 600 for university level. Tk. 600 is provided as honorarium to insolvent freedom fighters on a monthly basis. Under the VGD programme women are receiving 30 kg of rice or wheat or 25 kg atta for one year.

During FY2007-08, 100 per cent of the target set for the full fiscal year was achieved in case of allowance programme to the widowed, deserted and destitute women; maternity allowance for the poor lactating mother and capitation grant for public orphanage (Table 1.28). About 100 per cent of the target was also achieved in case of capitation grant for private orphanage. In case of honorarium programme for insolvent freedom fighters, 100 per cent of the target beneficiaries were covered and 100 per cent of the total budget allocation was spent during of FY2007-08. About 100 per cent of the target beneficiaries received benefit from the programme for the assistance to the fully retarded and 100 per cent of the total budget allocation was spent during FY2007-08. As for rehabilitation of the acid burnt women and the physically handicapped, number of actual beneficiaries was 136.5 per cent of the targeted number while total spending was only 80 percent of the budget allocation.

Public Food Distribution System (PFDS)

The government distributes rice and wheat under the PFDS through priced and non-priced (targeted) channels. Monetised distribution is the sale of rice and wheat through Essential Priority (EP), Other Priority (OP), Large Employers (LE), Flour Mill (FM), OMS, and Fair Price Card (FPC). Non-monetised (targeted) channels include targeted safety net programmes such as Food for Works (FFW), TR, GR, VGD, VGF, Food for Education (FFE) and other relief channels.

Distribution of rice and wheat under the PFDS has been used as a useful tool to help mitigate the adverse implications of low purchasing power of resource poor people in the society. It is encouraging to see that about 92 per cent of the total 1,697 thousand metric tonnes of allocated foodgrains was distributed during FY2007-08 (Table 1.29). The corresponding figures for FY2006-07 were 86.80 per cent and 1,685.4 thousand metric tonnes respectively. While distribution through priced channels was lower in FY2007-08 (74.62 per cent as against 94.45 per cent in FY2006-07), the same for non-priced channels was way above the corresponding figure for FY2006-07.

However, distribution under OMS, TR, and VGF in FY2007-08 witnessed significant decline when compared to those in FY2006-07. On the other hand, performance under LE and VGD was significantly high in FY2007-08. The fact that disbursement in the Chittagong Hill Tracts (CHT) region considerably surpassed the target with an achievement of 126.67 per cent is also to be appreciated. Maintaining a comfortable reserve position of foodgrains for distribution among the vulnerable group is of utmost importance. In this regard, the government will have to take appropriate steps to procure adequate foodgrains from both domestic and international markets.

Table 1.29: Sector-wise Public Distribution of Foodgrains *('000 MT)*

Distribution Channel	Allocation FY2006-07 (RB)	Distribution		Allocation FY2007-08 (RB)	Distribution	
		Total	%		Total	%
Priced						
Essential Priorities (EP)	285.00	260.00	91.23	256.00	209.00	81.64
Other Priorities (OP)	22.40	19.00	84.82	27.00	21.00	77.78
Large Employers (LE)	21.00	15.00	71.43	12.00	12.40	103.33
Open Market Sale (OMS)	417.00	408.00	97.84	389.00	268.00	68.89
Flour Mill (FM) / Fair Price (FP)	-	2.00	200.00	-	-	-
Sub Total	745.40	704.00	94.45	684.00	510.40	74.62
Non-Priced						
Food for Work (FFW)	201.00	125.00	62.19	185.00	155.00	83.78
Test Relief (TR)	150.00	149.00	99.33	150.00	76.00	50.67
Vulnerable Group Development (VGD)	200.00	163.00	81.50	265.00	267.00	100.75
Vulnerable Group Feeding (VGF)	250.00	230.00	92.00	274.00	188.00	68.61
Gratuity Relief (GR)	64.00	32.00	50.00	64.00	38.00	59.37
VGF (Relief)*	-	-	-	-	231.55	-
Hill Tracts/Others	75.00	60.00	80.00	75.00	95.00	126.67
Sub Total	940.00	759.00	80.75	1013.00	1050.55	103.71
Total	1685.40	1463.00	86.80	1697.00	1560.95	91.98

Source: Management Information System (MIS), Directorate-General of Food.
Note: * 231.55 thousand MT was Saudi and other relief.

1.9 OUTLOOK AND CHALLENGES FOR FY2008-09

1.9.1 Growth Outlook

Real GDP growth target for FY2008-09 has been set at 6.5 per cent in the budget for F2008-09, which was only 0.29 per cent higher than what is expected in FY2007-08. All other things remaining the same, achievement of the growth target set for FY2008-09 will require either some rise in the rate of investment or an improvement in the ICOR or a combination of both, compared to FY2007-08.

The new MTMF projects a combination of a minor ICOR improvement (ICOR of 3.8, 0.1 lower than FY2007-08) and a moderate rise in investment (24.4 per cent of GDP, higher by 0.2 per cent of GDP over FY2007-08) (Table1.30). Considering the average rise

Table 1.30: Recent ICOR Trends in Bangladesh

Indicators	FY06	FY07	FY08	FY09
Growth rate of GDP at constant price (%)	6.6	6.4	6.2	6.5
Investment as % of GDP	24.7	24.5	24.2	24.4
ICOR	3.7	3.8	3.9	3.8

Source: CPD-IRBD database.

of investment by 0.2 per cent of GDP during the last five years, with highest increase by 0.6 per cent of GDP in FY2003-04, investment and capital productivity growth projections for FY2008-09 appear to be rather conservative. At the same time, assuming a normal year for FY2008-09 (no major natural calamities), there should be some automatic growth enhancement in the upcoming fiscal year.

While the growth target for FY2008-09 remains modest, one major concern with regard to attaining the "hoped-for" 7-8 per cent growth in the medium term (which has been claimed to be "highly probable" in the national budget for FY2008-09) would be the issue of mobilising resources to finance the investment demand. Here, it is pertinent to mention once again that Bangladesh has continued to remain an under-invested country over a protracted period of time; indeed, in recent years the gap between savings and investment has increased.

During the last 13 years, gross investment (as a percentage of GDP) increased from 20.0 per cent to only 24.2 per cent in Bangladesh (it increased from 26.9 per cent to 36.3 per cent in India over the comparable period). Factors contributing to this slow pace of increase in Bangladesh could be fall in public investment (as a percentage of GDP) which tends to negatively affect private investment. Public investment as a percentage increased to 7.8 per cent in India FY2007-08.

1.9.2 Medium Term Macroeconomic Outlook

The new MTMF (FY2009-11) forecasts the economy to grow at 7.0 and 7.2 per cent during FY2009-10 and FY2010-11 respectively (Table1.31). The MTMF also targets to lower inflation rate to 7.5 and 7.0 per cent in FY2009-10 and FY2010-11 from 9.5 per cent in FY2008-09. Such a target would require reversal of the prevailing price dynamics and demands an all out effort to increase domestic productivity, and production not showing any sign of retreat. Much will depend on global price dynamics. If there is a slump in global demand, with consequent downward pressure on commodity prices, this will be of benefit to Bangladesh.

According to the targets set by the MTMF (Table1.31), budget deficit, which has been targeted at 5.0 per cent of GDP in FY2008-09, is expected to come down gradually to 4.0 per cent of GDP by FY2010-11, mostly due to the envisaged reduced growth in public expenditure and increased revenue earnings (as a share of GDP). However, slowdown of public expenditure is expected from slower growth of development expenditure, rather than revenue expenditure. This does not augur good for the economy where this is large unmet demand for infrastructure that is likely to play a crucial role in terms of crowding-in private sector investment.

Table 1.31: Medium Term Outlook of Bangladesh Economy

Medium Term Macroeconomic Framework			
Indicators	Budget	Projected	
	2008-09	2009-10	2010-11
Output (%)			
Real GDP growth (%)	6.5	7.0	7.2
CPI inflation	9.0	7.5	7.0
GDP deflator (% change)	7.5	6.5	6.0
Gross Domestic Investment (% GDP)	24.4	26.3 2	7.0
Government Accounts (% of GDP)			
Total Revenue	11.3	11.7	11.9
Tax	9.3	9.6	9.8
Non-Tax	2.1	2.1	2.1
Total Expenditure	16.3	16.1	15.9
Current Expenditure	10.1	10.9	10.8
Of which: Interest Payments	2.0	2.0	2.0
Overall Balance (excl. Grants)	-5.0	-4.4	-4.0
Financing (Net)	5.0	4.4	4.0
Domestic Borrowing	2.8	2.2	2.0
External Borrowing	2.2	2.2	2.0
Money and Credit (% Change)			
Net Domestic Assets	17.5	17.3	17.1
Private Sector	17.0	19.0	19.0
Broad Money	16.9	15.8	15.3
Balance of Payments			
Exports, f.o.b (% change)	16.5	17.0	17.5
Imports, f.o.b (% change)	21.0	21.0	21.0
Remittances (USD million)	9492	11862	14828
Current Account Balance (% of GDP)	-0.9	-1.3	-1.7
Gross Official Reserve (USD million)	6000	6350	6500
Gross Official Reserve (Months of Imports)	2.6	2.3	1.9

Source: Budget documents, PRSP-II.

In the monetary sector, broad money growth is expected to slow down during FY2009-10 to FY2010-11, compared to FY2008-09. Private sector credit, however, is projected to rise during FY2009-10 to FY2010-11(Table 1.31).

Significant growth is projected on all BOP components over the next three years. Export growth targets have been set at 16.5 per cent, 17.0 per cent and 17.5 per cent for FY2008-09, FY2009-10 and FY2010-11 respectively against an import growth of 21 per cent projected for all the three years (Table 1.31). Movements in commodity prices and the issue of food import will decide whether such high import growth will actually take place. Robust growth in remittance earnings is expected to continue while foreign exchange reserve is expected to remain steady and reach USD 6.5 billion by FY2010-11.

1.9.3 Employment Outlook

The last Labour Force Survey (LFS) in Bangladesh was conducted in 2005-06. Since then no real time data is available to assess the present situation and to make future projection. Proxy indicators for FY2007-08, i.e. low ADP implementation and strained situation with regard to overall investment, however, do not evince a promising picture in this regard. According to the draft PRS-II projections, labour force will grow to 54.6 million in FY2008-09, 56.4 million in FY2009-10 and 58.3 million in FY2010-11, indicating an additional 5.44 million inclusion to the labour force over the three year period. This will mean on average an additional 1.8 million people entering the job market every year. On the other hand, total employment is predicted to increase to 52.25 million, 53.97 million and 55.75 million in the respective years. These assumptions allude to an unemployment rate of 4.3 per cent throughout the PRS-II period. During the last survey (LFS 2005-06), unemployment rate was found to be 4.2 per cent. While this indicates towards an already deteriorated employment situation, no improvement is expected in near future if the PRS-II projections are taken into cognisance. Such pessimistic assumptions in the national strategy are not in accordance with the national aspirations of reducing unemployment rate at a faster pace, which could help Bangladesh acclerating her poverty reduction trend. A more energetic planning is called for from this perspective.

To create new employment opportunities the PRS-II made the following three core policy suggestions - firstly, introducing policies for making growth more employment-friendly; secondly, increasing overseas migration of workers; and thirdly, undertaking special schemes for job creation (especially through microcredit) and employment based safety nets through public works programmes.

Given the expanding overseas employment market, energetic steps are required if Bangladesh is to take advantage of the emerging opportunities. Particular emphasis is needed on skill upgradation. Initiatives such as private-public partnerships in vocational training targeted at aspiring workers ought to be given high priority. Creating conducive investment environment for the Non-resident Bangladeshis (NRBs) should also get precedence. There is also a growing need for providing support to facilitate aspiring migrant workers from low-income households and backward regions in the form of credit and other support. Recently, Palli Karma-Sahayak Foundation (PKSF) has decided to team up with Bureau of Manpower Export and Training (BMET) and provide support through easy term loans for aspiring migrant workers from hard core poor families in monga-prone areas. This is a welcome initiative. The government is also planning to introduce guaranteed employment programme in FY2008-09. Creation of 20 crore man-days work during the lean seasons of the year through this programme is expected to make some positive impact on the overall employment situation. However, Bangladesh will need to be more ambitious in this area.

1.9.4 Challenges for FY2008-09

In view of the state of macroeconomic indicators in FY2007-08, a number of emerging challenges for Bangladesh economy may be identified for the upcoming year. "Overcoming of the crisis" mentioned in the budget for FY2008-09 will indeed hinge on the efficacy with which the CTG, and subsequently, the newly elected government, are able to address these emergent challenges. It is to be reckoned that whilst the CTG will be in charge of economic governance for the first half of FY2008-09, it will be the responsibility of the newly elected government to steer the economy forward during the second lap of the journey.

Reining-in High Inflation, Particularly Food Inflation

Average inflation in FY2007-08 remained high, close to double-digit figures. This average figure, however, does not fully capture the implications of price rise for the general consumers since prices of essential items such as rice, wheat, milk powder and vegetable oil, comprising a significant component of household expenditure, outpaced the average food inflation in the past year. Whilst the possibility of reducing the prevailing high prices in any substantial way is unlikely, and will depend on both domestic and global factors, maintaining stability in the food market must be seen as a key objective in implementing the budget in FY2008-09. Both market and non-market interventions will need to be brought into play to achieve this. These will include OMS, a focused and strengthened role of Trading Corporation of Bangladesh (TCB), inducement to broad base private sector imports, continuous monitoring of the dynamics of supply and demand situation, maintaining appropriate stocks, and carrying out fiscal interventions when required. For essential items such as rice, key to stabilising price levels will be higher domestic production in the upcoming Aman and Boro seasons for which availability of good quality seeds and inputs, at affordable prices, on time and in the required amount, will be necessary.

Reducing Income and Regional Inequality

Rising income inequality has undermined Bangladesh's achievements in reducing poverty. As is evidenced by consecutive HIES reports, in spite of poverty reduction of 1 per cent per annum in the 1990s, and 2 per cent per annum between 2000 and 2005, income inequality (as evidenced by gini-coefficient of income distribution) has been on the rise in Bangladesh. Between 2006 and 2008 both the poverty situation and income distribution has, in all likelihood, deteriorated. According to CPD estimates, up to about 8.5 per cent of households have perhaps experienced income erosion (mainly because of rising food prices) to the extent that they have fallen below the poverty line. Since rising food prices affect poor households disproportionately, it would be logical to pursue that income inequality has exacerbated further. This is notwithstanding the fact that successful large scale public food distribution and safety net programme have targeted hard core poor. Accordingly, the challenge in FY2008-09 will be to create earning opportunities through income augmentation and employment creation for people living below the poverty line. The emergence of growing regional disparity as a major cause of concern will necessitate targeted regional programmes and projects, and perhaps block allocation through regional development fund (as proposed in the document on regional disparity prepared by the Planning Commission).

More Thrust on Agriculture

In spite of its falling share in GDP, agriculture's role as major absorber of incremental labour force and its crucial role in terms of food security, will necessitate renewed attention to this key sector of the Bangladesh economy. The HYV technology has arguably reached a technological frontier, and further productivity enhancement would require introduction of a set of new seed-technology combination. Investment in agriculture will need to be given emphasis, both under public sector initiative and also through greater participation of the private sector. In recent times, flow of credit through private sector (in partnership with NGOs) has seen appreciable increase. This will need to be supported through appropriate incentives. Inducements for technology adoption, through fiscal stimuli, strengthened institutional support and more knowledge based support from the extension system, will need to be given high priority. Crop rotation, crop insurance, crop diversification and modern cropping practices will need to be supported through strengthening of public-private partnerships. Agriculture, both crop and non-crop sub-sectors such as fisheries, livestock and poultry, will need to be geared to a pace and level where it is able not only to meet domestic demand, but also to access global market opportunities which are likely to emerge as a result of the ongoing negotiations in the WTO on Agreement on Agriculture (AoA). Heightened attention will need to be given to SPS-TBT compliance issues if those opportunities are to be realised through enhanced export of agri and agro-processed exports.

Improving Quality and Enhancing Implementation of ADP

Public sector continues to remain a major source of service delivery in Bangladesh, particularly in areas related to human resource development such as education and health. The sector also plays a crucial role in terms of providing infrastructure and other services that augment private sector investment and create conducive environment for private entrepreneurs. However, in recent years ADP implementation record has tended to be quite discouraging, in the range of 75-80 per cent of even the RADP, in most instances. Disbursement of ADP has been particularly low in case of a number of critically important sectors including power and energy, which have tended to adversely impact investment and productivity. There is a need to strengthen institutional capacity of the government to properly allocate, implement and monitor the ADP. It may be necessary to revisit the procurement policy to examine whether amendments are required to expedite decision making in the course of ADP implementation.

Augmenting Remittance Flow

As is known, remittance flow has emerged as a major source of FX earning for Bangladesh. Whilst remittance earning was less than USD 2.0 billion in FY2000-01, that reached close to USD 8.0 billion in FY2007-08. It is currently the single most important FX earner (in net term) of Bangladesh. The number of workers leaving Bangladesh has risen three-times over the last four years. Given the demographic dynamics, in coming years the market for service and care providers is likely to increase manifold in the developed world. Bangladesh lags far behind countries such as Philippines in terms of per capita remittance earnings because only about 3 per cent of her migrant workers belong to the category of professionals, and more than 50 per cent belong to the unskilled category. There is a need to design a comprehensive medium term strategy to augment the skills of the migrant workers. It has been seen that remittance earnings also play a highly positive role in augmenting income of poor households, and reducing income inequality. However, hard core poor households have not been able to tap into this market because of inability to mobilise the initial capital. There is thus an urgent need to set up an appropriate mechanism (e.g. provide loan against future earnings, impart skills) to enable these households to participate in the overseas labour market. In this context, recent initiative of the PKSF to facilitate participation of hard core poor households calls for careful examination for the purpose of replication.

Energy Security

Energy has emerged as a key constraining factor that inhibits investment in Bangladesh. This is true for both domestic investment and FDI. Per capita energy availability is lowest in Bangladesh compared to other regional countries. Potential growths in agriculture, industry and services have been severely limited on account of lack of electricity and gas. What is particularly disturbing is that in spite of having been declared a priority sector, pace of ADP implementation has been consistently low in this sector. There is an urgent need to revisit the energy strategy if Bangladesh is to register high GDP growth rate and ensure high pace of poverty reduction. The draft Coal Policy needs to be finalised speedily. The CTG has initiated offshore bidding process for exploration of gas and oil resources in the Bay of Bengal (28 blocks). It is to be noted that of these blocks, 12 have been licensed by India and Myanmar as well. In view of this, it will be advisable that Bangladesh initiates a process of consultation with these countries to come to negotiated settlements on disputed issues.

An Effective Safety Net Programme

Bangladesh has passed through a challenging time in FY2006-07. Consecutive floods, Sidr, production losses and high inflation have led to a situation where food security for people below the poverty line has come under severe strain. It is to Bangladesh's credit that she has been able to tackle the situation by bringing more than 10 million people under one or other form of safety net programmes. Targeting and entitlement of such programmes need to be improved further to ensure that a speedy and flexible response is available to meet the needs of the hour. There is a need for closer cooperation with local government bodies to raise the effectiveness of such programmes.

Improving Terms of Trade (ToT)

Bangladesh's export sector has demonstrated commendable resilience at a time of challenging global environment (declining world trade, recession in major economies, lower consumer spending). However, it is equally true that Bangladesh's ToT has been experiencing a secular fall in the recent past. At a time when global commodity prices are rising, Bangladesh's average export prices are on the decline. There is an urgent need for intra and extra-RMG diversification as well as diversification of markets to ensure higher value addition, movement up the value chain and better prices in the global market.

Technology upgradation, productivity enhancement, process and product modification and design capability improvement are becoming key factors in translating Bangladesh's comparative advantages into competitive advantages. Realising potential export opportunities in ship-building, pharmaceuticals, light engineering and home textile will require significant investment in technology and skills development. A dedicated "Technology Development Fund" (in line with one in India) needs to be set up towards this.

Higher Mobilisation of Investible Resources

Mobilisation of greater investible resources for the entrepreneurs will be key in attaining higher GDP growth in Bangladesh. It needs to be ensured that government borrowings, particularly from the banking sector, do not crowd-out the private entrepreneurs from the credit market. The current buoyancy in the capital market will need to be supported through appropriate incentives to business enterprises with good track record to get listed in the capital market. Off-loading of public sector enterprises, securitisation, etc. will need to be encouraged. Of crucial importance will be appropriate monitoring of the securities market to guard against manipulation, insider trading, and creation of "boom and bust" situations. Bangladesh Bank's monetary policy, particularly interest rate policy, will play an important role in terms of creating an environment that stimulates savings and generates credit and equity for investors.

Moving Ahead with Institutional Reforms

The CTG has set up BBF and RRC with a view to putting in place an investment friendly environment for the entrepreneurs. Both the BBF and the RRC have put forward a number of recommendations which relate to introduction of e-commerce, doing away with unnecessary regulatory barriers and putting in place systems that facilitate quality service delivery by state-owned entities and, at the same time, are consumer and investor friendly. These initiatives are expected to reduce cost of doing business in Bangladesh and provide encouragement to both domestic and foreign investors. There is a need to vigorously pursue and continue with these reforms. It is hoped that the newly elected democratic government will ensure sustainability of these reforms and continuity of the functioning of these bodies, so that reforms towards business friendly and consumer friendly environment in Bangladesh remains an ongoing endeavour.

1.10 CONCLUDING REMARKS

The end of FY2007-08 coincided with rapid rise in global commodity prices, including food, fuel and fertiliser prices. These developments had serious implications for macroeconomic management during the early months of FY2008-09, at a time when the country was just starting to come out of the severe after-shocks of consecutive natural disasters. The global inflation and the consequent impact on domestic prices undermined the macroeconomic prospects for FY2008-09 and led to reactive steps in terms of provisions for subsidy, projections about domestic borrowings and fiscal-budgetary deficits in the budget for FY2008-09. Thus, the severe strain experienced in managing the economy in FY2007-08 informed the budget for FY2008-09 to the extent that the Finance Advisor termed the budget as a document "to overcome crises." Erosion of purchasing power and consequent reversal of poverty reduction trends required energetic corrective steps which would help deal with the immediate and urgent tasks of strengthening social safety net programmes. However, as FY2008-09 was crossing its half-way mark, the consequences of global financial meltdown and the remittent recessionary trends started to change the entire scenario that informed its journey in July 2008. The emerging scenario had important implications for how critical macroeconomic indicators of Bangladesh would develop in the second half of FY2008-09. Falling commodity prices eased some of the fiscal-subsidy pressures, whilst the prospect of deepening of the global recessionary trends implied that some of the components of the external sector such as export and remittance, and to some extent aid and FDI, could come under increasing strain. Call for review of GDP growth projections were made by some, whilst others maintained that in spite of the uncertainties and volatilities, Bangladesh would be able to attain most of her macroeconomic targets. Thus, as FY2008-09 crosses its equator, the economy remains challengingly poised between optimism and cautionary notes. The transition to democratic governance that has just been made on the wave of high aspirations and profound change, will hopefully prove the optimists to be correct.