



বাংলাদেশের উন্নয়নের স্বাধীন পর্যালোচনা

State of the Bangladesh Economy in FY2016-17

Third Reading

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The CPD IRBD 2017 Team alone remains responsible for the analyses, interpretations and conclusions presented in this report.

State of the Bangladesh Economy in FY2016-17

Third Reading

SECTION I. INTRODUCTION

The present report is the third reading of the State of Bangladesh Economy in FY2017. This is prepared under CPD's flagship programme titled *Independent Review of Bangladesh's Development* (IRBD). The objective of this report is to track trends in major macroeconomic correlates and to present an assessment of the performance of key sectors of the Bangladesh economy during FY2017 in the run-up to the national budget for FY2018. As part of its traditional exercise involving a review the performance of the economy during a particular fiscal year and analysis of key emerging developments, CPD closely monitors the economy throughout a fiscal year. The IRBD exercise to be carried out in the ongoing fiscal year will also include an immediate assessment of the upcoming national budget for FY2018, to be released on 2 June 2017, the day after the national budget is set to be presented at the national parliament.

This report has picked up three major issues of the economy from the perspective of investment and employment generation. These broad areas are: (i) growth and structural transformation; (ii) external sector with focus on remittances and exports; and (iii) sources of finance by looking into banking sector and capital market. These issues are discussed in four chapters which are titled as follows.

1. Whither Macroeconomic Management
2. Emerging Global Scenario and Challenges for External Sector Management
3. Banking Sector: A Growing Malignancy in the Economy
4. Capital Market at Bay

The report concludes with highlighting a number of urgent measures to be pursued by policymakers and depicting the outlook for the economy in the coming days. The report considers latest available data and information from domestic and international sources, as well as insights gleaned from key informants. In preparation of this report CPD confronted more than usual data constraint. Annex Table 1.1 depicts how availability of data within the reference time period has declined compared to the preceding fiscal year.

SECTION II. WHITHER MACROECONOMIC MANAGEMENT

CPD's earlier review of the state of the Bangladesh economy highlighted the prevailing macroeconomic stability attributed to restrained budget deficit, sliding inflation in the backdrop of low level of global commodity prices, declining interest rate and positive balance of payment. This emerging scenario provides a unique opportunity to the government to calibrate an expansionary fiscal policy in accordance with its developmental objectives that is geared to supporting private investment uptake and accelerating economic growth momentum. The review also cautioned that while an expansionary fiscal policy for FY2018 is called for, the government will need to address the structural weaknesses in budget implementation by undertaking the required reforms. In this context, the present section revisits the macroeconomic trends of the economy in the run-up to the forthcoming national budget for FY2018.

Strong economic growth projected by BBS

As stated in the provisional estimate by the Bangladesh Bureau of Statistics (BBS), GDP growth rate is expected to reach 7.24 per cent in FY2017 which was 7.11 per cent in FY2016. This will be the third time in the country's history over the last 2 decades (since FY2007) that the GDP growth would cross the 7 per cent mark. At the same time, for FY2017, Bangladesh's per capita gross national income (GNI) has been projected to be about USD 1,602, which is USD 138 higher than the preceding year of FY2016. Even though GNI recorded a growth of 9 per cent in FY2017, it must be noted that the previous growth figure of GNI was 11.3 per cent. As regards per capita GDP, this too has been estimated to rise to USD 1,538 in FY2017 from the previous level of USD 1,385 in FY2016, registering an increase of USD 153 (11 per cent growth). Lower growth of GNI compared to GDP is attributed to the falling inflow of remittances (resulting current account deficit) along with marginal depreciation of BDT against USD, both a departure from recent trends.

Of the estimated growth rate of 7.24 per cent for the current FY2017, from Table 2.1 it can be discerned that agricultural sector's contribution will be to the tune of 0.5 per cent (0.43 per cent in FY2016), contribution of industry sector about 3.18 per cent (3.24 in FY2016) and that of the services sector about 3.31 per cent (3.21 per cent in FY2016). As is observed, industry sector's contribution is underpinned by the manufacturing sector despite lower growth of export earnings. Services sector's contribution is mainly enhanced by growth of public administration and defence, education, health and social works, and wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods. The abovementioned sectors account for 50.2 per cent of the estimated 3.31 per cent growth on account of the services sector. Indeed, if this year's elevated growth figure is considered, it can be observed that additional growth has been driven by services sector while somewhat declined contribution of industry sector has been compensated by that of the agriculture sector.

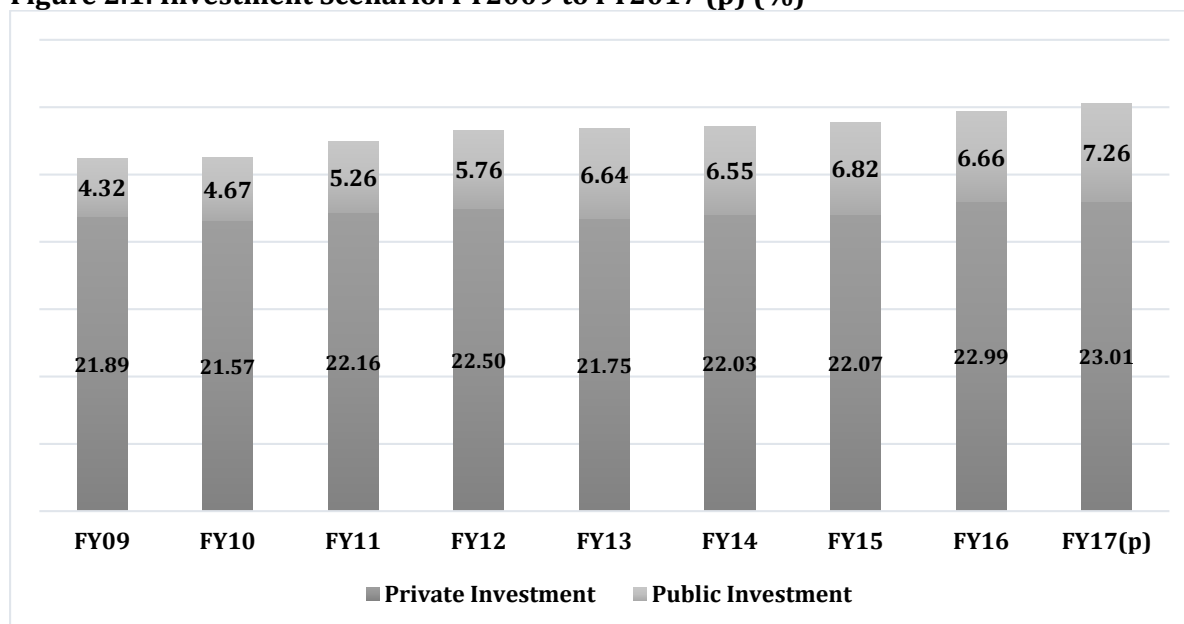
Table 2.1: Contribution to GDP Growth in last Seven Years (%)

Industrial Origin Sector	FY11	FY12	FY13	FY14	FY15	FY16	FY17(p)
Agriculture Sector	0.78	0.52	0.41	0.70	0.53	0.43	0.50
<i>Crops & horticulture</i>	0.40	0.18	0.06	0.34	0.16	0.07	0.14
Industry Sector	2.31	2.47	2.59	2.27	2.74	3.24	3.18
<i>Manufacturing</i>	1.64	1.69	1.80	1.60	1.93	2.26	2.21
Services Sector	3.25	3.43	2.88	2.92	3.00	3.21	3.31
<i>Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods</i>	0.89	0.90	0.83	0.90	0.86	0.88	0.92
<i>Public Administration and Defence</i>	0.27	0.24	0.21	0.22	0.32	0.38	0.34
<i>Education</i>	0.12	0.16	0.13	0.16	0.17	0.26	0.26
<i>Health and Social Works</i>	0.12	0.07	0.09	0.09	0.09	0.13	0.13
Tax less subsidy	0.12	0.10	0.13	0.16	0.28	0.24	0.25
GDP Growth	6.46	6.52	6.01	6.06	6.55	7.11	7.24

Source: Calculated from Bangladesh Bureau of Statistics (BBS) data

Note: p denotes provisional estimates.

As reported by the BBS, investment as per cent of GDP is expected to rise by 0.6 percentage points to 30.27 per cent in FY2017 thanks primarily to a spurt in the public investment levels (Figure 2.1). However, the investment-GDP ratio figure is still 0.63 percentage points lower than the Seventh Five Year Plan's (7FYP) projection of 30.9 per cent. According to the 7FYP, by the end of FY2020, investment-GDP ratio is expected to be 34.4 per cent. Private investment as per cent of GDP is projected to be only 0.02 percentage point higher in FY2017, though during the preceding year the recorded change was 0.92 percentage point. For public investment as per cent of GDP, the BBS projection expected a rise by 0.59 percentage point. It is also to be noted that in FY2017, incremental capital-output ratio is also expected to be almost unchanged.

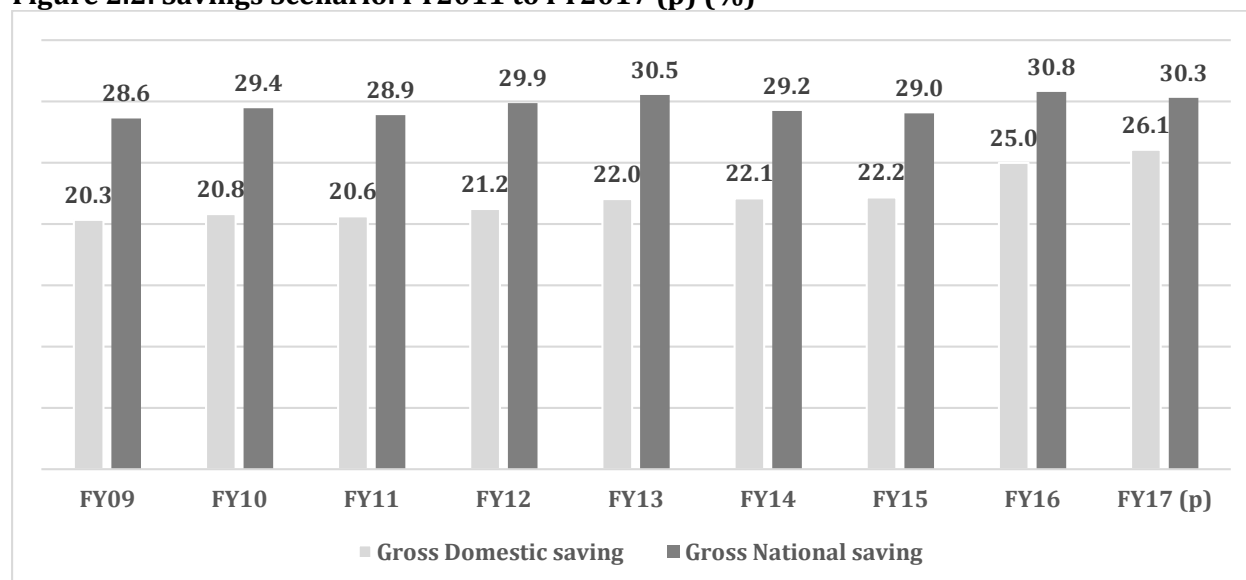
Figure 2.1: Investment Scenario: FY2009 to FY2017 (p) (%)

Source: Bangladesh Bureau of Statistics (BBS)

Note: p denotes provisional estimates.

Domestic savings-GDP ratio is expected to rise by about 1.1 percentage points to 26.1 per cent in FY2017 (Figure 2.2). On the contrary, national savings-GDP ratio is projected to decline by 0.5 percentage point to 30.3 per cent in FY2017 in the backdrop of the large current account deficit. Indeed, this may be the first time in the recent history of Bangladesh when national savings and total investment (as a share of GDP) have come this close.

Figure 2.2: Savings Scenario: FY2011 to FY2017 (p) (%)



Source: Bangladesh Bureau of Statistics (BBS)

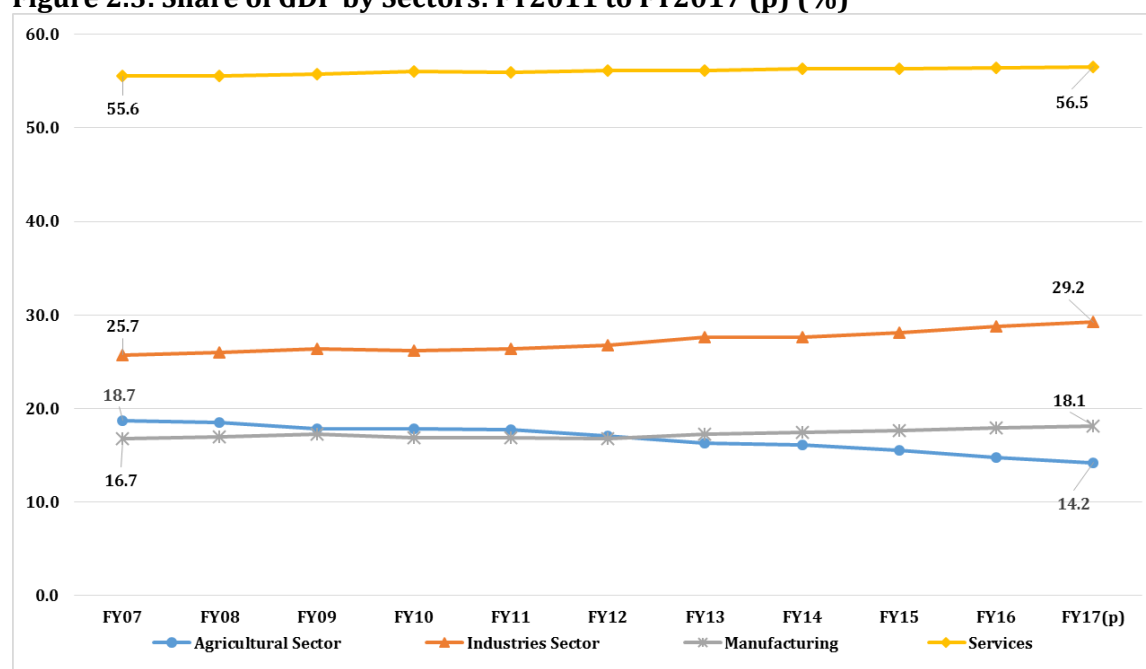
Note: p denotes provisional estimates.

It needs to be considered that the provisional estimate of GDP has been prepared with limited available information and did not consider more recent trends in key macroeconomic correlates. For example, the provisional estimate of BBS has predicted a strong growth of agriculture sector (3.40 per cent in FY2017 which was 2.79 per cent in FY2016). This accelerated growth is predicted to be driven by strong performance of crops & horticulture sector which, in all possibility, has not considered the loss of Boro output. Besides, the value addition of manufacturing sector has been estimated with first five/six months of data which could not captured the falling growth rate of export earnings in the latter months. Also, the estimates have been prepared with an assumption that entire government budget earmarked for FY2017 will be implemented. When the final figures of budget implementation will be available, the associated GDP figures may also need to be significantly revised. Nevertheless, even if the provisional figures are perhaps overestimated, the GDP growth outcome for FY2017 may still be recognised as quite respectable, particularly when compared to global developments.

As is known, in Bangladesh, significant emphasis is given to the discourse on the GDP growth rate. However, it is critically important to examine both structure of the GDP growth and its distributional impact. Indeed, these two aspects are also interrelated. Structure of economic growth in an economy like Bangladesh can be assessed from the vantage points of structural transformation and employment generation. In case of Bangladesh, the gradual shift in the economy, from agriculture to industry and services, is clearly discernible (Figure 2.3). On a welcome note, between FY2007 and FY2017, share of agriculture sector in GDP declined by (-) 4.5 percentage points while industry and services sector gained 3.5 percentage points and 1.0 percentage points respectively. As employment figures are not available, it is difficult to assess

employment generation impact of this particular pattern of economic growth structure. More importantly, from the perspective of broader development objectives, economic growth in Bangladesh must accompany decent job creation. It may be noted that the BBS took up an initiative to prepare quarterly Labour Force Survey data but release of this data has now been discontinued. It is expected that the quarterly data will be released soon for full fiscal year (FY2016). It may be observed that the GDP growth as projected for FY2017 is driven by strong growth in manufacturing output. However, it is reckoned that a significant part of this growth has been capital intensive in nature. This trend is particularly becoming visible in the RMG sector in view of the post-Rana Plaza tragedy reforms. Hence, the incremental benefit from this type of growth may accrue to the rich capitalist class rather than the poor working class.

Figure 2.3: Share of GDP by Sectors: FY2011 to FY2017 (p) (%)



Source: Bangladesh Bureau of Statistics (BBS)

Note: p denotes provisional estimates.

Revenue mobilisation by NBR is strong but needs to keep momentum

Revenue mobilisation target for FY2017 was ambitious to start with and CPD (2017) predicted a possible shortfall to the tune of Tk. 38,000 crore. Despite of the strong growth performance recorded by the NBR, the revised budget was likely to reduce the revenue mobilisation target by about Tk. 32,000 crore. Against the annual target, according to the NBR sources, the attained growth rate during July-February period of FY2017 was 19.6 per cent; which was 14.4 per cent in FY2016. Interestingly, income tax collection growth has almost doubled, from 9.7 per cent in July-February FY2016 to 18.1 per cent in FY2017. This is indeed a positive sign. All other components, apart from 'turn over tax' posted growth rates which were higher than the preceding years. Regrettably, revenue collection from non-NBR sources was rather disquieting according to the data available for first four months only.

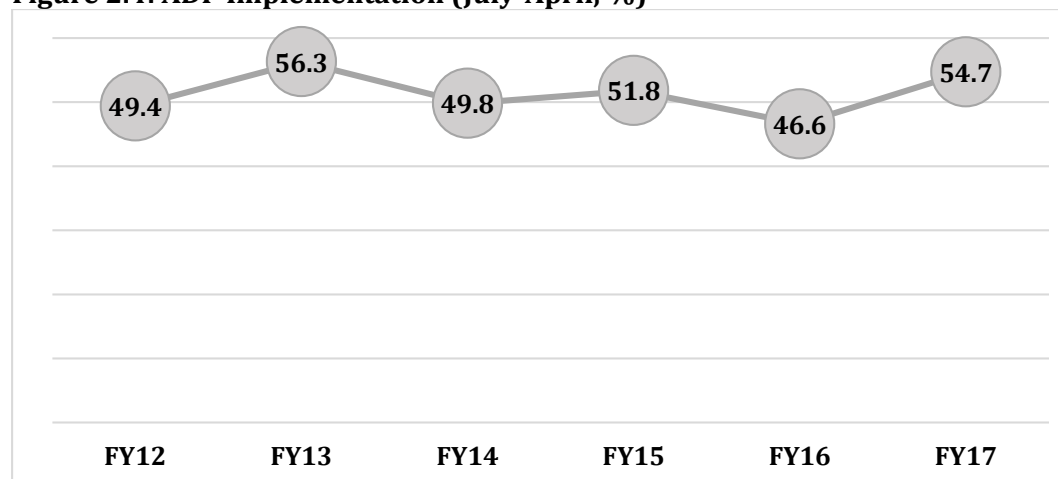
For FY2018, the revenue collection growth target may be fixed at about 34.0 per cent over the revised target. The annual growth target for FY2018 may rise further as the actual revenue mobilisation could fall short of the revised target for FY2017. In this connection, further efforts

towards domestic resource mobilisation along with exploration of new avenues ought to be one of the key priorities that should inform the forthcoming budget for FY2018. It must be acknowledged that for the upcoming FY2018, GoB will implement the much discussed VAT and SD ACT 2012 perhaps with a uniform rate that would be lower than the previously set 15 per cent. However, as mentioned earlier in CPD (2017), in order to implement the abovementioned ACT in a realistic and staggered manner, an action agenda needs to be developed. Furthermore, to facilitate a higher revenue collection growth, CPD (2016a) had proposed several reform measures which include changes to the current advance income tax (AIT) collection system through making tax deducted at source (TDS) online, introduction of the Benami Property Bill, and strengthening the Transfer Pricing Cell to curb illicit financial flows. Moreover, the government should expedite preparation of a new Direct Tax Act and an amended Customs Act as these reforms are key to raising revenue mobilisation in a sustainable and realistic manner.

ADP implementation pace recovered as local resource utilization improved

According to the IMED data, during July-April of FY2017, about 54.7 per cent of total ADP allocation has been spent. Over similar time frame in the preceding year, implementation rate was recorded at 46.6 per cent. This is an improvement and also the second highest implementation rate, after FY2013 (Figure 2.4). It may be noted that ADP implementation has recovered from its earlier slump which was recorded in July-April of FY2016 and has now returned to the trend performance pace.

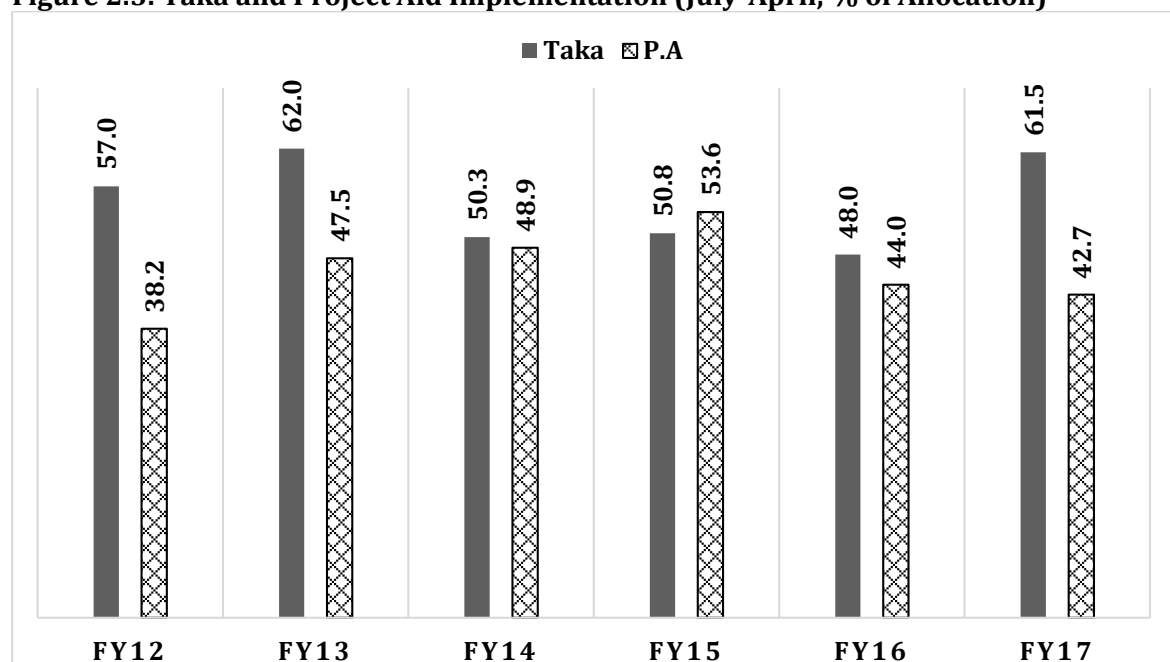
Figure 2.4: ADP Implementation (July-April, %)



Source: Authors' calculation from IMED data.

Indeed, this recovery is primary attributable to higher utilisation of local resources (Taka). In contrast, utilisation of foreign funding (42.7 per cent) is also the lowest in last five years (Figure 2.5). Besides, the pace of implementation for the fast track projects have remained mostly unsatisfactory due to majority of the projects being stalled for long period of time. Despite, slow progress in ADP expenditure, the revised allocation for ADP has been kept unchanged in FY2017.

Figure 2.5: Taka and Project Aid Implementation (July-April, % of Allocation)



Source: Authors' calculation from IMED data.

Up to February, 2017 implementation rates for the period of FY2017 for the Padma Multipurpose Bridge and Padma Bridge Rail Link were calculated to be 29.8 (38.4 per cent as per RADP FY17) and 13.8 per cent (11.8 per cent as RADP FY17) respectively against allocations for FY2017. Similarly, up to February, allocations for FY2017 for the Dhaka Mass Rapid Transit Development Project (Metro Rail) and Rampal Power Plant have been used to the tune of only 7.4 per cent and 2.4 per cent respectively, while as per cent of RADP these stand at 13.9 per cent and 1.2 per cent respectively. The Dohazari-Ramu-Cox's Bazar-Myanmar Railway was initially projected to start in 2010, but it appeared to have stalled for large part of this period. However, implementation rate in FY2017 has been 130.3 per cent of the approved ADP FY2017, whilst 79.8 per cent of the RADP FY2017. Matarbari Coal Plant's implementation rate was recorded at 11.6 per cent of ADP FY2017, whilst it was 52.8 per cent of RADP FY2017. Implementation of deep sea port projects at both Paira and Sonadia appear to have stalled, even though there had been allocations in FY2017. Slow progress of the mega projects is reflected in the low demand for funds. Slow implementation pace of these projects may translate into higher cost as is evident for a large number of development projects which were completed way behind their respective deadlines. This pattern of slow pace of implementation may result in uncertainty among private investors as regards timely delivery of the needed infrastructure contingent upon which they would make investment decisions.

Top 10 ministries/divisions accounts for 72.9 per cent of the total ADP allocation for FY2017. Performance for implementation for particularly four ministries/divisions, viz. Local Government Division (71.7 per cent), Power Division (83.9 per cent), Road Transport and Highways Division (71.6 per cent) and Energy and Mineral Resources Division (46.1 per cent) have been the highest in the last 4 years. In contrast, the rest of the six ministries achieved an implementation rate lower than preceding years (Table 2.2). Government has been active in trying to improve the power situation in the country which is reflected in the implementation rate recorded by the division. In the proposed ADP for FY2018, Local Government will receive the

highest allocation of Tk 21,465 crore, followed by Power Division with an allocation of Tk 18,845 crore and the Road Transport and Highway Division will receive Tk 16,820 crore. Indeed, 90 new projects have been added to the ADP, but the completion of the remaining existing projects must be accounted for as well.

Table 2.2: Implementation of Top 10 Ministries (Jul-Apr, %)

Ministries/Divisions	FY14	FY15	FY16	FY17
Local Govt. Division (Including Block Allocation)	66.3	66.6	61.3	71.7
Power Division	47.3	51.6	57.7	83.9
Bridges Division	7.5	39.7	28.3	26.8
Road Transport and Highways Division	55.0	56.6	58.3	71.6
M/O Railway	56.5	49.6	36.6	39.0
M/O Health & Family Welfare	53.9	42.8	37.7	36.8
M/O Primary & Mass Education	61.5	51.0	56.7	44.7
M/O Education	50.3	52.4	49.5	46.5
M/o Water Resources	51.9	31.5	41.4	40.9
Energy and Mineral Resources Division	20.4	39.9	36.1	46.1
Top Ten Ministry	48.2	51.5	50.1	56.0
Grand Total	49.8	51.8	46.6	54.7

Source: Authors' calculation from IMED data.

Utilisation of Indian LoCs: Lessons from the past experience

In 2010, India extended a line of credit (LoC) for the first time worth USD 1 billion to Bangladesh with a view to strengthening economic cooperation between the two countries. Later, a number of welcome adjustments were made with respect to the original amount of loan commitment including USD 200 million being converted into grants, and increase of the rest credit amount to USD 862 million from USD 800 million in 2015. In addition, annual interest rate was also fixed at 1 per cent which was lower than the originally proposed 1.75 per cent, with a 20-year repayment term, including a five-year moratorium. However, concerns remained as regards conditionalities in the form of tied part of the loan. It is often argued that under the first Indian LoC 75 per cent loan amount was tied in nature. In addition, concern lies as regards implementation of the projects under the first Indian LoC. According to official sources, till now (May, 2017), out of 15 projects only 8 projects have been completed and 7 projects are still ongoing. With regard to the disbursement, only 52.2 per cent of LoC amount was disbursed including USD 200 million grant which was utilised for the Padma Bridge Project. Excluding the grant amount, this accounts for only 41.1 per cent of the revised loan commitment. Meanwhile, India has extended two more LoCs to Bangladesh to the tune of USD 2 billion in 2016 and USD 4.5 billion in 2017. Although it is encouraging that India was forthcoming with additional LoCs despite of slow progress of the projects under 1st LoC, it is perhaps pertinent to understand the implementation challenges for improved utilisation of 2nd and 3rd Indian LoCs.

Under 1st Indian LoC, 15 projects were approved of which 13 projects were directly linked to the development of Bangladesh Railway. Besides, two projects were undertaken to modernise and strengthen Bangladesh Standards and Testing Institute (BSTI) and procurement of dredgers, ancillary crafts and accessories for Mongla port. It may be noted that the first line of credit was used predominantly to improve domestic connectivity and standard of Bangladesh Railways bearing in mind the possible multi-modal regional connectivity. Of these projects, 9 projects were

related to procurement only, and 3 projects each were for construction and modernisation or institutional strengthening. It is important to note that, as of now, all the 8 projects being completed under the 1st Indian LoC were procurement projects. Among the other 7 ongoing projects only 3 projects have utilised more than 50 per cent of estimated project cost while 2 projects are at the inception level. As informed by official sources, major impediments afflicting project implementation include problems associated with land acquisition, review and approval of Development of Project Proposal (DPP), lack of conformity among and between different agencies and limited competitive bidding process for procurement. For example, because of land acquisition related challenges, the USD 308.9 million worth construction of the Khulna-Mongla port rail line project waited for about 42 months from the date of awarding of the contract. It is also important to realise that time overrun has pushed overall cost of the project up. Hence, the additional cost will need to be financed by GoB's own resources.

Under the 2nd Indian LoC 14 projects were identified, of which 11 has received approval from the EXIM Bank. Among the identified projects, four projects are under roads and highways, three under railways, two projects each under education sector and information technology, and one each under power sector, inland shipping port development and establishment of economic zone. Unlike 1st LoC, only 3 projects are directly related to procurement, while six projects are directly related to construction of roads, railway lines and buildings. Besides, rest of the five projects are linked to establishment of economic zones, establishment of power transmission channels and modernization and upgradation of existing institutions and infrastructures. No change has been made regarding interest rate and repayment period. However, for the civil construction works, conditional tied portion of procurement was brought down to 65 per cent (from 75 per cent) in the agreement. The provision for further reduction of procurement under conditional tied arrangement remained open in cases of unavailability of supplies from the Indian counterpart.

Nevertheless, implementing the projects under 2nd and 3rd LoCs will be even more challenging as they include a significantly higher number of construction projects (8 out of 11 and 15 out of 17 respectively) compared to the 1st LoC. It is also important to recognise that there is a shift in project identification and approval under 2nd and 3rd LoCs when compared to 1st Indian LoC. A large number of construction projects are linked to infrastructure development in view of Bangladesh-India bilateral multimodal transport connectivity. Upon completion, these will also contribute to India's transit facility through Bangladesh. As Bangladesh aims to implement these projects in a timely manner, the government will need to seek scope for negotiating a reduced part of sourcing requirement and a more competitive bidding process for procurements. It is also important to improve coordination among different agencies involved in the implementation process in order to reduce the time and cost overrun. It is also time for Bangladesh to initiate required complementary/matching projects that are needed to reap the benefits of ongoing large scale projects being implemented under the Indian LoCs.

Need for adjusting interest rate of NSD certificates acknowledged

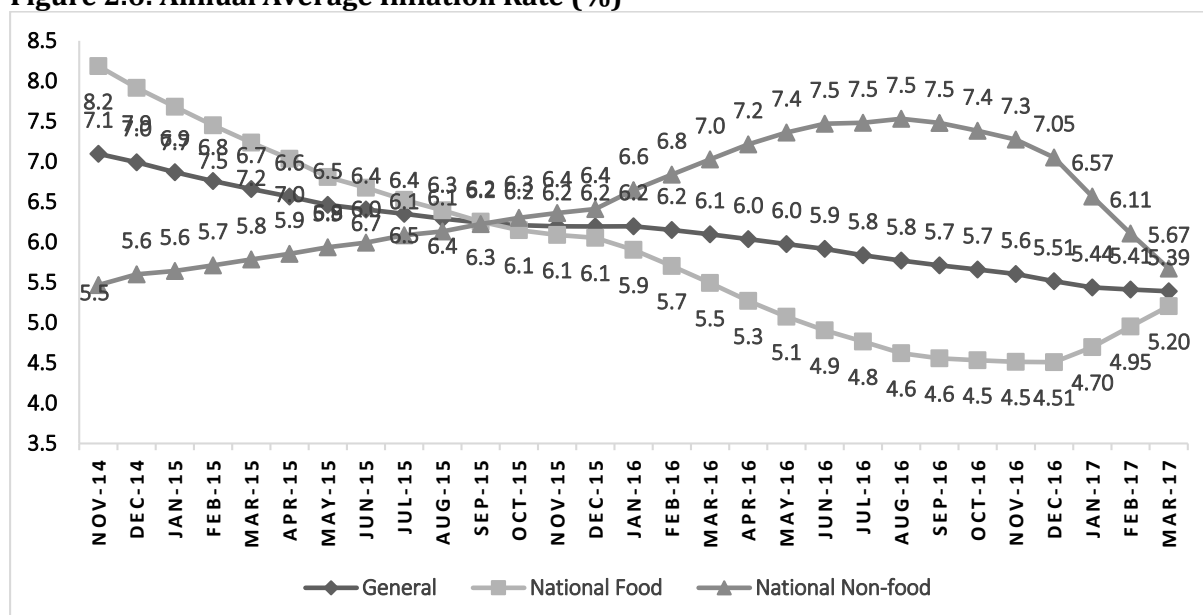
Overreliance on NSD sale for deficit financing continued all through the year for financing the budget deficit. Net sales of NSD certificates stood at Tk. 33,283 crore during July-February of FY2017 which is 67.3 per cent higher than that of the corresponding period of FY2016. Besides, sales during the first eight months was already an astounding 69.7 per cent higher than the annual target of Tk. 19,610 crore. As NSD instruments entail payment of higher interest rates and hence, higher debt servicing liability, CPD (2017) recommended a downward revision of the NSD rates,

as also as regards the maximum ceiling on purchase in view of the fall in the deposit interest rates in commercial banks and in view of the medium to long term implications of accumulating debt servicing liabilities of the government. It is encouraging to find that the government has also acknowledged the need.

Rising rice price fuelling inflation

The Consumer Price Index (CPI) inflation in Bangladesh has witnessed a declining trend in FY2017. (Figure 2.6) The general (annual average) inflation rate was 5.39 per cent in March 2017 which is within the Bangladesh Bank's Monetary Policy Statement (MPS) target of 5.3-5.6 per cent. This decreasing inflation rate is primarily due to the contribution of a declining trend in non-food inflation. All components of non-food inflation have experienced a slow down, though on the contrary inflation rate of 'national recreation, entertainment, education and cultural services' has been on the rise. Contrary to the abovementioned situation, food inflation has been on an increasing trend since January 2017 and was 5.2 per cent in March 2017, up by 0.3 per cent over the previous month. One could identify a gradual convergence between food and non-food inflation. Indeed, there is no scope to be complacent with the current inflationary trends and it is important to put under scrutiny the rising trend in food inflation.

Figure 2.6: Annual Average Inflation Rate (%)



Source: Bangladesh Bureau of Statistics (BBS)

Rising price of rice is driving the food inflation at present. It may be noted that, rice accounts for a lion's share in the commodity basket of the CPI. Currently coarse rice is being traded at Tk. 45-46 per kg (in May 2017) which is about 42.2 per cent higher than the price of a year ago which was Tk. 30-38 per kg (in May 2016). Prices of other variety of rice are also about 15-18 per cent higher. This shows that with the current structure of rising food inflation, it is the poorer consumers who are most affected since (coarse) rice is the single most important commodity in their consumption basket.

In FY2017, the target of Boro rice production was about 19 million metric tonne (MT). Possibility of meeting this target is rather unlikely as production has suffered from early flash-floods in the

Haor wetlands and 'blast' pest attacks on paddy crops. 57 unions of nine districts (Sunamganj, Sylhet, Moulvibazar, Habiganj, Brahmanbaria, Kishoreganj and Netrakona, Comilla and Natore) have suffered from early flash-floods. According to the Department of Agricultural Extension (DAE), about 433 thousand hectares of Boro fields were submerged in the latest flash-floods in these nine districts. In the aforementioned nine districts, three-year (FY2014-FY2016) average cultivated land under Boro crop was about 1,086 thousand hectares. It is revealed that about 40 per cent of total cultivated land under Boro crop suffered in these areas. Besides, in these nine districts, three-year average yield rate was 3.8 MT per hectare which was marginally lower than the national average yield rate of 4.0 MT per hectare. Assuming no change in the yield rate in FY2017, it is estimated that due to early flash flood in Haor wetlands there may be a loss to the tune of 1.6 million MT Boro rice production i.e. about 8.5 per cent national Boro rice production. According to a media report, the corresponding official figure was 1.2 million MT. However, anecdotal information and estimates using unofficial sources suggest that the loss of Boro rice production may be double in FY2017 than what has been estimated earlier.

The loss of Boro rice production may further accentuate as 'blast' pest attack has been found in 2,500 to 3,000 hectares of land in 34 districts including the highly productive regions such as Rangpur, Bogra, Rajshahi, Naogaon, Joypurhat, Kushtia, and Jessore. Assuming, 4 MT per hectare yield rate and 50 per cent of rice production loss per hectare due to 'blast' pest attack, it is estimated that an additional 6,000 MT loss in Boro rice production.

The rising rice price in recent months in the backdrop of the declining public stock appears to be the major cause that is pushing food inflation upward (CPD, 2017). The public foodgrains stock was estimated to be 561.5 thousand MT of which only 245.6 thousand MT was rice during the month of May (FPMU, 2017). It may be mentioned in this connection that, Aman procurement fell short of the target by 56 thousand MT. Boro procurement started from the beginning of May 2017 and is expected to continue till the end of August 2017. The target for procurement for paddy, parboiled rice and white rice has been set at 700 thousand MT, 700 thousand MT and 100 thousand MT respectively. Prices have also been set at 24 Tk. per kg for paddy, 34 Tk. per kg for parboiled rice and 33 Tk. per kg for white rice to be procured from the domestic markets.

Success of the procurement process remains uncertain due to higher prices existing in the domestic market. Government should be aware of the emergent scenario and be ready to import rice. Removal of the existing 25 per cent tariff on rice imports also needs to be considered. While rural farmers may have surplus rice for consumption at this moment, rice distribution programmes, in the forms of open market sales and others, for the urban poor and flood affected people, needs to be initiated without delay.

SECTION III. EMERGING GLOBAL SCENARIO AND CHALLENGES FOR EXTERNAL SECTOR MANAGEMENT

3.1 External sector management: Crack in wall

Traditionally, Bangladesh's external sector has served as a bedrock of the economy. With robust export growth, high inflow of remittance, comfortable current account balance and the consequent rising reserves and stable exchange rate, Bangladesh's external sector has been a star performer. However, in a departure from the recent past years, in the course of the ongoing FY2016-17 the Bangladesh economy has come under some pressure in terms of the external sector dynamics and performance. The signals stemming from the sector are rather mixed.

Export growth has underperformed in view of the targets set for the major contributing sectors. Thus, with the fall in export growth, and some rise in growth of imports, current account experienced significant pressure. Current account balance has shown negative sign for the first time over the last five fiscal years and stood at USD (-) 1.38 billion at the end of March 2017 as against USD 3.36 billion in March 2016. Besides muted export performance and rise in import payments, the negative sign is also attributed to the significant fall in remittance. Remittance earning growth has been in the negative terrain for the first ten months of this fiscal year. BDT's exchange rate against USD has witnessed some volatility in recent times with sharp depreciation in the secondary market which called for central bank intervention.

Although import payments recorded period-on-period growth of 11.1 per cent in the first nine months of FY2016-17, reserves stood at a robust USD 32.2 billion although its fast rise appears to have been halted. Overall balance of payments stood at a positive USD 2.60 billion at the end of July-March FY2016-17 which, however, was lower than that of the previous fiscal.

The good sign is that the overall global economic outlook appears to be positive as per the World Bank and IMF¹ reports - growth in the advanced economies (Bangladesh's major markets) is set to gain some momentum in 2017 and 2018. However, projections of major retailers are not encouraging and a large part of the growth will come from high-tech sectors. On the other hand, the projections are that petroleum prices will continue to remain low, with only some rise expected. According to the projections made by UNESCAP², the price growth of Bangladesh's exportables was likely to decline in 2017 to 4.2 per cent from 3.8 per cent in 2016; if export is to grow this will need to be through growth in export volumes.

While there is a debate as regards flow of remittance (formal and informal flow), the fact remains that, overall, external sector of the country is transmitting mixed signals and policymakers should take due notice of this.

3.2 Export sector performance

Export earnings during the first ten months of FY2016-17 (July-April) have shown considerable volatility on a month-on-month basis. Exports have experienced a general declining growth in the

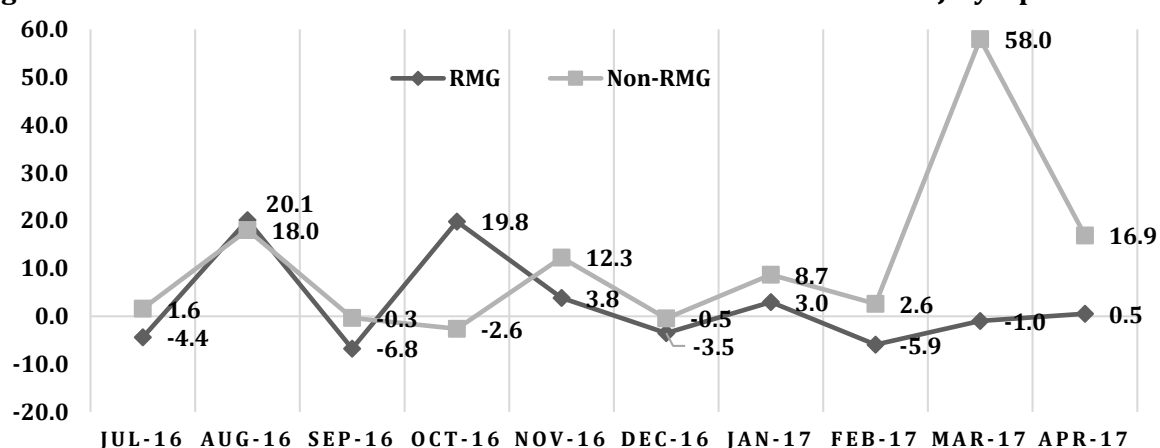
¹World growth is expected to rise from 3.1 per cent in 2016 to 3.5 per cent in 2017 and 3.6 per cent in 2018.

² Source: <http://www.unescap.org/sites/default/files/aptir-2016-ch1.pdf>

second and third quarters (Box 3.1 – II). Export growth has been half of what was targeted. The growth in the first ten months was (-) 3.9 per cent as against annual target of 8 per cent set out for FY2016-17 (Box 3.1 – I).

The weak trend was mainly attributable to the fall in the RMG³ export earnings. On the other hand, the slight recovery noted in the March-April period has been thanks to the rise in non-RMG export earnings. Since RMG exports are the major contributor of the total export earning of Bangladesh (80.6 per cent for July-April FY2017⁴), the 11.7 per cent period-on-period growth for July-April FY2017 for the non-RMG export earning was unable to raise total export growth significantly (Box 3.1 – II). Non-RMG export growth (month-on-month) has been higher than RMG exports growth for the last two quarters of the current fiscal year, starting from October 2016 (Figure 3.1). The performance in non-RMG exports has been higher than what was targeted, achieved growth for July-April FY2017 was 11.7 per cent as against targeted growth of 7.4 per cent (Box 3.1 – I).

Figure 3.1: Month-on-month Growth of RMG and Non-RMG Products for July-April FY2017



Source: Authors' calculations using data from Export Promotion Bureau (EPB).

It is observed that achieved growth has fallen short of target for RMG (2.2 per cent in the face of a target growth of 8.1 per cent). At a more disaggregated level, for both knit and woven RMG. Intra-RMG growth composition shows that woven export earnings have incurred negative growth in July-April FY2017 period when compared with earnings of July-April FY2016 when this was 12.7 per cent (Box 3.1 – I). Relative performance in traditional markets (2.8 per cent growth) and non-traditional markets (7.5 per cent growth) is to be noted. While encouraging, the muted performance in Bangladesh's traditional markets is rather disquieting (Box 3.1 – III).

Exports to the US market has remained in the negative terrain and recorded a growth of (-) 5.2 per cent for the period of July-April FY2016. In the month of April, export growth to US was 2.5 per cent, positive performance after two successive quarters. During the July-April period, RMG and non-RMG exports to US recorded growth of (-) 6.8 per cent⁵ and 9.9 per cent respectively

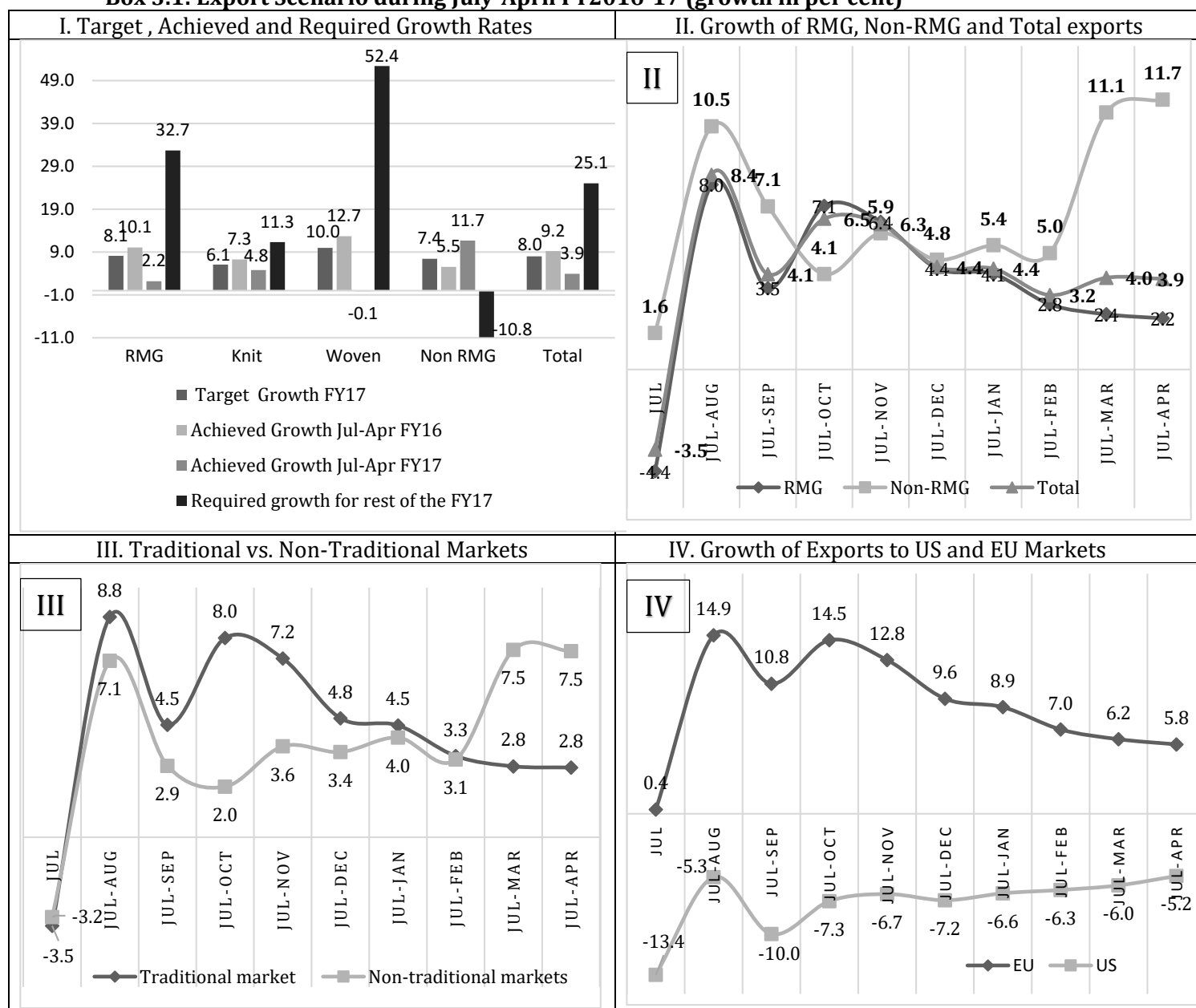
³ From here on, figures for RMG exports or imports constitute of the total figure of Knit (HS 61) and Woven (HS 62).

⁴ Non-RMG exports have contributed 19.4 per cent of export earnings of Bangladesh for July-April FY2017.

⁵ Both Knit and Woven-apparels recorded negative growth of -7.1 and -6.7 per cent for the period of July-April FY 2017 relative to same period in previous fiscal year.

(Box 3.1 – IV). Export earnings from the EU market has also been falling for the last two quarters (since October 2016). Export to EU recorded a growth of 5.8 per cent in July-April FY2017 (over July-April FY2016). This growth was influenced by the 5.9 per cent growth in RMG export earnings (6.9 per cent growth in knit and 4.6 per cent growth in woven export earnings). Growth in non-RMG exports earnings was 4.6 per cent. It emerges from further analysis that the fall in growth of exports to the EU market was mainly price-driven. Relative appreciation of BDT against Euro and depreciation of Euro against USD is likely to have contributed to this⁶.

Box 3.1: Export Scenario during July-April FY2016-17 (growth in per cent)



Source: Authors' calculations using data from Export Promotion Bureau (EPB).

⁶ Euro has been highly volatile against USD over the past 10 months in FY 2016-17 due to several reasons including Brexit, French election etc., Euro was down to its minimum exchange rate of (EUR/USD) at 1.04 on 20 December 2016.

Table 3.1: Annual growth of RMG imports of the US and the EU

Annual Growth of Import of USA and EU	US market				EU market			
	2012	2014	2015	2016	2012	2014	2015	2016
<i>from the World</i>	7.4	6.4	3.4	-5.3	5.8	8.6	10.0	0.1
<i>from Bangladesh</i>	12.9	8.8	10.4	-1.7	43.3	24.3	23.6	8.2
<i>from Cambodia</i>	13.9	-0.8	-1.1	-13.1	109.5	53.0	31.5	14.0
<i>from China</i>	3.1	2.6	1.4	-8.6	-4.0	1.4	5.5	-7.6
<i>from Vietnam</i>	21.7	31.0	13.3	2.5	29.4	25.7	25.6	6.7

Source: Computed from the United States International Trade Commission (USITC) and EuroStat data.

Performance as regards RMG imports (in terms of import value) by the US and the EU (in Table 3.1) shows that in the US market RMG imports have fallen secularly in recent years. In 2016, annual growth was (-) 5.3 per cent in the US market. However, it is to be noted that imports from Bangladesh has fallen to a lesser extent of (-) 1.7 per cent. Vietnam is the only country from which US imports of RMG has increased in 2016 (growth rate 2.5 per cent). Vietnam's export performance in the US market has been consistently better than Bangladesh as also in comparison to other countries through all the observed years (in Table 3.1). Growth of RMG imports by the EU has fallen drastically from 10 per cent in 2015 to 0.1 per cent in 2016, with China and Vietnam being the hardest hit. Bangladesh performed better than the World average with growth of imports from Bangladesh being 8.2 per cent. However, Cambodia has been the frontrunner in the EU market with growth of 14 per cent in 2016. As may be recalled, in the EU market, export performance of Bangladesh received a boost in 2012 due to the relaxation of rules of origin (RoO) requirement from two-stage to single-stage processing. Whilst the initial boost this has given Bangladesh has gradually tapered off, she appears to be benefitting from the comparative advantage originating from the favourable RoO for woven RMG items. It appears that it is Vietnam in the US market and Cambodia in the EU market which have been able to take best advantage of the emergent situation.

Further in-depth analysis reveals that price dynamics are in play behind the falling growth of import values in the US and the EU market. Table 3.2 shows the price dynamics of RMG products in the US and the EU markets imported from Bangladesh and its competitors.

Table 3.2: Country-wise and Year-wise Comparison of Per Unit Woven and Knit Items in US Market and EU Markets

<i>US Market</i>						
Product	Year	Bangladesh	Cambodia	China	India	Vietnam
Knit (HS code 61)	2010	10.4	14.9	15.8	15.5	16.8
	2012	13.4	17.0	17.8	19.8	19.1
	2014	14.0	17.5	17.0	19.7	19.3
	2016	13.4	16.6	15.1	18.2	18.1
Woven (HS code 62)	2010	12.9	14.4	16.1	25.5	17.0
	2012	17.0	17.0	19.0	30.9	21.2
	2014	17.4	18.6	18.9	31.4	22.2
	2016	16.6	18.0	17.1	29.7	22.5
<i>EU Market</i>						
Product	Year	Bangladesh	Cambodia	China	India	Vietnam
Knit (HS code 61)	2010	10.8	14.1	12.1	14.2	12.5
	2012	22.8	26.5	24.3	28.5	24.8
	2014	23.1	26.9	23.0	27.7	28.5
	2016	19.4	21.9	17.3	19.8	26.3
Woven (HS code 62)	2010	9.4	13.0	13.7	22.1	17.2
	2012	19.1	26.1	26.4	42.7	32.9
	2014	19.6	26.8	26.8	40.2	34.4
	2016	15.2	20.8	21.1	31.0	28.7

Source: Computed from the United States International Trade Commission (USITC) and EuroStat data.

Table 3.2 shows that in US average price of the major export item, woven apparels, has experienced increase in the 2010-2014 period and then has experienced a secular decline. Similarly, in the EU, the trend has been the same for the dominant knitwear item. Volume-driven nature of export earnings performance (as against a price-driven one) becomes apparent from the above.

3.3 Import performance

Bangladesh's import payments has seen a gradual rise in recent months. Growth was 8.2 and 11.1 per cent at the end of the second and third quarters, albeit below the 17.3 per cent growth experienced in the first quarter. Among the major 23 items, nine product categories show growth rate higher than the 11.1 per cent growth for all imports during the period July-March FY2016-17⁷; six of the rest (interestingly, five of which are intermediate goods) recorded negative period-on-period growth⁸. Import growth of wheat (31.9 per cent) and consumer goods (24.1 per cent) have risen noticeably – analysis shows that these were mostly volume-driven. Imports of intermediate goods and capital goods have respectively contributed to 54.1 per cent and 23.8 per cent of total imports during the period July-March FY2016-17⁹.

⁷ Top five imported products with highest growth rates were: pulses (50.5 per cent), sugar (35 per cent), spices (32 per cent), wheat (31.9 per cent) and petroleum products (25.6 per cent).

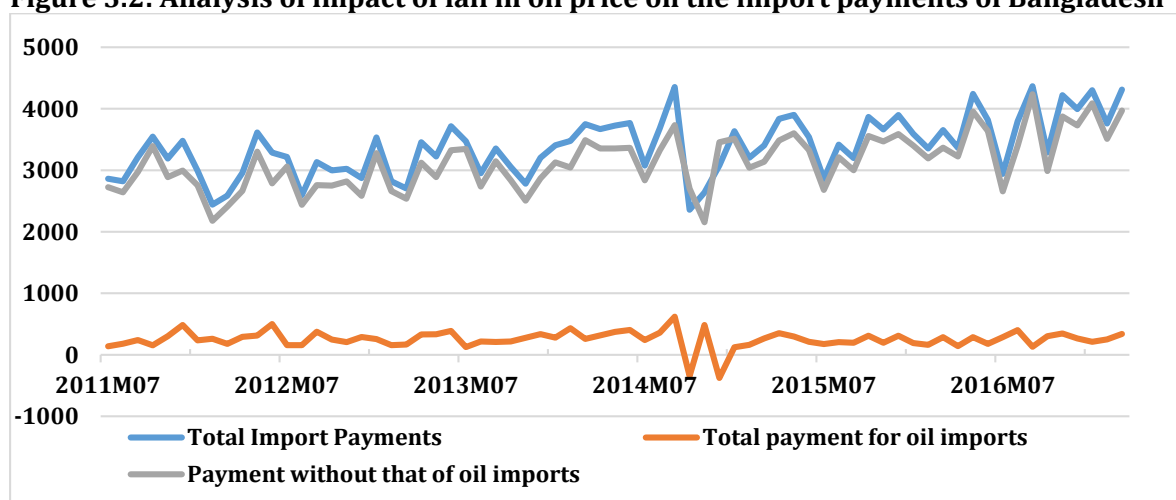
⁸ These six imports are: rice ((-) 64.3 per cent), fertilizer ((-) 38.4 per cent), oil seeds ((-) 30.9 per cent) and less prominently negative growth rates are being depicted by the raw materials for RMG and textile industries, namely yarn ((-) 0.8 per cent), textile and articles thereof ((-) 2.0 per cent) and staple fiber ((-) 0.6 per cent). The fall in fertilizer import payment was due to increase in price in the third quarter of FY2016-17.

⁹ More specifically, import payments of intermediate goods of textile and articles industry and iron, steel and base metals industry and capital machinery contributed respectively to 12.7, 8.3 and 8.3 per cent of the total import payments.

An analysis of structure of import over the last five years do not evince any major shift. However, share of capital goods has been on the rise – from 20.0 per cent in total imports in FY2013 to 23.8 per cent in FY2017 (July – March). Share of capital machineries has also seen some rise – from 6.0 per cent to 8.3 per cent over the corresponding period. Share of crude petroleum and POL items has seen a fall from 8.3 per cent to 7.3 per cent in the backdrop of fall in prices. Interestingly, share of consumer’s goods has fallen from 12.3 per cent to 7.7 per cent of the corresponding period.

As is known, oil price has been falling since July 2014. It is observed that the overall movement in import payments excluding oil import payments is not significantly different that that with oil import payments (Figure 3.2).

Figure 3.2: Analysis of impact of fall in oil price on the import payments of Bangladesh



Source: Authors’ compilation based on data from NRB and World Bank Pink Sheet.

Analysis of incremental growth shows that capital goods contributed the most (38 per cent) to the incremental growth in import payments, which includes contribution of payments of capital machinery (17.2 per cent). Intermediate goods contributed to 26.2 per cent of the incremental growth, lower than that of last fiscal year; key contributors were on account of payments for iron, steel and base metals (16.5 per cent)¹⁰ and petroleum products (12.5 per cent)¹¹.

For July-March FY2016-17, total letter of credit (L/C) Opening and Settlement has shown a positive growth of 13.0 per cent and 11.3 per cent respectively compared to matched period in FY 2015-16¹². The compositional share of consumer goods (12.5 per cent), intermediate goods (8.5 per cent), industrial raw materials (37.3 per cent), petroleum products (5.4 per cent) and capital machineries (11 per cent) in the total amount of L/C opening for the period under discussion are analogous to those of the last fiscal year. L/C opening for petroleum products has

¹⁰ This is supposedly the effect of increase in the price of Iron ore, which recorded month-on-month increase of 97 per cent in December 2016, remained high in January-March 2017 period. (Source: World Bank Pink Sheet)

¹¹ In last fiscal year intermediate goods contributed the most (53.9 per cent) to the incremental growth in import payments, propelled by payments for petroleum products (23.2 per cent) and textile articles (20.1 per cent).

¹² The growth of L/C opening for July-March FY 2015-16 was 2.29 per cent lower than that of corresponding period in FY 2013-14.

experienced positive growth of 19.2 per cent which is quite high¹³. On the other hand, growth in L/C opening for industrial raw materials was only 4.4 per cent over the corresponding period of discussion. Similarly, back to back L/C opening for RMG raw materials stood at USD 5.9 billion with the growth being 3.6 per cent. Thus, L/C opening figures of production related items do not augur any significant acceleration in production in near-term future.

On the other hand, imports of capital machineries in terms of L/C settlement depicted a growth of 52.8 per cent and L/C opening for capital machineries showed a growth of 17.3 per cent¹⁴ for the period July-March FY2016-17 compared to corresponding period of the last fiscal year. This rise in imports of capital machineries has been largely on account of implementation of various large-scale infrastructure development projects and power plant projects. Noteworthy growth of 32.1 per cent has been observed in the growth of L/C opening for energy/power industry (which stood at USD 0.66 billion); the corresponding L/C settlement figure is USD 1.2 billion (220.4 per cent higher than the figure of USD 376 million observed for July-March FY2015-16). Likewise, notable growth has been observed in L/C opening of machineries for telecom industry (14 per cent), garment industry (12.6 per cent) and textile (5.2 per cent). Robust growth of these important items will likely have positive impact on investment, albeit with some time lags.

3.4 Terms of trade

Bangladesh's terms of trade has been showing a secularly declining trend since the new base was established (FY2006). The increase in import price index and the fall in terms of trade despite the 52.1 per cent decrease¹⁵ in the price of crude oil, one of the major import components, indicate that given its export and import structure, Bangladesh was not able to reap the benefits of falling global commodity prices. As can be seen from price movement of Bangladesh's key export, RMG, overall average export-weighted prices of Bangladesh could not keep up with average import-weighted price of Bangladesh (inspite of fall in fuel price import), leading to decline in ToT¹⁶.

Table 3.3 Terms of trade of Bangladesh

Fiscal Year	Export price index	Import price index	Commodity terms of trade (base: FY06 =100)	Calendar Year	Change in Oil price	
					Yearly	Compared to peak (2012)
FY 06-07	104.9	103.6	101.2	2007	4.2	-21.8
FY 07-08	116.3	131.4	88.5	2008	26.6	-1.0
FY 08-09	125.1	140.4	89.2	2009	-32.1	-32.8
FY 09-10	132.6	148.3	89.4	2010	23.5	-17.1
FY 10-11	146.4	166.5	87.9	2011	18.6	-1.7
FY 11-12	151.7	176.4	86.0	2012	1.7	0.0
FY 12-13	163.0	189.6	86.0	2013	-0.5	-0.5
FY 13-14	172.1	200.4	85.9	2014	-6.1	-6.5
FY 14-15	182.3	212.4	85.9	2015	-41.6	-45.4
FY 15-16	196.0	228.2	85.9	2016	-12.2	-52.1

Source: Bangladesh Bank and World Bank.¹⁷

¹³ Though L/C settlement has shown negative growth of (-) 1.74 per cent.

¹⁴ The period-on-period growth in FY2015-16 was 13.9 per cent and in FY2014-15 was 5.7 per cent

¹⁵ In the period of 2004-2016, oil price was at its peak in 2012 at the rate of USD 95.3 per barrel (bbl). Then there was a fall in oil price in the following years as shown in Table 3.3.

¹⁶ Considering the US market for instance, the prices of knit and woven products decreased by x and y per cent respectively in the year 2016.

¹⁷ Source: <https://www.bb.org.bd/pub/annual/anreport/ar1516/chap11.pdf>

3.5 Exchange rate

In recent years Bangladesh Bank's exchange rate policy with its open market operations has kept BDT stable in terms of major currencies. However, Nominal Exchange Rate (NER) was allowed to slide a bit and BDT depreciated by 1.2 per cent in the third quarter of FY2016-17, with USD/BDT rate reaching its maximum value of 80.6 on 17 May 2016¹⁸. The year 2016 ended with an upward trend in the NER; on the other hand, Real Effective Exchange Rate (REER) experienced some appreciation and was 150.1 in December 2016¹⁹. Foreign exchange reserves stood at USD 32.4 billion at the end of the July-March period of FY2016-17²⁰.

In the recent period exchange rate experienced some volatility. Average rate of USD/BDT for import payments between 11 April 2017 and 27 April 2017. The Bills for Collection (BC) selling rate was the highest for most banks on 25 April 2017. The average USD/BDT rate for import payments varied from BDT 80.3 to BDT 84.8 on 25 April 2017, and from BDT 80.3 to 84.95 on 26 April 2017 for different banks. On 26 April 2017, Bangladesh Bank had to intervene in the currency market and introduced a bar of BDT 2 on deviation of the average BC selling rate from the inter-bank exchange rate. This calmed the market and consequently the rates came down to level off with the headline exchange rate by 2 May 2017. In the period of 23 – 27 April 2017 the USD/BDT rate for importers increased by the maximum extent of BDT 4.77. Table 3.4 shows the number of banks with the extent of dispersion between the average exchange rate for import payments and the inter-bank exchange rate on 25 April 2017 (and 26 April 2017).

Table 3.4: Number of banks as per the deviation of headline exchange rate and average BC selling rate

Number of	Banks		Foreign		Local Private		State-owned	
	25 Apr	26 Apr	25 Apr	26 Apr	25 Apr	26 Apr	25 Apr	26 Apr
Deviation ≥ 4.0	5	9	3	2	2	7	0	0
3.5 ≥ Deviation < 4.0	14	10	2	2	12	8	0	0
3.0 ≥ Deviation < 3.5	8	8	0	1	8	7	0	0
2.5 ≥ Deviation < 3.0	8	4	0	0	6	2	2	2
2.0 ≥ Deviation < 2.5	3	5	0	0	1	3	2	2

Source: Authors' calculation based on data collected from the Bangladesh Bank.

This sudden volatility was attributed to the cumulative pressure originating from the rise in L/C settlement, higher demand for foreign loan payments and declining remittance flow through the banking channels. Some analysts have also not ruled out market manipulation and alluded to lack of proper oversight by the central bank. Steps should be put in place to guard against the situation which gave rise to the market volatility.

3.6 Remittance

Month-on-month remittance flow has been in the negative terrain all through FY2016-17. At the end of July-April FY2016-17, remittance was 16 per cent lower than that of July-April FY2015-

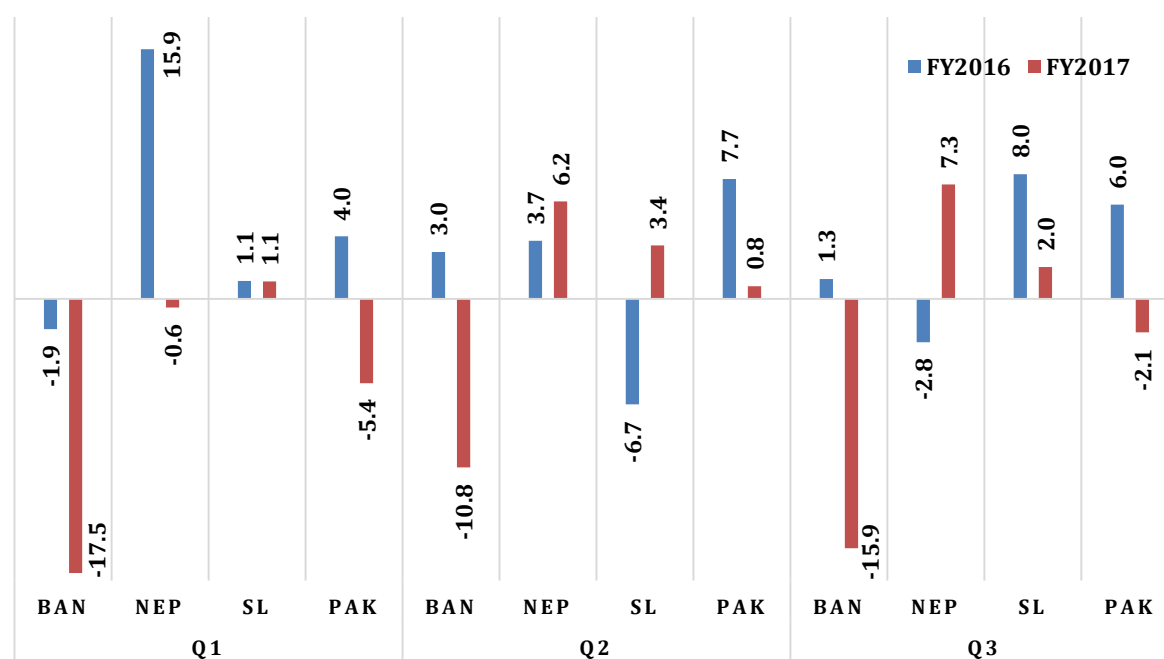
¹⁸ The USD/BDT rate started this fiscal year (FY2016-17) with the value of 78.4, and first increase was encountered on 27 October 2016.

¹⁹ REER has been appreciating since FY2010-11, more recently being 114.4 in FY2013-14 and 130.6 in FY2014-15. (Base: FY2010-11 and considering 10 currency basket, Source: Annual report of the Bangladesh Bank)

²⁰ 14.2 per cent lower than that of the analogous period in FY2015-16.

16²¹. Structure of remittance flow shows that 58.1 per cent of the remittance earning came from the Gulf countries (with 17.5 per cent coming from United Arab Emirates (UAE) and 16.8 per cent from Saudi Arabia). Among the non-Gulf countries, the US (12.8 per cent), the United Kingdom (9.6 per cent) and Malaysia (7.3 per cent) were the largest sources of remittances. This gloomy picture, true for all major markets²² was attributable to several factors including slowdown of economic growth in Bangladesh's traditional source economies. Similar trend is observed in the global scenario. The yearly growth of global remittance inflow has been low in recent years and has moved to the negative terrain in 2015 ((-) 2.37 per cent) and 2016 ((-) 1.24 per cent). A cross-country comparison of quarter-over-quarter growth rates is shown in Figure 3.3, it reveals that the fall in remittance has been pervasive for almost all countries except for Nepal. However, as the figure shows, the depth and consistency in the fall in remittance have been particularly telling for Bangladesh when compared to other countries such as Pakistan and Sri Lanka.

Figure 3.3: Cross-country comparison of remittance by quarter-over-quarter growth



On the contrary, migration outflow data has shown robust growth with a period-on-period growth of 34.2 per cent. Migration outflow in FY2017 was mostly contributed by Gulf countries having the major compositional share of 83 per cent, attributed by that of KSA (40 per cent), Oman (16 per cent) and Qatar (12 per cent).

Remittances have come down in spite of more than five lac workers going abroad over the first nine months of the current fiscal. Since no reliable figure is available for returnee migrants, there is hardly any doubt that growth of net migration has also been quite robust. That about a fourth of the new migrants were women, with law paying jobs, does not fully explain the narrative of falling remittances. Bangladesh Bank had indeed carried out field investigation to identify the

²¹ The period-on-period growth was (-) 2.1 for July-April FY2015-16.

²² Only Qatar, Italy, Germany and South Korea have shown positive period-on-period growth of 34.3 per cent, 45.9 per cent, 14.1 per cent and 27.7 per cent respectively for July-April FY2016-17.

reasons²³. Discussion with key informant and anecdotal information indicate that a large part of the fall in remittance flow may be explained by substitution taking place between formal and informal channels of money transfer, particularly from Middle-East, Singapore and Malaysia. Many migrant workers are sending money through intermediaries who are taking advantage of mobile platforms and various software applications (apps). Some of the reasons driving this trend (in substitution of formal channels by informal channels) are higher exchange rate margin, shorter transaction processing times²⁴, quick delivery of money to the beneficiaries, easy access, and lower service fees compared to the banks in host countries. All these leads to lower costs of sending remittance back to Bangladesh. To make the situation worse, because of higher vigilance on account of terrorist financing, and the attendant cost rise, banks in important corridors are charging higher transaction fees. CPD has earlier argued for waiving these additional charges for those who send remittance below a certain amount. Table 3.5 below shows a comparison of the costs borne by remitters in some of the major host countries. It is seen that for most of the country corridors (except for Singapore) rate of sending remittance were higher than the Sustainable Development Goal (SDG) target of 3 per cent. Proposals have been floated to make remittance sending process free of cost for remitters²⁵. Some steps in this direction will encourage remitters to use formal channels. In view of the attendant situation, steps should be taken on two fronts: at the domestic front, by discouraging use of illegal platform and by taking measures to accelerate transfer of remittance through formal channels. Energetic steps should also be taken through global negotiations to bring down banking fees that are charged on small amounts of remittances set through key corridors.

Table 3.5: Cost of sending remittances to Bangladesh (% fee required to send USD 200 equivalent)

From	FY2016 Q2	FY2016 Q3	FY2016 Q4	FY2017 Q1	FY2017 Q2	FY2017 Q3 ²⁶
<i>UK to Bangladesh</i>	3.5	4.0	4.0	4.6	4.7	5.0
<i>USA to Bangladesh</i>	4.2	4.8	4.3	5.1	4.8	5.0
<i>KSA to Bangladesh</i>	3.3	3.7	4.3	3.8	3.6	3.9
<i>Malaysia to Bangladesh</i>	4.4	3.9	3.9	3.6	3.3	3.9
<i>Singapore to Bangladesh</i>	1.6	2.3	2.3	2.3	2.2	2.6

Source: World Bank Remittance Prices Database.

The growth of number of female migrant workers has risen in the past three years²⁷ with yearly growth of 34.8 per cent, 36.5 per cent and 13.9 per cent. In view of this increasing trend, safety and security have become major concerns. Since some of the key host and sending countries are all signatories of the Colombo Process, initiatives should be taken towards further strengthening of the measures taken under this process be further strengthened from these respects.

²³ Report published on 8 May 2017.

²⁴ Five to ten minutes in case of full digitalised processes with apps and mobile banking.

²⁵ As reported in The Daily Star on 14 May 2017.

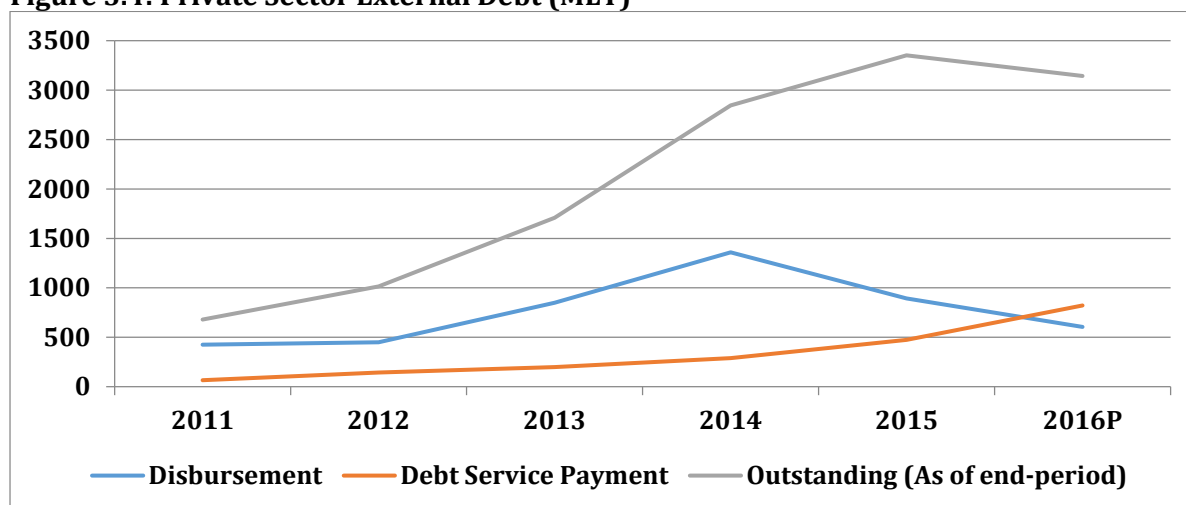
²⁶ The world average for this period is 7.45 per cent for every USD 200 sent.

²⁷ In the years 2014, 2015 and 2016.

3.7 Balance of Payments

Current account balance was negative for July-March period of FY2017. The balance amount came down to USD 1.38 billion for July-March FY2016-17 compared to the corresponding figure of USD 3.36 billion for FY2016²⁸. This downward pull was mainly driven by the negative trade balance of USD 7.04 billion and the fall in remittance flow that was equivalent to USD 1.83 billion. However, the overall balance could be maintained at a positive amount of USD 2.6 billion (though lower than USD 3.5 billion of corresponding period in FY2015-16). A 20.3 per cent period-on-period growth of FDI and 7.72 per cent growth of medium and long-term (MLT) foreign loans contributed to this. From the following figure it is seen that recourse to foreign loans has risen significantly since 2011. Debt Service payment has also been on the rise with repayment obligations maturing. Further data analysis shows that major share of the loans, of value of USD 0.95 billion, has maturity period of between 5 to 7 years; USD 1.61 billion worth of loans has interest rates between 4 to 6 per cent. Total foreign aid received by Bangladesh during July-February FY 2016-17 was USD 1.38 billion which was 2.9 per cent lower than that of the corresponding period of the last fiscal year.

Figure 3.4: Private Sector External Debt (MLT)



Source: Statistics Department, Bangladesh Bank.

3.8 Concluding remarks

With export growth registering only half of what was projected for FY2017, with remittance falling significantly, with continuing fall in the terms of trade and with a deteriorating terms of trade, Bangladesh's external sector is witnessing a turning point. This is manifested in the significant fall of about three billion USD in the current account balance which has gone into negative territory. The prospect of LDC graduation and the fact of having graduation to middle income status are likely to bring in more near-term challenges (shift from low interest to blended financing, preference erosion as international support measures get phased out gradually). In this backdrop, a rethinking of external sector management will be called for.

The exchange rate of BDT has depreciated, albeit to a small extent, and it is reckoned that there is further scope for this in view of the falling current account balance, exchange rate movement

²⁸ Current account balance was (-)1118 for July-February FY2016-17

of competitors, open market exchange rate movements and for giving incentives to exporters and remitters.

Forex reserves, whilst robust, could come under pressure in view of export and remittance performance, debt servicing liabilities of various types. Bangladesh Bank should closely monitor liabilities originating from loans taken by the country's private sector particularly from the point of view of currency and maturity mismatch and movement of LIBOR. In this backdrop, a careful and conservative approach should be pursued in view of demands for partial capital account convertibility to allow Bangladeshi investors to invest abroad.

While global remittance flow has seen some decline in recent times, comparative record of key receiving countries indicate that in case of Bangladesh this, at least to some extent, can be explained on account of substitution of remittance inflow from formal channels to informal channels. Whilst legal actions against illegal platforms will be necessary, parallel initiatives to facilitate speedy and cost effective remittance transfer, through appropriate domestic as well as initiatives at the regional and global levels will be called for. To secure the interests of the increasing number of female migrant workers, labour wings of Bangladesh embassies in key host countries should be further strengthened and adequate safeguard measures undertaken, both at pre and post-migration stages. Bangladesh will also need to take best advantage of the Colombo process on migration.

To conclude, business as usual in external sector management will not do. Some of the fault lines in the edifice, flagged the preceding discussion, is already transmitting cautionary signals. Issues of enhancing competitive strength through skill augmentation and productivity gains, product and market diversification of exports, prudent reserves and exchange rate management in view of evolving demand-supply situation – all these will call for renewed thinking managing the external sector in these challenging times.

SECTION IV. BANKING SECTOR: A GROWING MALIGNANCY IN THE ECONOMY

4.1 Introduction

A sound financial sector is key to a sustained economic development for any country as it facilitates the financial mechanisms between borrowers and lenders, helps expedite capital accumulation, and makes use of resources into productive sectors. In Bangladesh, the contribution of the financial sector has increased over the years. In FY2011, financial sector's share in GDP was 2.99 per cent at constant price which has increased to 3.41 per cent in FY2017 (BBS, 2017). Commercial banks play the dominant role, possessing almost 80 per cent of the financial sector. In FY2017 the share of banking sector in GDP was 2.91 per cent. The contribution of other financial institutions including non-banking financial institutions and insurances was only 0.5 per cent of GDP.

Despite significant growth, the sector is currently faced with a number of serious challenges. Overall performance of banks, particularly of state owned commercial banks (SCBs) is far from satisfactory. The sector is struggling to recover from the setbacks of large financial scams in a number of state-owned and private commercial banks, unearthed in recent years. Most indicators reveal a poor health and lack of discipline in several banks.

CPD has been following the development in the banking sector closely and writing on the sector in its IRBD reports. Given the emergent concerns of various sorts, this report also highlights some of the challenges of the sector and make recommendations to move forward. More specifically, the issue of non-performing loans (NPLs), recapitalisation and governance issues are the focus of this section.

4.2 Tepid growth of deposit and credit

Total deposit of the sector in 2015 stood at 46 per cent of GDP that increased from 38 per cent in 2005. However, it has declined compared to that of 2010 (49 per cent). On the whole, three indicators of financial depth, i.e. ratios of money supply (M2) to GDP, total deposits to GDP, and total domestic credit to GDP have increased over the years (Table 4.1).

Table 4.1: Financial Depth of Bangladesh

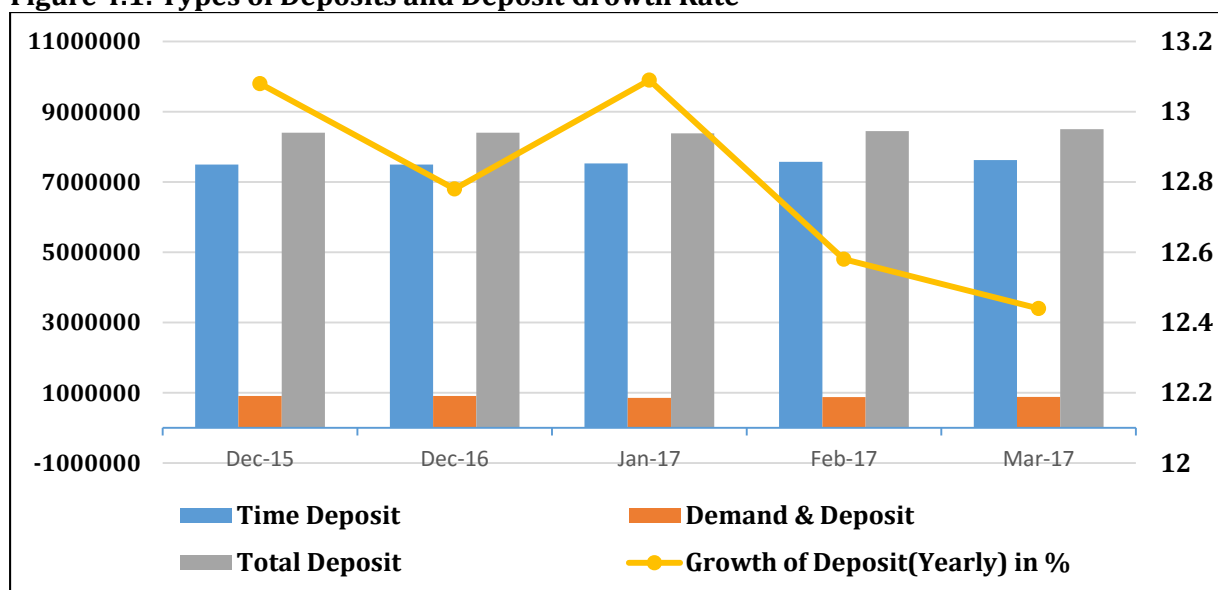
Indicators	2005	2010	2015
M2/GDP	0.41	0.52	0.51
Deposit/GDP	0.38	0.49	0.46
Credit/GDP	0.32	0.39	0.49

Source: Bangladesh Bank and BBS.

More recent data indicates that though the total amount of deposit has increased in the month of March FY2017, the growth rate of deposit has declined. Lower deposit rate may have affected the growth of deposit. The amount of time deposit and demand deposit both have been increased from previous two months.

Deposit growth has decreased to 12.4 per cent in March 2017 from previous March which was 13.04 per cent (Figure 4.1).

Figure 4.1: Types of Deposits and Deposit Growth Rate



Source: Statistics Department, Bangladesh Bank.

Growth of domestic credit increased slightly to 12.2 per cent in March 2017 compared to 11.4 per cent in March 2016 (Table 4.2). The target of credit growth is 16.4 per cent as spelt out in the Monetary Policy Statement (MPS) of Bangladesh Bank published in January 2017. Though growth of credit to the private sector was 16.1 per cent in March 2017, close to Bangladesh Bank's target of 16.5 per cent, credit to the public sector has been negative ((-)9.5 per cent) (Table 4.2). The reason behind low demand for bank credit by the public sector is government's reliance on NSD (details in Section II). Due to lower demand for credit, liquidity in the banking system is high. Total liquid asset amounted to Tk. 2,67,508.6 crore in March FY2017, while the minimum requirement was Tk. 1,60,319.4 crore.

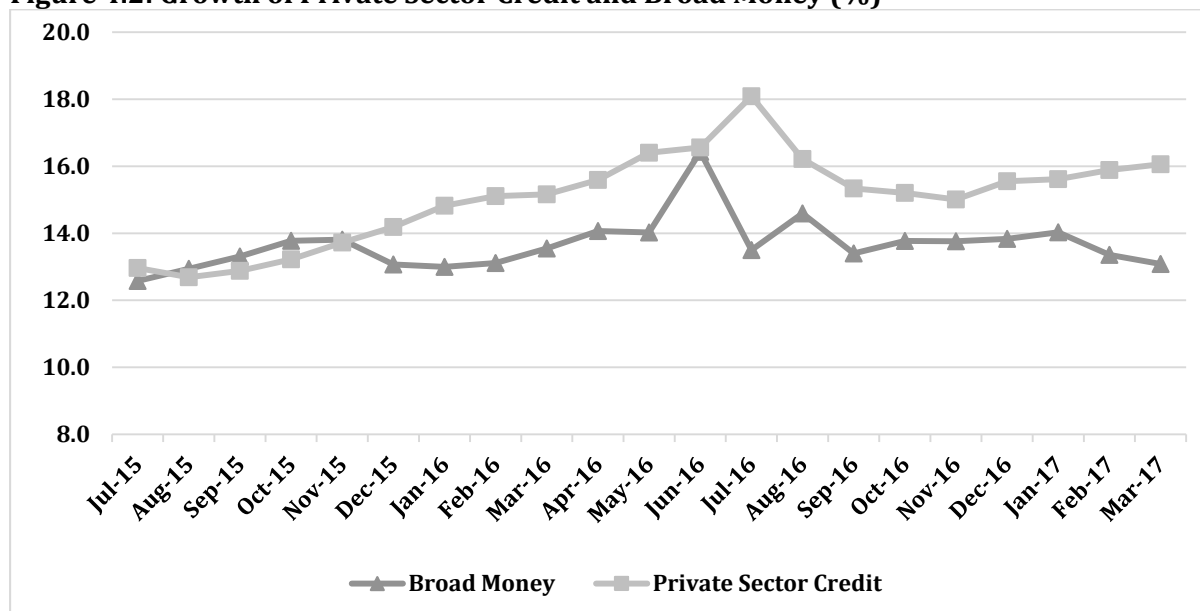
Table 4.2: Growth of Monetary Indicators (Outstanding as of March 2017)

Indicators	Jun 2016 (Actual)	Mar 2016 (Actual)	Mar 2017 (Actual)	Jun.17 (Jan'17 MPS Prog.)
1. Net Foreign Assets	23.2	24.1	15.3	10.1
2. Net Domestic Assets	3.6	10.3	12.3	17.3
Domestic Credit	14.2	11.4	12.2	16.4
Credit to the public sector (incl. Govt.)	3.6	-5.6	-9.5	16.1
Credit to the private sector	16.8	15.2	16.1	16.5
3. Broad Money	16.3	13.5	13.1	15.5
4. Reserve Money	30.1	15.8	19.0	14.0

Note:* denotes values for February.

Source: Bangladesh Bank.

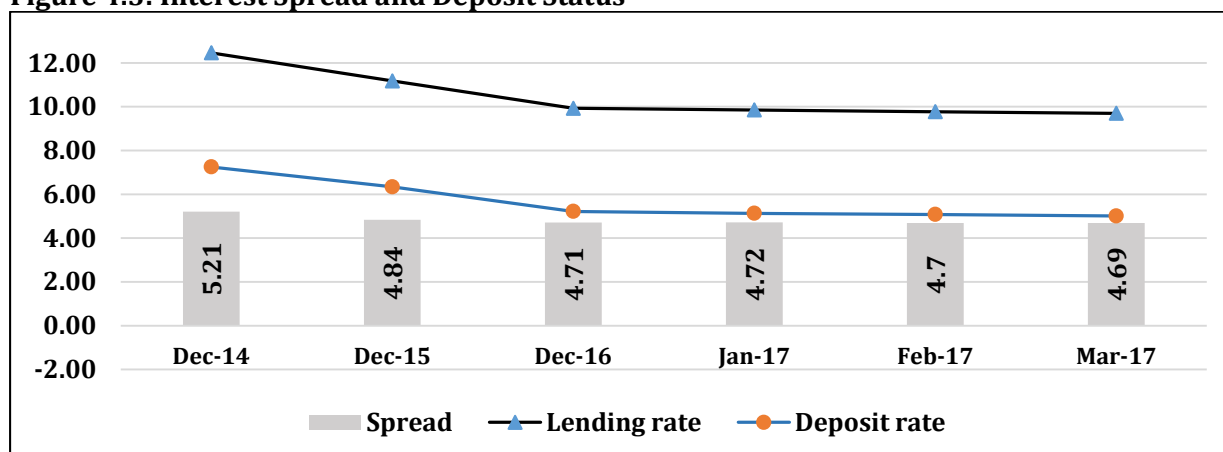
Figure 4.2: Growth of Private Sector Credit and Broad Money (%)



Source: Bangladesh Bank.

In an effort to attract investment, emphasis has all along been put on lowering bank rates. In November FY2016 the lending rate has downsized to single digit. High lending rate has been attached to high deposit rate. Bangladesh Bank desires that commercial banks should keep their interest rate spread within 5 per cent. In recent period there is a downward trend of both lending and deposit rates. The interest spread for the month of March FY2017 is 4.69 which has decreased from the previous year (Figure 4.3).

Figure 4.3: Interest Spread and Deposit Status



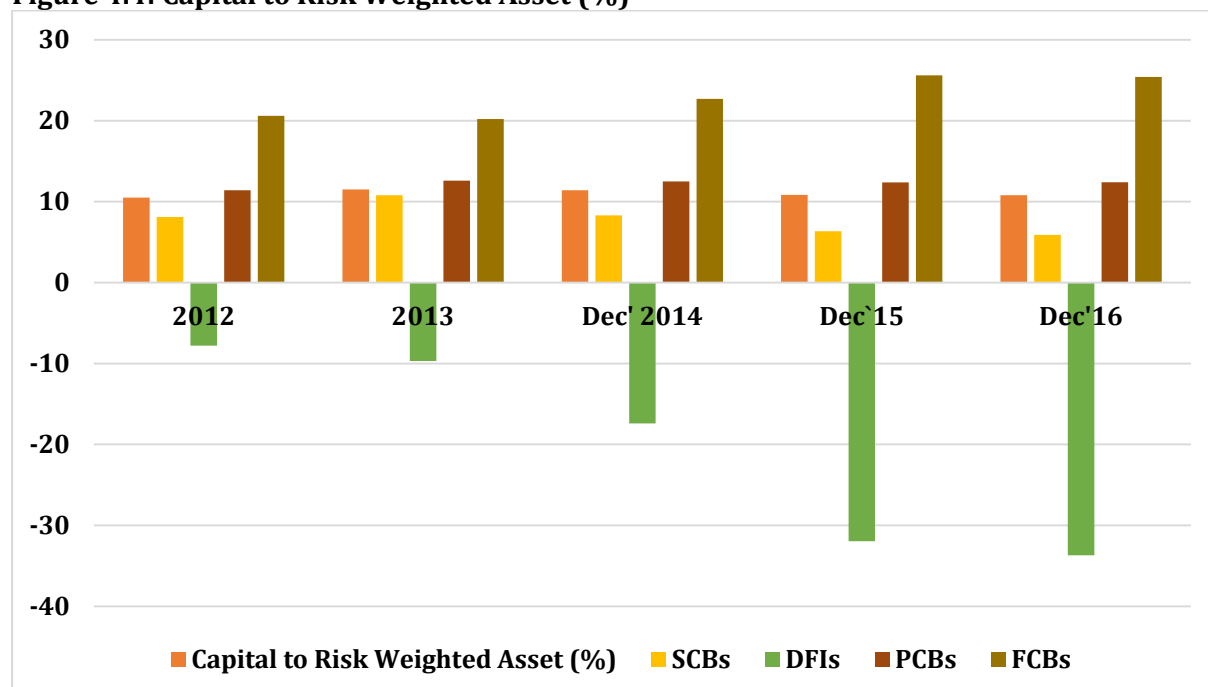
Source: Monthly Major Economic Indicator (Various Issues), Bangladesh Bank.

4.3 Capital adequacy is below BASEL III requirements

High NPL and low profitability have resulted in low capital adequacy in the banking sector. Bangladesh is in the process of full implementation of a global regulatory guidelines such as Basel III for capital adequacy from January 2020. The process of Capital Conservation Buffer (CCB) requirement for banks has started from early 2016 and will be fully implemented by 2019 in line

with the Basel III framework.²⁹ At end of December 2016, the risk weighted capital adequacy ratio (CAR) in the banking sector was 10.8 per cent (Figure 4.4) which was slightly higher than the minimum requirement of 10.0 per cent and 50 basis points higher than the ratio recorded during September 2016. SCBs and development financial institutions (DFIs) could not maintain the minimum CAR requirement, indicating vulnerability of these banks. Private commercial banks (PCBs) and foreign commercial banks (FCBs) maintained their CAR above the minimum requirement. DFIs' situation has worsened in December 2016 quarter from previous quarter June 2016 (Bangladesh Bank).

Figure 4.4: Capital to Risk Weighted Asset (%)



Source: Bangladesh Bank.

4.4 No respite from NPLs

The central bank has made some effort to ensure an effective banking system and to bring SCBs and DFIs under strict monitoring and control mechanism. The introduction of the Bank Company (Amended) Act 2013, formation of risk management committee, implementation of credit and risk management training, spelling out the terms and references and responsibilities of the board of directors, and a number of reform measures at the administrative level are among those.

Despite various initiatives taken by the central bank, the amount of NPLs has piled up. During January -March FY2017 period it rose to Tk. 73,409 crore from Tk. 62,170 crore in the preceding quarter.³⁰ NPL in the banking sector has a general pattern observed during the last few years which shows that towards December of each year NPL comes down, but starts to rise afterwards.

²⁹ 'Basel III' is a comprehensive set of reform measures, developed by the Basel Committee on Banking Supervision, to strengthen the regulation, supervision and risk management of the banking sector.

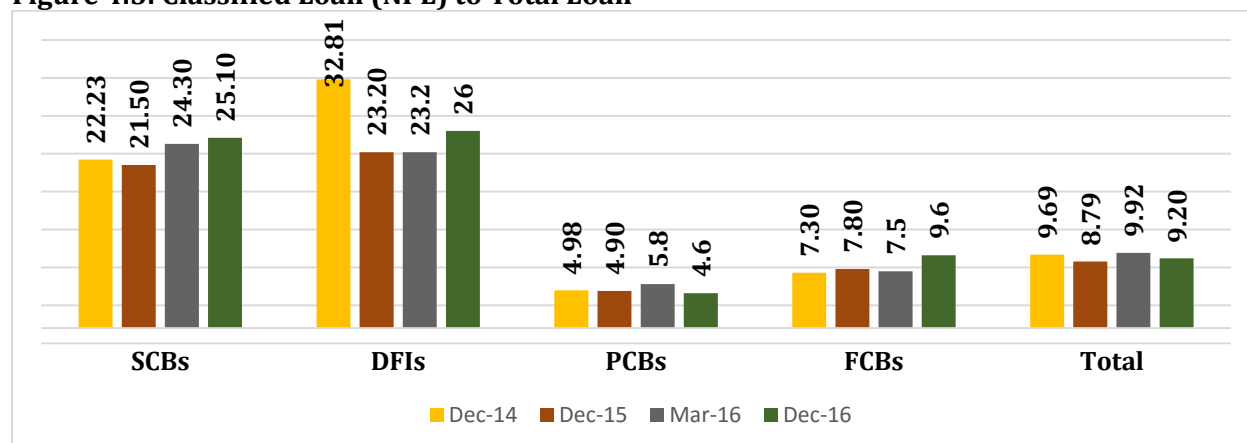
³⁰ Reported on Financial Express. Available at:

<http://www.thefinancialexpressbd.com/2017/05/17/70594/Q1-non-performing-loans-leaps-to-Tk-734.09-billion/print>

This is due to banks' effort to clean up their balance sheets at the end of the year. In December 2016, the NPL was 9.2 per cent and within the next three months it rose to 10.5 per cent. During January-March 2017 period, the total amount of NPLs in six SCBs went up to Tk. 35,717 crore from Tk. 31,026 crore in the previous quarter. Regional comparison shows that Sri Lanka and India has much lower NPL than Bangladesh, though Pakistan shows a poorer performance in case of NPL (Figure 4.6). Though Bangladesh Bank adopted a flexible loan-rescheduling policy in December 2013, it did not bring positive outcome as intended (Figure 4.5; Table 4.3). Among the SCBs, Janata Bank tops the list of loan default followed by Agrani, Sonali and Rupali Banks. Bangladesh Bank introduced a separate loan restructuring policy for big defaulters worth Tk. 500 crore or more in 2015. So far 11 corporate groups have availed the facilities. Of them, seven are clients of Janata Bank. Three groups which made a total loan of more than Tk. 2,300 crore regularised by various banks have failed to continue their payment of instalments. Under the central banks' restructuring policy, different banks have restructured over Tk. 4,800 crore of loans of one company. Increased NPL in Bangladesh is the result of relaxed recovery effort, financial fraudulences, lack of government and political influences.

Increased NPL and lower credit to the domestic sector have hit the profitability of banks through it increased in December 2016 compared to June 2016. This increase is lower than that of December 2015. Profitability indicators such as Return on Assets (ROA) and Return on Equity (ROE) show that in December 2016, ROA increased to 0.7 per cent from 0.44 per cent in June 2016, while ROE increased to 9.9 per cent in December 2016 from 7.13 per cent in June 2016 (Figure 4.7). These increases are led by FCBs followed by PCBs.

Figure 4.5: Classified Loan (NPL) to Total Loan



Source: Bangladesh Bank Quarterly Reports.

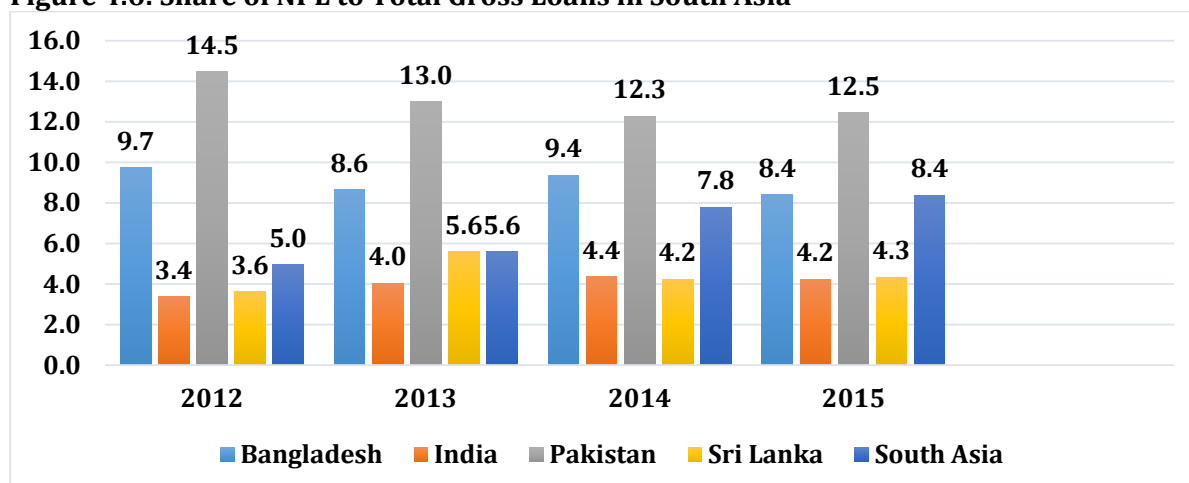
Table 4.3: Banking Sector Performance

Indicators	Bangladesh			India	Pakistan
	2005	2010	2015	2015	2015
Capital to Risk Weighted Assets (%)	5.6	9.3	10.8	13.94	20.1
NPL to Total Loans (%)	13.6	7.3	8.8	3.81*	1.89
Expenditure/Income Ratio	92.1	70.8	76.3	49.13	
Return on Asset (%)	0.6	1.8	0.8	0.46	2.5
Return on Equity (%)	12.4	21	10.5	7.74	25.8

Source: Annual Reports, Bangladesh Bank, Annual and Quarterly Reports State Bank of Pakistan and India.

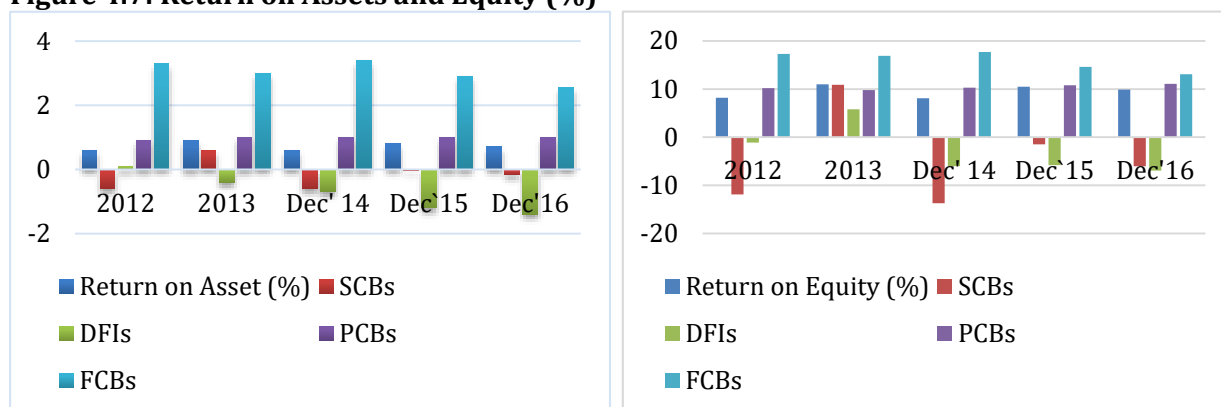
Note: *India, Pakistan-Net NPA to Net Advances.

Figure 4.6: Share of NPL to Total Gross Loans in South Asia



Source: World Bank.

Figure 4.7: Return on Assets and Equity (%)



Source: Bangladesh Bank.

4.5 Cost of recapitalisation is high

The government has been providing generous support to SCBs in order to improve their balance sheet. In recent years certain amount is earmarked in the national budget to make for the losses of the SCBs. In the budget of FY2017, the government had allocated a recapitalisation fund equivalent to Tk. 2,000 crore in order to meet the capital shortage of banks created by loan defaults. But the default loan situation of the SCBs has not improved. For the last three consecutive years, i.e. FY2014, FY2015 and FY2016, the allocated budget funds to meet the capital shortfalls was about Tk. 5,000 crore for each fiscal year. Such recapitalisation funds were not much of a help since they could only improve the balance sheet of the ailing banks, but not the overall loan default situation. The actual expenditure for recapitalisation was highest in FY2014.

Among the receiving banks, Sonali Bank received the highest amount Tk. 2,794.8 crore of recapitalisation budget fund followed by BASIC Bank (Tk. 2,390 crore). The financial condition of the two SCBs deteriorated due to massive loan anomalies and malpractices. Among the other fund-receiving banks, Agrani Bank received Tk. 1,081 crore, Janata Bank Tk. 814 crore, Rupali

Bank Tk. 272.5 crore, Bangladesh, Krishi Bank Tk. 789.7 crore and Rajshahi Krishi Unnayan Bank received Tk. 318 crore as recapitalisation fund.³¹

In a resource constraint country the opportunity cost of such a large amount is high. CPD has estimated the share of recapitalization fund in incremental revenue income of Bangladesh to understand the magnitude of resources that is misused (Table 4.4). This resource could otherwise be utilized for the social sector where budget allocation falls short of the requirement. Table 4.5 shows that if the recapitalization fund was used for education and health sector, it would improve the share of these sectors' budget in GDP.

Table 4.4: Recapitalisation as Percentage of Incremental Revenue Income

	Total Revenue (Tk. crore)	Incremental Revenue (Tk. crore)	Amount of Recapitalisation(Actual) (Tk. crore)	Recapitalisation as % of Incremental Revenue
FY2009	64285			
FY2010	75559	11274	1,000	8.9
FY2011	92993	17434	1,050	6.0
FY2012	113786	20793	341	1.6
FY2013	128823	15037	420	2.8
FY2014	140369	11546	4,477	38.8
FY2015	144009	3640	2,617	71.9
FY2016	172910	28901	1799.6	6.2
Total (2010-2016)	868449	108625	11,705	10.8

Source: Monthly Fiscal Frameworks (Various Issues), Budget Brief (Statement IV-various issues).

Table 4.5: Share of Education and Health Budget if Recapitalisation Fund is Included

Years	Education Budget (Actual Expenditure) Tk. Crore	Health Budget (Actual Expenditure) Tk. Crore	Amount of Recapitalisation(Actual) Tk. Crore	Education as % of GDP(Actual Expenditure)	Share of Education Budget in GDP if Recapitalisation Amount is Included	Health as % of GDP(Actual Expenditure)	Share of Health Budget in GDP if Recapitalisation Amount is Included
FY2010	15550	6183	1,000	1.95	2.1	0.78	0.90
FY2011	18383	7286	1,050	2.01	2.1	0.80	0.91
FY2012	18737	7476	341	1.78	1.8	0.71	0.74
FY2013	20748	8545	420	1.73	1.8	0.71	0.75
FY2014	25089	9384	4,477	1.87	2.2	0.70	1.03
FY2015	28001	10394	2,617	1.85	2.0	0.69	0.86
FY2016	37811	12600	1799.6	2.20	2.3	0.73	0.84

Source: Calculated by CPD based on budget documents.

³¹ Reported on Dhaka Tribune. Available at: <http://www.dhakatribune.com/business/banks/2017/03/25/state-banks-fail-improve-bad-loan-situation/>

4.6 Amendment to the Banking Company Act is a regressive measure

The government has approved amendments to three provisions of the Bank Company Act on 8 May 2017. First, increasing the tenure of the board of directors of a private bank will be increased from six to nine years. Second, the elected chairman, directors and the managing director of a private bank will require the consent of Bangladesh Bank prior to assuming office. In the current law they have to seek permission from Bangladesh Bank before participating in the election. Third, up to four members of a family may be appointed as board of directors for a bank, while the law currently permits only two members from one family.

The Banking Companies Act has been subject to several amendments on a regular basis. In 2003, an amendment significantly improved corporate banking governance as it established the requirement to form an audit committee and introduced independent directors. Other such amendments have been successful, such as in 2009 the amendment pushed for the mainstreaming of corporate social responsibility (CSR) in financial institutions and achieved increased investments in CSR.

Bangladesh's banking sector is dominated by family members. Such dominance often means that there is resistance to adopting corporate regulations. There is also a tendency for important decisions to be made at family gatherings rather than at corporate meetings. In view of this the Banking Companies Act was amended in 2013 to curb such activities. This amendment had allowed banks to have a maximum of 20 members on the Board, of whom three directors must be independent. This allowed a maximum of two family members to hold directorial posts. This law was enforced in 2014.

In Bangladesh's banking sector, it is not uncommon to observe owner-management collusion to perform irregularities. Owner interference in the management of PCBs also led to various malpractices in these banks. This most recent amendment is regressive in nature since it will be taking a step back from the previous changes made to the Act. This law will mean that family ownership will have greater control in banks with the possibility of erosion of corporate governance.

4.7 Orderly transition to end Islami Bank crisis

Islami Bank Bangladesh Limited (IBBL), established in 1983, was facing allegations of being involved in terrorist financing and funding political violence for the last few years. In view of demands from various corners, investigation was launched against the bank's activities and its connection with the anti-liberation groups. In order to protect the public interest and the depositors, Bangladesh Bank imposed special control on any appointment at the senior management level of Islami Bank in December 2015.

The newly created management committee are now charged with managing the bank. However, a number of developments have created concerns about the smooth functioning as well as the future of the bank. Amidst major changes in the management of the bank, the concentration of shares has shifted towards a single owner-borrower. In view of the ongoing turmoil in IBBL and uncertainty, an orderly transition is urgently required. The situation demands a statement from Bangladesh Bank. In the interest of common depositors and borrowers and in order to improve

its governance the central bank has to play a role at this critical moment. Some of the developments are presented in Box 4.1.

Box 4.1 Chronology of Developments on Islami Bangladesh Bank Limited³²	
17 July 2012 report	<ul style="list-style-type: none"> U.S. Senate Permanent Subcommittee on Investigation in its report titled <i>U.S. Vulnerabilities to Money Laundering, Drugs and Terrorist Financing: HSBC Case History</i> disclosed that two Bangladesh-based banks, IBBL and Social Islami Bank Limited (SIBL) were involved in terror financing.
2 April 2016	<ul style="list-style-type: none"> Bank declared 10 per cent dividend on April 2 for 2016 against a net profit of Tk. 450 crore
8 May 2016	<ul style="list-style-type: none"> Taskforce to strengthen action against militancy financing has asks the authorities of IBBL to submit statement of dividends provided to its non-profit depositors since the inception of the bank.
5 January 2017	<ul style="list-style-type: none"> IBBL Chairman was replaced by a former Secretary of the GoB. New managing director and chief executive officer was appointed.
10 January 2017	<ul style="list-style-type: none"> Four executive vice presidents (EVPs) of the IBBL were promoted to deputy managing directors (DMDs)
23 May 2017	<ul style="list-style-type: none"> Islamic Development Bank, one of the founding members of IBBL, declared it would sell 8.7 crore shares out of its total holding of 12.08 crore shares in the bank at the current market price
25 May 2017	<ul style="list-style-type: none"> Two independent directors of IBBL resigned from the board, two days after they were removed from their executive posts.

Looking ahead

The banking sector has burgeoned over the years in terms of the number of banks, amount of asset and contribution to the economy. CPD, in its previous reports has consistently been emphasising on the need for improved governance through strong monitoring and supervision, use of technology and ensuring independence of the regulatory authorities. The need for a Financial Sector Commission has also been reiterated time and again which will look into the challenges of the sector and make recommendations for an accountable and strong banking system. If the current trend of mammoth NPL, inefficient management and lack of governance continues, the banking sector can cripple a flourishing economy instead of contributing towards its advancement.

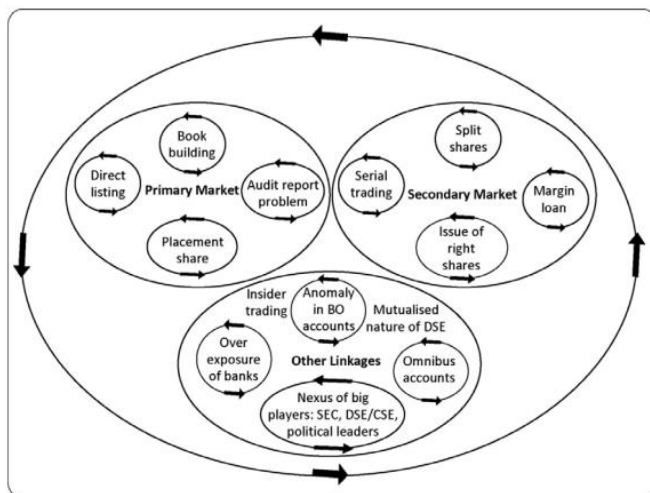
³² <http://www.dhakatribune.com/business/banks/2017/05/26/whats-going-islami-bank/>
<http://www.thedailystar.net/frontpage/islami-bank-crisis-deepens-two-directors-quit-1411177>
<https://businessnews-bd.net/ibbl-four-evps-promoted-to-dmds/>
<http://www.newagebd.net/article/6551/articlelist/323/Cartoon>
<http://www.eurasiareview.com/12112012-bangladesh-banking-for-terror-analysis/>

SECTION V. CAPITAL MARKET AT BAY

5.1 Introduction

It has been more than six years since the share market debacle of December, 2010. Following the bubble and bust, a number of official investigations had been put in place; a number of academic studies have tried to identify the causes of the scam, attendant weakness in restoring confidence in the market. CPD has also conducted several studies in this regard (CPD, 2011; Moazzem et al., 2012). These have identified 17 different types of problems which include the followings: (1) Lack of transparency in BO accounts; (2) Presence of bull cartels; (3) Weak monitoring of book building system; (4) Rampant use of placement shares; (5) Frequent recourse the malpractice of serial trading; (6) Insider trading; (7) Faulty audit reports of many listed companies; (8) Faulty operations of merchant banks that are too many in number; (9) Retailer-like behaviour of institutional investors; (10) Role of commercial banks; (11) Weak oversight of the Bangladesh Bank; (12) Participation of small investors in 'Keynesian Beauty Contest'; (13) Faulty operations at DSE/CSE, (14) Weak and ineffective role of SEC as a regulator; (15) Weak institutional capacity of the SEC, (16) Lack of enforcement of rules and regulations; and (17) Lack of coordination among the various regulatory bodies. Presence of these 'toxic elements' had created a 'vicious cycle' in the capital market (Figure 5.1) that resulted in market manipulation and these need to be addressed through appropriate restructuring and reform measures.

Figure 5.1: Market Collapse in 2010: Vicious Cycle of Toxic Elements



Source: Moazzem et al., 2012

In response to the market collapse, SEC announced a medium to long term plan to restructure the capital market and undertook a diverse range of measures accordingly. Various regulatory and operational measures undertaken in the context of the problems were identified by CPD studies. A large part of such measures are regulatory in nature. These were particularly related to transparency in BO accounts, book building system, reduction in the use of placement shares, introduction of better auditing practices, efficient operation of merchant banks, better management and operation of the SEC and demutualisation of stock exchanges etc. At the same time, a number of operational measures were also undertaken. These measures have been well appreciated by stakeholders (Shah, 2016). However, the important issue at hand is whether these

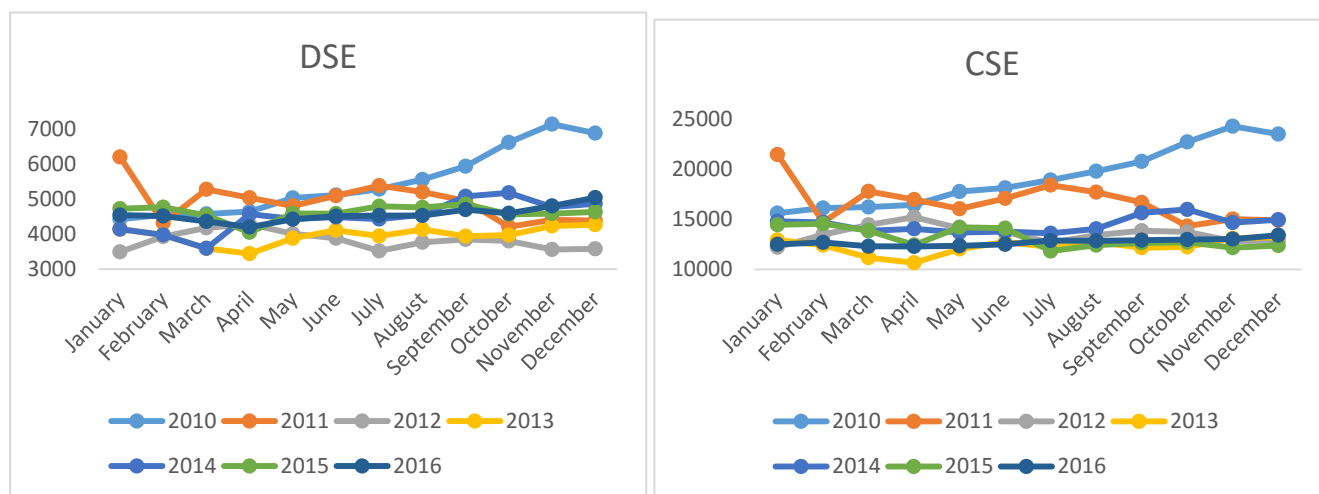
measures were able to ensure market efficiency, and hence build confidence among the involved stakeholders.

In this backdrop, this section examines the level of efficiency of the capital market in order to appreciate the effectiveness of various reform measures introduced over the past six years. Based on the analysis, the paper examines major weaknesses in the market that continue to persist in the market. The study makes an attempt to capture their implications on market performance and efficiency. Finally, the paper puts forward a set of suggestions for improved operational efficiency in the market.

5.2 Overview of the capital market: Examining market level efficiency

Over the last six years, the majority of the capital market indicators has experienced significant levels of correction. Major market related indicators such as DSEX, CSEX and P/E ratios have experienced downward revision between January, 2011 and April, 2017: by about -12.8 per cent, -52.7 per cent and -44.0 per cent respectively (Figures 5.2 and 5.3). DSEX and CSEX have stabilised at around 5,000 and 12,000 marks respectively. Consequently, market capitalisation has undergone significant reduction over the past years. Number of companies enlisted in the capital market has come down (on average 9 companies per year) though number of applications submitted for enlistment was significantly high.³³

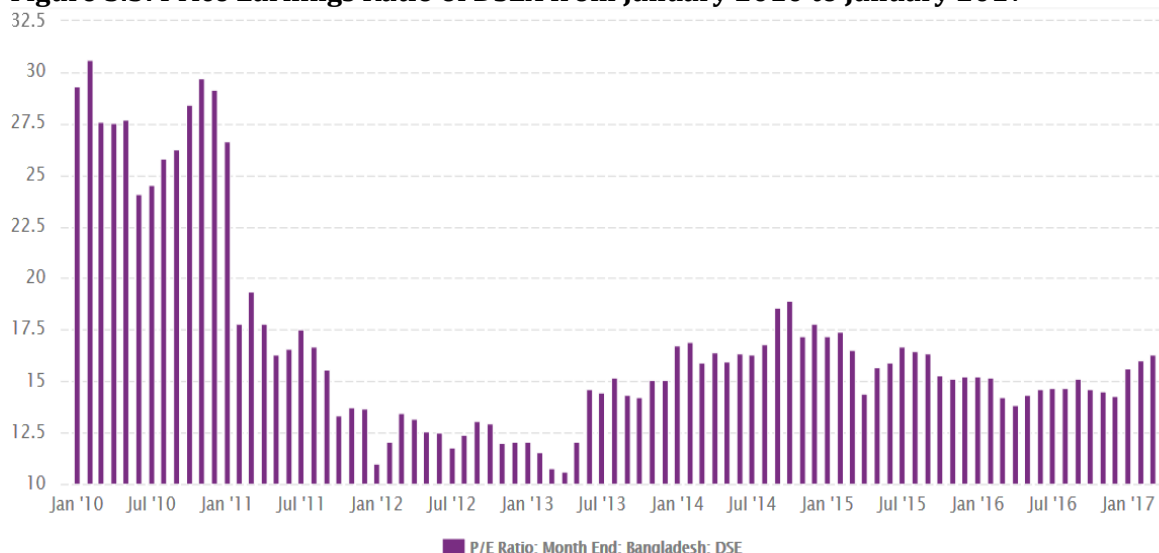
Figure 5.2: Trends in DSE and CSE Share Price Index (DSEX and CSCX)



Source: Prepared by authors based on data extracted from the DSE and CSE websites

³³ More importantly, new listing of companies has decreased significantly in recent years (4 companies in 2015, 8 companies in 2016 and 3 companies thus far in 2017).

Figure 5.3: Price Earnings Ratio of DSEX from January 2010 to January 2017



Source: Prepared by authors based on data extracted from the DSE and CSE websites

5.3 Examining the 'Efficient Market Hypothesis'

This study has examined the efficient market hypothesis in relation to the Dhaka Stock Exchange by using the Random Walk Model. Sample data comprises of the daily index value of DS30 and DSEX for the period of 1 January, 2015 to 22 May, 2017 which include a total of 583 observations for both these indicators. It is observed from the test from the test that z values of both the indices are significantly higher than the normal limit (-1.645 to +1.645) and corresponding p-values are also zero which indicates that the consequent price changes did not move in an independent manner and returns of DS30 and DSEX did not follow the random walk theory. This would indicate that DSE's level of efficiency is weak.

Another way to test randomness is to examine the serial correlation of the index values. Lo and MacKinlay (1988) developed a variance ratio test to check the efficient market hypothesis (EMH). The test implies that if the natural logarithm of a time series Y_t is a pure random walk, the variance of its q-differences rises proportionally with the difference of q.³⁴ To test the EMH for the DSE, the autocorrelation tests with 20 lags were performed for DS30 and DSEX. The result of these tests showed that, in case of DS30, the null hypothesis is rejected for all lags at 5 per cent level of significance except for lag 1, 3, 5 and 14. While in the case of DSEX, the null hypothesis is rejected for all lags at 1 per cent level of significance. The study further tests the joint hypothesis of autocorrelation coefficients up to 20 lags applying Ljung-Box Q statistics. The result of Q-statistics reveals that the autocorrelation coefficients up to 20 lags are jointly significant for DS30 and DSEX at 5 per cent and 1 per cent level of significance respectively. This implies that the returns of DS30, and DSEX did not follow as per the Random Walk Model. This would indicate that DSE was afflicted by weak form of efficiency.

³⁴ In other words, if a series follows a random walk process, the variance of its q period should be q times the variance of the one period difference.

5.4 Analysis of market related indicators of newly listed companies since 2011

Performance of capital market since the market collapse in 2010 may be examined based on different market related indicators. This study considers information on the newly listed companies since January, 2011. Of the 73 enlisted companies, data was available for 54 companies. Of the approved IPOs in different years, highest number of companies belonged to textiles (23), followed by engineering (12), fuel and power (9) and pharmaceuticals (6). Highest number of companies were listed in the years 2014 (17), 2013 (14) and 2015 (13); however, the number of enlisted companies has come down in 2016.

Share price of a traded company generally indicates company's current performance as also its possible future performance. The share price of the newly listed companies did not maintain a consistent trend over the past six years. In majority of the cases, changes in share prices of the same company has varied widely over the years. In most of the years, changes in average price of most of the companies were found to be negative.

Moreover, changes in share prices are not always consistent with other company level indicators such as earning per share (EPS), price-earnings ratio, net asset and net profit after tax (Table 5.1). It was observed that in most cases, share prices of newly listed companies have suffered losses immediately after their trading had initiated in the market. Analysis of 54 companies reveals that share price of almost two-thirds of the newly listed companies decreased in the second day and that the trend continued in the following days. Till the seventh day, majority of companies had experienced a fall in share prices. This indicates inconsistency in the price set for trading; this also indicates inherent weaknesses in the listing process.

Table 5.1: Changes in Key Indicators of Newly Listed Companies between 2011 and 2016 (Four Indicators: EPS, P/E Ratio, Net Asset, Net Profit after Tax)

Indicators	No. of listed companies since 2011	Percent of total companies
No change in key indicators	3	5.56
Only one indicator is positive	16	29.63
Only two indicators are positive	18	33.33
Three indicators are positive	11	20.37
Four indicators are positive	6	11.11
Total	54	100

Source: Authors' estimates based on collected data.

More importantly, changes in the values of key company performance indicators of newly listed companies are not consistent with one another. Analysis reveals that changes in values of key indicators (between 2011 and 2016) i.e. EPS, P/E ratio, profit after tax and net asset value of different companies in many cases were found to be difficult to explain.

Additionally, such a trend in company performance is difficult to explain when this is compared with sectoral performance. It is found that the majority of sectors related to the listed companies has performed relatively well during the concerned period (2011-2015) (Table 5.2). Overall, relationship between sectoral performance of various industries (reflected in the Quantum Index of Production (QIP)) and company level performance of listed companies was not found to be aligned.

Table 5.2: Changes in QIP of Selected Medium and Large Enterprises

Major Industry Group	Manufacture of food products	Manufacture of textiles	Manufacture of Leather and related products	Manufacture of paper and paper products	Manufacture of chemical and chemicals products	Manufacture of pharmaceuticals medicinal chemicals	manufacture of other non-metallic mineral products	manufacture of basic metals	manufacture of fabricated metals products	Manufacture of electrical equipment	Manufacture of machinery and equipment
2010-11	138.7	139.5	129.0	169.7	70.8	165.0	134.6	111.5	137.7	122.5	173.0
2011-12	161.3	139.4	132.3	171.3	80.8	169.8	138.2	114.3	138.8	125.2	178.3
2012-13	219.1	142.4	139.8	160.4	84.6	178.8	139.5	136.4	149.0	128.5	155.9
2013-14	241.5	139.7	147.8	152.0	80.4	230.6	144.2	150.2	164.3	132.1	172.7
2014-15	333.1	122.8	140.5	174.7	77.5	291.0	182.8	187.1	182.3	164.6	204.9
<i>% Change</i>											
2011-12	16.4	-0.1	2.6	1.0	14.1	2.9	2.7	2.5	0.8	2.3	3.1
2012-13	35.8	2.1	5.6	-6.4	4.8	5.3	0.9	19.4	7.4	2.6	-12.6
2013-14	10.2	-1.9	5.8	-5.3	-5.0	29.0	3.4	10.1	10.3	2.8	10.8
2014-15	37.9	-12.1	-5.0	15.0	-3.6	26.2	26.8	24.6	10.9	24.6	18.7

Source: BBS, 2017.

Analysis of performance of listed companies since 2011 raises a number of questions as regards functional efficiency of the market, particularly with regard to consistency of the data on performance related indicators for the listed companies, quality of financial reporting of the listed companies, trading behaviour of investors in the secondary market, quality of financial audits, enlistment process for new companies, performance of issue managers and role of DSE/CSE and regulatory role of SEC.

5.5 Major concerns with regard to the capital market

Quality of financial reporting of listed companies

Performance indicators of listed companies indicate that financial reports prepared by the companies often do not show the 'actual' performance of the companies. It happens inspite of several regulatory and operational measures having been undertaken by the SEC with a view to improve financial reporting standards of the listed companies. The measures included selection of listed audit firms for reporting, rotation of listed audit firms every three years and options for re-audit. It is important to examine whether SEC has actually monitored the compliance requirements to be followed by listed companies, whether SEC took the needed measures for re-auditing and if so, what kinds of penalty was imposed on listed companies in case of failure to comply with the required standard. According to Table 5.3, SEC did take certain steps against the complaints lodged.³⁵ However, most of the complaints were related to non-payment or delays in payment of dividend, transfer of shares and refund warrants etc.³⁶ However, such complaints did not concern quality of financial report and quality of auditing.

Table 5.3: Complaints against Listed Companies in 2011 and 2015

	2011			2015		
Complaints	NCR	UP	CR	NCR	UP	CR
Overall	173	22	133	52	27	25
% Resolved	76.87%			48.07%		
In per cent						
Nonpayment or delay in payment of dividend	8.09	18.18	8.27	30.70	29.60	32.00
Nonpayment of debenture installment	0.58	4.55	0.00	0.00	0.00	0.00
Regarding transfer of shares	4.62	13.64	3.76	7.69	11.10	4.00
Non receipt of letter of rights share offering	56.65	18.18	63.91	0.00	0.00	0.00
Non receipt of annual report	6.36	0.00	7.52	3.85	0.00	8.00
Refund warrant	0.58	4.55	0.00	0.00	0.00	0.00
Non demat of shares	23.12	0.00	0.75	0.00	0.00	0.00
Miscellaneous	0.00	40.90	15.8	57.6	59.20	56.00

Note: NCR: No. of complain received; UP: Under process; CR: Case resolved.

Source: Authors' estimate based on collected data.

³⁵ However, the number of complaints as well as number of complaints resolved have declined in recent years- from 76 per cent of complaints resolved in 2011 to 48.1 per cent in 2015.

³⁶ There is large number of complaints under miscellaneous category.

Due diligence applied for enlistment of companies

During 2011 and 2017, a total of 131 companies submitted prospectus to the SEC for enlistment; of these 73 companies received approval and were subsequently enlisted. This would mean that about 44 per cent of applications did not get the necessary approval. A number of regulatory and operational changes have been put in place in relation to submission of applications, particularly under book building method and collection of funds drawn through IPO process. The average number of times companies were required to resubmit their applications was 2.57 in 2011 which was 1.4 in 2017. In other words, the average number of resubmissions has declined.

Interestingly, the average number of resubmission is relatively higher in case of companies which had applied under the category of fuel and power (4.4) followed by textiles (3.68) and engineering (3.06). Out of the 131 companies, there are 42 cases where companies resubmitted their applications only once. It is important to examine whether IPO applications are scrutinised properly and in case of resubmission whether compliance process has been duly followed. There were procedural delays in case of approval of IPO proposals due to incomplete/improper submission of applications by issue managers. In such cases submission requirements increase and approval process gets delayed. Generally it takes about 10 months to get approval from the SEC. This was significantly higher than that of the Bombay Stock Exchange (two and half months).

Enlistment of IPOs

Enlistment of IPOs has reduced significantly since the boom and bust of 2010, more specifically after 2013. This may have been the case particularly due to introduction of additional compliance requirements through amendment of IPO rules in 2015-16 leading to the shift from 'merit-based' to 'disclosure-based' method of scrutinising IPO applications. Under the new system, companies need to comply with additional information requirements such as cash flow and EPS related information for the preceding two years. Besides, the process of exercising due diligence has improved with introduction of the requirement of physical inspection, use of auditors from panel of auditors selected by the SEC, and also introduction of better corporate governance at the company level etc. These changes made the process of getting approval of IPOs more stringent. In case of book building system as well, a number of changes have been introduced. Despite these welcome measures, below par performance of many of the companies listed through the IPO process gives rise to concerns as regards efficacy of the newly enacted measures.

Performance of merchant banks and brokerage houses

There is a concern that the number of merchant banks and brokerage houses is higher than the volume of trade taking place in the capital market. A large number of these entities is not involved in financially viable operations; most importantly, many of these have dearth of adequate capital. Moreover, operation of some of the merchant banks and brokerage houses has not been above question. While the problem concerning margin loans appears to have receded to the background in recent years, the issue persists. It is important to see whether margin limit of these companies has been properly maintained. Additionally, the number of market intermediaries currently in operation appears to be rather high – as many as 450 intermediaries (236 in DSE and 148 in CSE) have received license to operate in these markets of relatively small size. Moreover, these intermediaries operate through branches all across the country. Investors often complain about the quality of operation and services rendered by the branches of these intermediaries. There are allegations about lack of transparency in operating the individual beneficiary owners (BO) accounts by these companies. In view of the significantly large number of financial

intermediaries and their branches, regularity of inspection by the SEC has suffered. Even in case of those which were inspected by the SEC and referred to the enforcement department for some action, speedy measures could not be undertaken (Table 5.4). Indeed, with the limited human resource, at its disposal, it is difficult for the SEC to perform its task. A thorough examination of operation of merchant banks and brokerage houses is thus called for.

Table 5.4: SEC Inspection of Stock Broker, Stock Dealer and Merchant Bank

Year	Number of Inspections	Referred to Enforcement Dept. for Action	Under Process	Resolved
2011	37	18	5	14
2012	71	6	44	21
2013	113	38	71	4
2014	65	23	39	3
2015	12	2	8	2
Total	298	87	167	44

Source: BSEC Quarterly Review.

Transparency in BO accounts

At present a total of 2.9 million BO accounts are registered with the capital market. The number has varied over the years – from as low as 2.6 million in June, 2013 to as high as 3.6 million in May, 2015. Highest number of account holders belong to the individual account holders category – these account for over 60 per cent of total BO accounts. This is followed by joint holders (37 per cent). On the other hand, number of omnibus accounts has come down over time.³⁷ Concern has been raised as regards transparency with which BO accounts of individual/joint account holders has been maintained. A proper alignment of personal information of BO account holders with other relevant organisations will significantly reduce illegal practices in the capital market. This will also make tracking of transactions and deals by individual account holders for more easier.

Demutualisation

Although the process of demutualisation was initiated in November 2013, this is yet to be completed. As per the timeline, this process should be over by June 2017. Identification of strategic investors, and selling of 25 per cent of total paid up capital to strategic partners are still in progress. All these activities were planned to be completed by June, 2017. Once this is done, DSE will need to be self-listed. However, the 250 brokers of the DSE (of which 36 brokers are active) are yet to arrive at a consensus about selection of strategic partners as prospective investors' offered price for purchasing brokers' shares appears to the latter as low.

Following initiation of the process of demutualisation in 2013, the Board of DSE/CSE has been restructured – out of 12 directors only 4 directors are brokers' representatives while the rest of the directors including Chairman are 'independent' members. Hence, the Chairman and independent directors have a critically important role to play in decision making in the newly formed Board. In this context, Chairman and other board members will have to be technically sound in stock market related issues and they should be able to take decisions that are in the greater interest of the capital market. There is much room for improvement in this regard.

³⁷The number of principal accounts has increased though at a small number.

DSE/CSE

Level of due diligence required from DSE/CSE to ensure good compliance of listed companies' in connection with financial reporting appears to be weak. Following the amendment of rules with regard to process of reporting of financial statement of listed companies, DSE/CSE need to put comments on the submitted reports. In view of the poor quality of many of the financial reports, it is important to examine whether DSE/CSE has been able to pursue due diligence as rigorously as they should.

Insider problem

Despite introduction of guidelines as regards good corporate governance practices, capital market has often remained hostage to the insider problem. It has been alleged that directors of some companies did not have the minimum required shares. It is important to examine whether this actually is the case. It has also been observed that some directors often get involved in day to day management operations of listed companies.

Trading behaviour of investors in the secondary market

A number of initiatives have been undertaken to better educate and to raise awareness of investors about trading and investing in the capital market. However, trading behaviour of 'retail' and 'institutional' investors do not conform to the best practices. Access to information through automation of DSE/CSE should have been helpful to the investors. Investors tend to mostly look for short term gains with scant confidence as regards medium to long term business prospects of the companies. Moreover, shallowness of the capital market remains a challenge where the large number of willing investors do not have adequate opportunities for investment.

Bangladesh Bank

There is an Inter-regulatory Coordination Committee which includes representatives from the Bangladesh Bank, SEC, Insurance Development Regulatory Authority (IDRA), Microcredit Regulatory Authority (MRA) and cooperatives. In view of the over exposure of some of the commercial banks, with poor assets, Bangladesh Bank has asked the commercial banks to adjust their exposure to the capital market in a time-bound manner. As may be recalled, the Bangladesh Bank has allowed the credit taken by merchant banks from their mother banks not to be considered as 'bank's exposure' to the capital market. Considering these adjustments, individual banks' exposure to the capital market has to be maintained at the required level. Bangladesh Bank should now closely examine whether all banks have exposure within the stipulated limit. As per the new guidelines, all banks must have independent directors in order to comply with SEC guidelines. This requirement also needs to be examined and enforced.

Operation of SEC

Following the various regulatory reform measures, volume of activities on the part of the SEC was expected to rise which would have ensured better compliance in the operation of the capital market. However, till now a proactive stance remains to be seen and SEC's role is more reactive than proactive, focusing more on addressing complains lodged. As per the available information, SEC has taken various measures in view of complaints made against listed companies, market intermediaries, brokerage houses and issuer companies. However, the number of such complaints is also not very high. More importantly the process of resolving disputes and complaints also appears to be rather slow.

5.6 Suggestions for strengthening the institutional and operational structure of the capital market

Transparency in BO accounts

Transactions under the different types of BO accounts, particularly of individuals and joint accounts, need to be made transparent. It is alleged that many individuals and joint account holders tend to maintain multiple BO accounts which is more than the stipulated number. There are 'ghost' accounts which are maintained illegally by avoiding compliance requirements. In this context, information pertaining to the account holders needs to be aligned with other sources of information such as NID, information preserved at the NBR and with the Bangladesh Bank. SEC should take an initiative to undertake the needed changes in the CDBL system to include appropriate codes for NID, business identification number (BIN) (if required) and bank account numbers in order to identify BO account holders with other national databases.

Improvement in quality of auditing

Financial auditing system for the listed companies needs to be significantly improved. Although a number of measures have been undertaken in order to improve the auditing practices, quality of many of the financial reports continues to be doubtful. In this context, SEC needs to take a proactive stance. It should ask for 're-auditing' of firms on a random basis. In this context, delays in operationalisation of Financial Reporting Council (FRC) under the recently enacted 'Financial Reporting Act' has emerged as a major concern. Thus, establishment of the FRC with appointment of competent chairman and members, and its coming into force are urgently called for.

Proper review of IPOs

Although the IPO review process has improved with changes in reporting system and requirement of various documents, the process needs to be further strengthened. A review of share prices of newly traded companies in the first week of trading indicates that share price of most of the companies has declined from the second day of trading. In other words, the companies perhaps are not properly assessed before allowing them to go for trading. Unless appropriately assessed with physical inspection, 'paper-based' information about health of the companies remains doubtful. In this backdrop, SEC and DSE/CSE need to strengthen their assessment process with proper physical inspection to examine viability of companies and their actual intention to go for enlistment. Process of assessment should be accelerated so that companies may have a predictable timeframe.

Proper monitoring of merchant banks and brokerage houses

Inspection of activities of stock brokers, stock dealers and merchant banks need to be more frequent. Given the significantly high number of financial intermediaries and their branches, frequency of inspection at present appears to be very low. A large number of cases has been referred to the DSE/CSE involving complaints against financial intermediaries. These need to be speedily resolved. Out of 282 cases referred to DSE/CSE only 169 cases (about 60 per cent) have been resolved till now. In other words, about 40 per cent cases remain unresolved. It is important to know the reasons behind the delays of the part of DSE/CSE to settle the complaints. Settling such cases, speedily and in a transparent manner, will transmit a positive signal to the market. In a good number of cases, SEC had penalised some of the intermediaries for various illegal activities (Table 5.5). It is important to know the amount of money which has been collected by penalising companies, and also amount of money that is yet to be collected.

Table 5.5: Enforcement of Legal Measures

Against	2011		2012		2013		2014		2015	
	Warni ng	Penal ty	Warni ng	Penal ty	Warni ng	Penal ty	Warni ng	Penal ty	Warni ng	Penal ty
Total	176	105	107	98	54	36	80	72	76	52
%										
Company	88.6	42.9	46.7	57.1	29.6	38.9	56.3	20.8	17.1	34.6
CA Firm	1.1	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	3.8
Broker/ Dealer	4.0	45.7	43.9	29.6	48.1	41.7	35.0	48.6	65.8	36.5
CRC	0.6	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Merchant Bank	0.0	0.0	0.0	0.0	0.0	0.0	0.0	4.2	6.6	11.5
Issue Manager	1.1	1.9	0.9	0.0	1.9	2.8	0.0	1.4	0.0	7.7
Others	4.5	9.5	6.5	13.3	20.4	16.7	8.8	25.0	10.5	5.8

Source: BSEC Quarterly Review.

Strengthening the boards of DSE/CSE

The boards of the DSE/CSE need to be strengthened with appointment of competent and honest persons as independent directors. The Chairman and the board members need to have strong background on the capital market, and should be able to take decisions without influence of any vested quarters. The process of decision making needs to be more transparent, these decisions should be enforced quickly. For example, weak review process concerning IPO applications, slow progress in undertaking actions in view of complaints against financial intermediaries and lack of initiative to self-review the applications indicate that the Boards need more power to provide proper directives to the DSE/CSE administration to operate transparently and efficiently. On the other hand, brokers should be represented in the Board by new members with a view to provide new and dynamic thinking to make the stock exchange more forward-looking and strategic.

Completion of demutualisation process

It is important to complete the identification and selection process of institutional investors without delay. As the stipulated date for completion of the demutualisation process draws near (June 2017), it is needed to identify appropriate investors for investment in the capital market. It is expected that the selected institutional investors will be of high repute at global level, and will facilitate development of the capital market by maintaining high level standards. Following this, the self-listing of DSE/CSE needs to be completed.

Rules related to special tribunal need to be amended

Although the setting up of the special tribunal is a welcome measure, its pace of activity has been rather slow. At this moment, the tribunal is handling only 21 cases. A major drawback which afflict the special tribunal is that it only handles those cases which are transferred from other courts/tribunals (25 (B) under the SEC Act 1969). SEC or any other authority is not empowered to lodge any petition directly to the tribunal. In view of the above, the tribunal has not been able to meet the expectations and deliver. Hence necessary amendments of relevant clauses in the SEC Act is needed for the SEC to be able to lodge cases directly in the special tribunal.

Improving trading behaviour of institutional investors

It is important to introduce appropriate guidelines for trading by institutional investors in the capital market (e.g. as in India). Such guidelines are necessary to streamline trading behaviour of institutional investors in the backdrop of the many complains as regards market behaviour of many such entities.

Strengthening of the SEC

With putting in place of the various rules, regulations and guidelines, the responsibilities of the SEC have increased significantly and it has been further empowered. SEC now needs to change its focus in the areas of monitoring and enforcement from a 'complaint-based' mode to 'proactive review and assessment' mode. With the existing workforce of 173, it is difficult for the SEC to undertake the rising and diverse range of activities. As per plan, SEC needs a workforce of 800, of an additional 205 staff is currently underway. Most importantly, SEC needs more human resources to scrutinise the various relevant documents including financial documents provided by the listed companies. Frequent and randomly conducted special audits of companies should be SEC's regular practice. Additional workforce will be required for speedy resolution of the various complaints lodged. This will improve confidence in the market. Moreover, additional workforce need to be deployed for day to day monitoring of activities in order to identify anomalies, and for taking speedy measures in view of those.

Initiatives for increasing the depth of the capital market

Appropriate initiatives are needed to enhance the depth of the capital market. Firstly, given the potential opportunities of bond financing for infrastructure projects, it is important to develop a well-structured bond market in the country. Secondly, SEC should take measures to create greater opportunities so that small and medium scale companies are able to raise funds from the capital market. In this context, SEC should set annual targets for enlistment of SME firms in the capital market. Thirdly, SoEs which had earlier decided to offload a part of their shares, should be encouraged, through Ministry of Finance and other concerned institutions, to offload at least a part of the shares in the capital market.

SECTION VI. CONCLUDING REMARKS

From the perspective of macroeconomic management, it is important to consolidate the strengths and devise appropriate policies to address the emerging challenges in the Bangladesh economy. The current macroeconomic trends indicate a number of disquieting signals including increasing public debt burden, persisting weakness in the banking sector performance, sluggish capital market, lower growth in export earnings, and decline in remittance inflow. At the same time, it is also apprehended that in FY2018, cost of production in almost all sectors may experience an upward trend in view of implementation of new VAT and SD Act, possible depreciation of exchange rate, rise of wage good (rice price), and yet another round of upward adjustment of the tariffs for electricity and gas. To address these challenges a proactively responsive macroeconomic management is called for as a major policy stance in the upcoming national budget.

It may be noted that CPD has already elaborated this aspect in its April 2017 proposal for the national budget (CPD, 2017). In the following paragraphs we build on the foregoing analysis in this report as well as on the recommendations for national budget for FY2018 presented earlier.

Improve the quality of the budgetary framework

It has become critical for the government to improve quality of budgetary framework and turn the so called 'big budget' myth into reality. As has been established elsewhere, declared size of the budget (as a share of GDP) – from both revenue mobilisation and public expenditure point of view – has increased over the years. But in reality (after implementation) it did not improve by any discernible way (if not declined). For example, programmed total expenditure in FY2016 was 17.0 per cent of GDP as against 14.3 per cent in FY2010. However, actual public expenditure was only 13.5 per cent of GDP in FY2016, a decline from 14.0 per cent in FY2010. Concurrently, target for revenue-GDP ratio was 10.0 per cent of GDP in FY2010 which was programmed to increase to 12.0 per cent in FY2016. However, actual revenue-GDP ratio could only be enhanced to 10.0 per cent in FY2016 from the 9.5 per cent posted in FY2010. Thus, budget implementation capacity of the government agencies needs to be enhanced by a significant margin in order to have improved impact of public resource flow in the economy.

Strengthen quality of public investment

Government pledged to implement a number of reforms with a view to raising the ADP implementation rate. These included introduction of a Project Preparatory Fund (PPF), appointing project directors through direct interviews by the line government agencies, assigning a dedicated official in each government agency for monitoring and evaluating respective projects, and delisting the longstanding 'non-operational' projects from the ADP (CPD, 2016). Implementation Monitoring and Evaluation Division (IMED) also came up on a regular basis with recommendations in the annual progress report based on the challenges faced during the project cycle. Regrettably, these have not been adequately followed up with concrete policy actions. Time and cost overrun, with high opportunity cost, have become a persistent problem in public sector project implementation. It is also observed that project costs in Bangladesh are substantially higher than those in other comparable countries. For example, construction cost of one kilometre road in India costs about Tk. 12.5-15.0 crore, while in Bangladesh such cost is about three to four times. This is true for almost all types of project, particularly those in the construction sector.

Thus even though Bangladesh is investing a large amounts of resources in public infrastructure, such investments are yet to make an impact through delivery of services. Indeed, effective rate of return from such public investments has become very obscure. It is time for setting up a Public Expenditure Review Commission (PERC) to ensure quality of public investments underwritten by scarce domestic revenue.

Augmenting resource mobilisation

A number of planned reform agendas has remained unimplemented and this has severely constrained the capacity of the government to deliver budgetary programme. Successive delays in implementing the VAT and SD Act, 2012 had also held back several other revenue mobilisation reform agendas (including new Acts on Direct Tax and Customs) which constrained the revenue mobilisation efforts. For the forthcoming budget, implementation of the VAT and SD Act, 2012 will of critical importance. CPD (2017) has made a number of proposals for smooth implementation of the new provisions of VAT. In South and East Asia and among the LMICs, the median rate appears to be 12.0 per cent, and hence, this can be an acceptable VAT rate for Bangladesh. It was also recommended for the electricity VAT rate should not be increased at one shot in view of its likely negative impact on both consumption and private investment. In this context, government may fix the maximum retail price (MRP) of electricity inclusive of VAT. Hence, the government will also need to be ready to provide adequate subsidy to the sector which may be later withdrawn in a phased manner. While implementing the new VAT Act, it is important keep provision for SD to protect the interest of the domestic-market-oriented industries. To this end, needed strategic protection to these sectors will be critical, particularly in view of the need to augment aggregate demand in the context of slowdown in export growth and fall in remittances. A longer, well-thought out list of SD may also help the government compensating for a reduced VAT rate.

It may be mentioned that, while the government is assessing the scope for a reduced VAT rate, according to several media reports, increase in SD rates for fuel, cement and telecom are also being considered. If implemented, this will be counter-productive. An increase in SD rate for fuel import may mobilise resources for NBR, but it will also create burden for BPC. While producers and consumers of Bangladesh could not fully enjoy the benefit of decline in global prices of petroleum, it is time that the administered prices of kerosene and diesel are reduced to provide relief to the concerned groups. Similarly, cement is one of the most critical investment commodities in Bangladesh, imposing SD on which would mean taxing both public and private investment. SD on telephone use is also regressive in nature, and hence, should not be imposed.

In view of possible rise in cost of living, to provide some relief to taxpayers, CPD also proposed a reduction of income tax rate from the current 10 per cent to 7.5 per cent for the first slab. Such measure will help increasing disposable income of the taxpayers and the consequent multiplier impact on the economy will create opportunities for the government to compensate for revenue losses through creating scope for additional revenue earnings.

Enhance allocation to social sectors

Budgetary allocations for education and health sectors need to be enhanced significantly. It may be recalled that Bangladesh's education and health budgets as a share of GDP are among the lowest in the world. In view of ambitious SDG targets, it is time for Bangladesh to amend the

situation. The forthcoming national budget also needs to make adequate provisioning for implementing the National Social Security Strategy.

Financing budget deficit

Implementation of forthcoming national budget must also bring discipline in the area of budget deficit financing. In view of declined interest rates of bank deposits and rising debt servicing burden, the interest rates on NSD certificates along with the purchasing ceilings need to be rationalised.

On the other hand, more effective steps needs to be taken for utilisation of the foreign aid in the pipeline. This aspect will be of defining importance for FY2017 as the off-take of project aid experienced a decline in the outgoing fiscal year.

Incurring efficiency of the public distribution system

The government needs to be vigilant in view of the recent rise in rice price in the domestic market in the midst of harvesting season. The government will need to prepare a strategy to import rice as the Boro procurement may not reach its target. Import duty on rice may be reduced if private import is also required. In view of the volatility in prices of agricultural commodities, the government is well advised to set up an Agriculture Price Commission on an urgent basis to ensure incentivised price for the producers while maintaining market stability and protecting consumer interests.

The forthcoming budget should also review the subsidy package for agriculture. The present structure of agricultural subsidy is heavily Boro-biased. In view of the loss of the Boro season, the farmers should be incentivised to cultivate in the forthcoming Aus season. Besides, it has also become critical to provide adequate incentives to diversify crop sector and also promote poultry, livestock and fishery sectors.

Public food distribution programme needs to be used in strategic way to protect the affected people in the haor and char areas and urban poor. It is also time to rethink development strategy for marginalised people living in haor, char and river erosion areas. In view of the spirit of “leaving no one behind” the government may consider setting up a ‘Haor, Char and River Erosion Area Board’. This body can devise strategy and closely monitor development needs of citizens living in these areas.

Managing the exchange rate and addressing the weaknesses in the external sector

The government may need to continue with further downward adjustment of the exchange rate of BDT in the short term. The recent volatility in exchange rate for import has exposed a weakness in the foreign exchange management on the parts of both commercial banks and the central bank. The depreciation of Taka has its demerits; it may raise import costs leading to higher cost for producers and inflationary pressure for consumers. However, some depreciation of BDT is critically important in view of lower growth of export earnings and falling remittance inflow. To arrest influx of remittances through informal channel, legal actions against illegal platforms as well as parallel initiatives to facilitate speedy and cost-effective remittance transfer will be necessary. To this end, initiatives will be required both at domestic and global levels. In view of emerging pressure in the foreign exchange reserves, it is advised to pursue a rather careful and conservative approach towards Bangladeshi investors’ plea to invest abroad.

Addressing the banking sector

Inability to initiate the needed economic reforms is a major concern from the macroeconomic management point of view. This is particularly pertinent for the financial sector in Bangladesh. The banking sector is suffering from endemic structural weaknesses due to lack of policy and institutional attention. CPD has repeatedly urged for setting up an Independent Financial Sector Reform Commission (IFSRC) which needs to come up with appropriate recommendations to address the formidable fault lines in Bangladesh's financial sector. It has now become an emergency to undertake an in-depth review and assessment of the health and performance of the banking sector of the country, and come up with concrete guidelines to deal with NPL, rescheduling of bad debt, and recapitalisation of banks. The proposed commission can be empowered to undertake the required steps. In the context of forthcoming national budget, the government needs to be prudent in allocating taxpayers' money to SCBs for recapitalisation, pending a proper assessment of their performance as well as reform of their operation. Various recent experiences suggest that it is also important not to engage in external interference in governance of the private banks. On the other hand, the recently announced amendments of the Banking Company Act, favouring the sponsor directors, have been very ill-advised.

Boosting the capital market

The capital market is also struggling as has been highlighted by this report. A number of reform initiatives has already been taken regarding operation of the capital market. Completion of demutualisation process within the announced timeframe needs to be done, while the other corrective measures including appropriate review of IPOs, alignment of BO accounts with NID and other national databases, proper financial auditing of the firms, transparency of merchant banks and brokerage house operations need to be ensured. Strengthening of SEC and other regulatory bodies including DSE and CSE are critically important for successful operationalisation of these processes.

Improving quality of statistics

To undertake dynamic macroeconomic management, it is crucial to assess the trends of macroeconomic correlates on a real time basis. In recent times, major weaknesses have emerged in the areas of statistics on the economy. Quality of statistics has come under critical scrutiny. It may be mentioned that CPD has repeatedly highlighted the growing inconsistency of data available from different government agencies. These include, revenue earnings figure from NBR and MoF, ADP expenditure figure from IMED and MoF, and budget deficit and financing figures from Bangladesh Bank and MoF. The estimation of national accounts variables have also been repeatedly critically assessed by analysts. Delivery of open statistics has also weakened. Publication of quarterly LFS data was discontinued. Available fiscal data is not accessible beyond the first four months of the ongoing fiscal year. Indeed, over the years, quarterly reporting on the state of economy by the Finance Minister to the National Parliament has also become irregular. There is an increasing trend of not sharing of data by various public institutions.

In the era of SDGs, "Data Revolution" is the name of the game. Besides, Bangladesh has also expressed its strong commitment towards this. In this context, it has become exceedingly important to ensure independence and professionalism in the national statistical organisation of Bangladesh. It may be recalled that CPD in its reaction on the national budget for FY2017 called for setting up an Independent Statistical Commission to initiate necessary reforms in this area including validation of the macroeconomic correlates.

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ANNEXURE

Annex Table 1.1: Comparison of Data Availability

Review	IRBD FY2016 (3rd Reading)	IRBD FY2017 (3rd Reading)
Indicators	Data availability situation	
GDP	Provisional estimates for FY16	Provisional estimates for FY17
QIP (medium and large)	Till January FY16	Till December FY17
Inflation	April 2016	Till March 2017
Local and foreign investment registration and value	Till March FY16	Till April FY17, (did not receive local investment data)
Public Finance		
Revenue collection: NBR sources	Till March FY16	Till February FY17
Revenue collection: MoF sources	Till December FY16	Till October FY17
Public expenditure	Till December FY16	Till October FY17
ADP implementation: IMED sources	Till April FY2016	Till April FY2017
Financial Sector		
Interest rate spread (by bank type)	Till March 2016	Till March 2017
NPL as % of total loans (by bank type)	December 2015	September 2016
Capital to risk weighted asset (by bank type)	December 2015	December 2016
Profitability Ratios (RoA and RoE) (by bank type)	December 2015	December 2016
Outstanding position of term loans	Till December FY16	Till December FY17
Disbursement of industrial term loans	Till December FY16	Till December FY17
SME Loan disbursement (quarterly)	Till December FY16	Till December FY17
Agricultural credit and non-farm rural credit	Till March FY16	Till March FY17
External Sector		
Export	Till April 2016	Till April 2017
Import Payments (23 Items)	July-March FY16	July-March FY17
L/C opening and settlement	July-March FY16	July-March FY17
Migration	Till April 2016	Till April 2017
Remittances (by destination)	Till April FY16	Till April FY17
Forex	18 May 2016	24 May 2017
BoP	July-March FY16	July-March FY17
State of the Economy Report by the Hon'ble Finance Minister for the national parliament	July-Dec FY16	July-March FY17

Source: Authors' compilation.