

State of the Bangladesh Economy in FY2017-18

Third Reading

Dhaka: 3 June 2018



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Section I: Introduction

- ❑ The present report is the third instalment of the State of the Bangladesh Economy in FY18 prepared under CPD's flagship programme titled Independent Review of Bangladesh Development (IRBD)
- ❑ Objective of this report:
 - Track trends in major macroeconomic variables during FY18
 - Present an assessment of the performance of key sectors of Bangladesh economy during FY18 in the run-up to the national budget for FY19
- ❑ The report highlights four key areas that informs macro-financial performance of the Bangladesh economy, focusing on vulnerabilities and weaknesses. The four broad areas are:
 - Fiscal and Budgetary Framework
 - Monetary and Banking Sector Performance
 - Capital Market
 - External Sector Performance
- ❑ The report makes use of the most recent data from available official and credible international sources, as well as insights gleaned from key informant interviews
- ❑ The report concludes by highlighting a number of urgent measures to be pursued by policymakers through fiscal-budgetary measures and reform initiatives

Section II: Formulating Fiscal and Budgetary Measures for FY19

Revenue mobilisation target for FY19 would require a growth of about 40% (after accounting for the possible shortfall in actual collection over the revised target)

- ❑ Following the marginal improvement in revenue mobilisation in the first six months compared to the corresponding period of FY17, it is obvious by now that the revenue target for FY18 will not be attained
- ❑ Both tax revenue (17.6% growth as against the annual target of 44.4%) and non-tax revenue (2.9% growth as against the annual target of 35.8%) collection have missed their respective targets during the first half of FY18, by a significant margin
- ❑ According to CPD (2018a), revenue shortfall in FY18 is envisaged to be around Tk. 50,000 crore

2. Formulating Fiscal and Budgetary Measures for FY19

Revenue mobilisation is not keeping pace with the 7FYP targets

- ❑ Actual revenue mobilisation has lagged behind the corresponding medium-term targets of the plan
 - In FY17, revenue-GDP ratio was 10.2% whereas, 7FYP target for the same year was 13.5%
 - This gap is dominated by shortfall in income tax collection which could only meet two-thirds of its planned target
 - A large shortfall was also recorded in case of VAT and Supplementary Duties (SD), while non-tax revenue collection remained well below the target
- ❑ If the 7FYP target of tax-GDP ratio and revenue GDP ratio could be achieved, an additional amount of about Tk. 49,400 crore and Tk. 65,980 crore respectively could be mobilised
- ❑ Achieving the 7FYP targets in the area of revenue mobilisation for FY20 is rather unlikely
 - During FY18-20, total revenue collection needs to grow at an annual rate of 32.1% to meet the target of 7FYP while, income tax collection needs to grow at an annual rate of 43.5% to meet its target level in FY20

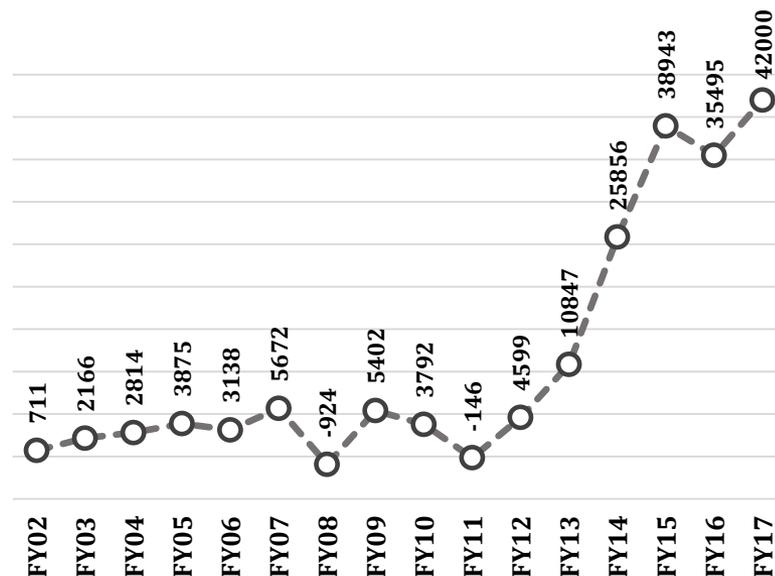
Components of revenue collection

Component	Actual FY17	7FYP targets for FY17	7FYP targets for FY20	Required annual growth during FY18-FY20
	(% of GDP)	(% of GDP)	(% of GDP)	(%)
Customs duty	1.1	1.2	1.3	18.3
VAT and SD	4.8	5.7	7.0	28.3
Income tax	2.7	4.1	5.4	43.5
Others	0.1	0.1	0.1	34.8
Non NBR tax	0.3	0.4	0.4	22.2
Non-tax revenue	1.2	2.0	2.0	35.8
Total revenue	10.2	13.5	16.1	32.1

Revenue shortfall has skyrocketed in recent years

- ❑ The mismatch between targeted level of revenue mobilisation and actual attainment has been a recurring phenomenon since FY02 in the Bangladesh economy except for two atypical years
- ❑ The UN-ESCAP (2014) reported, actual tax collection level in Bangladesh was far below the potential level – with the gap equivalent to about 7.5% of GDP
- ❑ Based on HIES 2010 data CPD study (2016) found that the actual income tax to GDP ratio was 1.53% as against the potential ratio of 3.05%
- ❑ The gap between actual income tax collection and the target has generally been the major component of the overall revenue shortfall over the recent years
- ❑ Failure to collect VAT at the targeted level also resulted in considerable revenue shortfall
- ❑ Deficit in non-tax revenue mobilisation, particularly relating to dividend and profit, and interest/fees/tolls and other receipts, has further accentuated the difficulty of mobilising the revenue at the envisioned level

Actual Revenue shortfall in Bangladesh (in crore Tk.)



❑ A concern: Difference between IBAS and NBR figures on the rise

Reduction of corporate tax rates ought to consider economy-wide impact

- ❑ Reduction of corporate tax is effective in attracting private investment only when the overall investment climate is conducive to business
- ❑ Corporate tax rates should not be reduced in a hasty manner and on an ad-hoc basis given that corporate tax rate contributes about two-thirds of income tax collection
- ❑ Higher tax rates are common for sectors where competition is regulated. India also imposes higher corporate tax rate for foreign companies (40%) compared to domestic companies (30%)
- ❑ A number of studies on the nexus between corporate tax and private investment, using both macro and micro level data, found that the reduction of corporate tax rate, in general, fosters private investment (e.g. Federici and Parisi, 2015; Bruhn, 2011; Senzu and Ndebugri, 2018; Babar, Awan and Nadeem, 2017)
- ❑ However, for many developing countries, fiscal incentives often do not effectively counterbalance the unattractive investment climate conditions such as poor infrastructure, macroeconomic instability, and weak governance and markets (United Nations, 2010)

Erosion of disposable income justifies raising of tax-free income ceiling

- ❑ In view of the rising food inflation and decreasing average monthly real wage of employed individuals since 2013, analysis depicts a picture of falling real disposable income of the individuals, particularly those belonging to the lower-middle and middle-income sections of the society
- ❑ Given this backdrop, CPD reiterates its earlier recommendations (CPD, 2018a) of raising the tax-free income ceiling to Tk. 3 lakhs, and, reducing the first slab of PIT rate to 7.5% from the prevailing rate of 10.0%

Effective operationalisation of transfer pricing cell is essential to curtail capital flight

- ❑ Capital flight has a general tendency to increase during the election years as individuals respond to possible decline in political and macroeconomic stability, and the prospect of adverse future fiscal measures (Kwaramba, Mahonye, & Mandishara, 2016)
- ❑ Concerted and coordinated effort from several policy actors including the Bangladesh Bank and NBR is required to limit the scope and extent of the likely illicit financial flows.
- ❑ Effective functioning of NBR's TPC through greater access to real time data, capacity building in forensic investigation, and logistical and policy support is crucial to this end

A well thought-out list of SDs needs to be crafted

- ❑ In the budget proposal for FY18, SD rates at import stage was changed for a total of 1,413 items with SD rates rising for 1,243 products and declining for 170 products
- ❑ In deciding on the SDs, this year's budget proposal ought to consider the soaring import payments and deteriorating balance of payment situation, along with the need to provide the domestic industry strategic support
- ❑ At the margin, this may also help the government compensate for the delayed reforms in the revenue mobilisation

Revenue mobilisation from niche areas should be spotlighted

- ❑ In view of the recurrent shortfall in revenue mobilisation and inadequate resource generation from traditional means, the government should explore the possibilities of raising revenue from niche areas
- ❑ Recovery of unpaid VAT accrued to the Large Taxpayers Unit (LTU) of the NBR, particularly those from state-owned enterprises, should be prioritised
- ❑ Swift realisation of disputed revenue claims through speedy court process and by taking recourse to the Alternative Dispute Resolution (ADR) mechanism must be put in motion

The next budget should not lose sight of the medium-term reforms

- ❑ While the next budget may not prioritise implementation of the planned reforms, debate and discussion should continue concerning this area in order to arrive at a consensus, hopefully gaining attention during the envisaged electoral debates as well
- ❑ Implementation of online VAT registration and filing system, and digitisation of VAT process, and bringing in more businesses under the system need to continue and pursued energetically
- ❑ It is important to have an implementation plan for VAT and SD Act 2012 in an informed way, taking into cognisance the prevailing concerns
- ❑ Emphasis should be given to finalisation of the draft Direct Tax Act and the Customs Act on an urgent basis
- ❑ The next budget may consider assessing the feasibility of introducing taxation of agricultural income, a comprehensive property tax and inheritance tax in line with international practices
- ❑ Attention should also be given to raising efficiency through broader deployment of technology including, for example, introduction of e-TDS with issuance of tax certificates by the NBR against e-TINs linked to all TDS collection

2. Formulating Fiscal and Budgetary Measures for FY19

Public expenditure framework needs to be redesigned to make effective use of the policy space in FY19

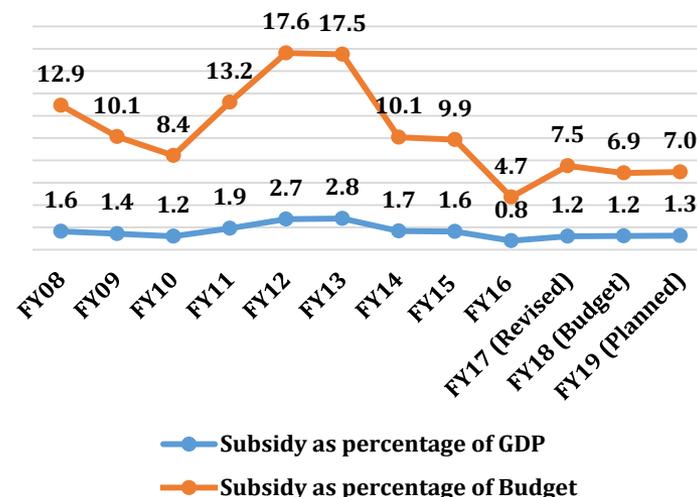
❑ Growth of public expenditure in early months of FY18 was well below the target

- Overall, the non-development expenditure registered no growth against the target growth rate of 34% during H1 of FY18

❑ **Rejuvenated subsidy demand is likely to tighten fiscal space**

- Subsidies may need to be increased in the budget for FY19 in view of the higher demand for power and gas leading to rise in power production and import of LNG
- BPC had moved on to the profit terrain in FY15 and continued to earn profit till FY17. It is highly likely that there will again be no allocation for BPC in the next budget
- Overall, the subsidy for power (PDB) and gas (Pertobangla) is set to increase by around 22% to Tk. 9,000-9,500 crore in FY19
- Agriculture and export subsidies are likely to increase by 5.6% and 12.5% in FY19

Subsidy as percentage of GDP and Budget



❑ Rejuvenated subsidy demand is likely to tighten fiscal space

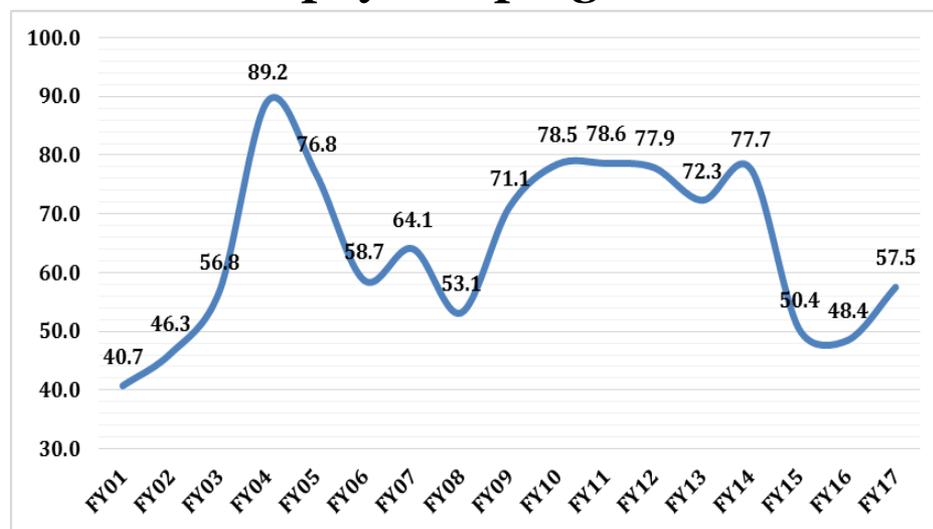
- Any adjustment as regards energy prices should be calibrated by taking into cognisance prices of fuel, gas and electricity, overall impact of the price-change mix for major stakeholder groups and the burden of the government's subsidy related expenditure
- According to the Petrobangla estimate, it will cost the government about Tk. 6,922 crore (USD 844.2 million) in a year to import 1000 mmcf/d equivalent of LNG and its re-gasification
- In the backdrop of the anticipated higher cost of importing LNG, Finance Minister has hinted about increasing the prices of gas and electricity in the upcoming fiscal year
 - Gas suppliers are seeking a 75% increase in the price of gases used for commercial purposes, from Tk. 7.39 to Tk. 12.95 per cubic metre
- ❑ **If the subsidy and prices of energy both increase simultaneously, it will put pressure both on the expenditure side and at the consumer level**
- ❑ Consumers and producers should not bear the burden of inefficiencies in implementing power/energy policies. Investment should be made in raising efficiency in related areas

2. Formulating Fiscal and Budgetary Measures for FY19

ADP expenditure, against allocation in FY18, is the lowest in recent years

- ❑ 50.2% of original ADP was spent during Jul-Apr of FY18 – lower compared to FY17 (54.7%)
- ❑ ADP was slashed by Tk. 6,000 crore (or 4.8%) to Tk. 148,381 crore
- ❑ Allocation was slashed for a number of sectors (e.g. Transport; Education and Religious Affairs; Science, Information and communication Technology; and Oil, Gas and Natural Resources) due to slow rate of implementation
- ❑ Low physical progress undermines quality of overall ADP implementation
 - During FY01-FY17, about 65% (on an average) of all completed projects were stated as complete without 100% physical progress

Percentage of completed projects that are declared as complete without 100% physical progress



Inadequate monitoring of physical progress by implementing agencies and their line ministries, negligence in submitting project completion reports and lack of initiative to respond to the identified problems by the IMED are some of the factors behind such discrepancies

Pervasive practice of including a large number of new projects and time extension in RADP

- ❑ The number of unapproved ADP projects that get allocation in the RADP has been on the rise in successive fiscal years. In contrast, the reduction in total allocation has also been increasing in the RADP as compared to the ADP
 - A total of 311 fresh projects was included in RADP of FY18 which was the highest in the last 10 fiscal years while the allocation was downsized by Tk. 7,550 crore which was also the highest since FY09
 - 26 out of these 311 projects (8.4%) are local government projects; 65 projects (20.9%) received a symbolic allocation of Tk. 1 crore or less while 15 projects received allocation of only 10 lakh or less
 - These symbolic projects are perhaps included in the RADP due to political considerations; however, these remain unimplemented due to inadequate resource allocation
 - A good number of projects in the top five sectors of the ADP in terms of their share in total allocation (65% in FY18), have seen time extension in RADP for FY18
 - Health sector encountered the highest proportion (34.5%) of extension of their projects followed by Education (31.3%), Power (23.2%), Rural Development (19.2%), and Transport (17 %)

The 'fast track' projects are not fast enough

Only 5 out of these 9 'fast track' projects are making visible progress. 8 out of these 9 projects have initially received allocation of Tk. 30,929 crore which is 19.8% of total ADP allocation for FY18

- ❑ The **PMB** project made 53.6% financial and 59% physical progress up to April 2018
 - Only 5% financial progress was made during Jul-Apr of FY18
- ❑ **DMRTDP** (Metro Rail) project attained 14.9% financial progress up to April 2018
 - Only 5.4% progress could be made during the first ten months of FY18
- ❑ **MUSCCFPP** attained only 14% cumulative progress up to April 2018
 - 11.2% financial progress has been made during July-April of FY18 which is a very positive sign
- ❑ **MSTPP's** (Rampal power plant) main plant fencing work has already been completed. Till April 2018, 15.9% of the full project cost could be utilised
 - 14.1% financial progress was made in the first ten months of FY18
- ❑ **RNPP** main project attained 8.1% cumulative progress up to April 2018
 - the main project was included into the ADP of FY18 and received one of the highest allocations
- ❑ Based on the project cost, the cumulative progress of Dohazari Ramu Cox's Bazar and Ramu to Gundam Rail Track project (dual gauge) till February 2018 was 16.4%

2. Formulating Fiscal and Budgetary Measures for FY19

CPD selected a set of **20 projects** under the ADP for FY18 for close scrutiny (share of these projects in ADP for FY18 was 11.7%)

- ❑ 13 of these 20 projects were supposed to be completed in FY17 (or even earlier)
 - All of these 13 projects were carried forward to the ADP for FY18
- ❑ The 20 priority projects registered somewhat higher (39.1%) than the average growth (37.8%) in Jul-Feb FY18
- ❑ Only 3 projects were closer to being completed by FY18
 - Veramara Combined Cycle Plant (360 MW) Development project achieved 100% financial progress by November 2018
 - All of these (could be completed) projects were already in the 'carryover' list
- ❑ 10 of these 20 projects were supposed to be completed in FY18 as per timeline
 - Only Tk. 3,496 crore was earmarked for these projects in RADP for FY18 (Tk. 9,548 crore was needed for timely completion)
- ❑ As per the revised allocation in FY18, at least 3 projects (Dhaka-Chittagong Railway Development Project, Construction of Ghorashal 365 MW Combined Cycle Power Plant, Shahjalal Fertilizer Project) should be completed
 - They also have a poor implementation rate and need a 'final big push'

Strengthen IMED with follow-up mechanisms to realise recent initiatives/policy decisions

- ❑ One may recall that a number of proposals relating to expediting ADP implementation was announced during the last few years by the Planning Minister. These included:
 - assigning a dedicated official to each government agency for monitoring and evaluating respective projects
 - delisting the longstanding 'non-operational' projects from the ADP
- ❑ Further, IMED has recently proposed inclusion of a number of provisions in the current DPP format with a view to discouraging the misuse of scarce public resources, ensuring transparency and accountability in development project execution. These include the incorporation of
 - the project design life
 - a compulsory feasibility study report
 - annual maintenance chart; analysis of stakeholders
 - responsibilities of project directors and executing agencies
 - indicators to measure the project impact in terms of achieving the SDGs

However, ensuring adequate follow up of these good initiatives remains a recurring concern. It is suggested that the upcoming budget should report on the progress made as regards the proposed actions

2. Formulating Fiscal and Budgetary Measures for FY19

- ❑ ADP of Tk. 173,000 crore has been proposed for FY19
 - 16.6% higher than the RADP for FY18 and 10.9% higher than ADP for FY2018
 - Of the amount, Tk. 32,555 crore (18.8% of total) has been set aside for the nine mega projects which is almost identical to the current fiscal year
 - Further, keeping in mind the national elections, all the 300 MPs would receive allocations to the tune of Tk. 7,595 crore in total for the construction of five-storey buildings for six madrasas in each electoral area
- ❑ An assessment of the gap between sectoral ADP expenditure and 7FYP public investment targets suggests that
 - Between FY16 and FY18, 6 out of 10 sectors received lower amount than their respective targets set out in the 7FYP. They also spent lower amount than was allocated in the respective ADP and RADP
 - On a positive note, priority sectors such as infrastructure (Transport and Communication) and social sectors (Education, Health) received more allocation than the 7FYP targets
 - However, due to inability of the concerned entities to utilise the allocated funds, the gaps between 7FYP targets and respective RADP and actual expenditure figures have increased in every fiscal year for the aforementioned three sectors

In FY2019, following the previous trend, if these allocations are not being fully utilised, the expected results will not being realised

2. Formulating Fiscal and Budgetary Measures for FY19

Based on the ADP analysis of the current fiscal year, five major conclusions can be drawn in view of the ADP for the next fiscal year

- ❑ The quality of ADP implementation has not made any major breakthrough
- ❑ The success of ADP implementation in FY2019 will largely hinge on the implementation of mega projects. Particularly, new projects or projects which are in the early stage of implementation will be required to kick-off well
- ❑ Better utilisation of project aid in the current and upcoming fiscal years will, to a large extent, determine the overall pace of implementation. This is also important in view of lowering debt-servicing liability
- ❑ The government could not avoid taking populist projects (e.g. allocation for MPs, symbolic projects for the local government); neither could it limit the number of projects
 - According to policy statement, the number of new projects should be limited to ensure allocation of adequate funds, for completing projects on time and to increase their development impact
- ❑ The current implementation pace of Fast Track projects may not be adequate for their timely implementation; as a result, the expected benefits will be delayed

2. Formulating Fiscal and Budgetary Measures for FY19

Put emphasis on higher allocation for social sectors and implement National Social Security Strategy (NSSS) targets in FY2019

- ❑ According to World Bank and IMF data, Bangladesh was ranked among the bottom group of countries with regard to **education** (85th out of 90 countries), **health** (197th out of 197 countries) and **social protection** expenditure (36th out of 47 countries) as percentage of GDP
- ❑ As may be observed from earlier trends, budgetary targets did not consider the proposals set out in the NSSS
 - Recently, after a meeting with the Finance Minister, it was agreed to raise the coverage of several programmes under the SSNP for FY19 which is likely to raise the per month allocation of several major SSNPs, but will still be short of NSSS targets
 - Comparing the NSSS target allocation to the budget allocation of FY18, it is seen that there was a significant gap of at least Tk. 1,640 crore for the old age allowance, Tk. 6,776 crore for child school stipends, Tk. 1,401 crore for the allowance dedicated to widowed women and Tk. 1,327 crore for disabilities schemes respectively
 - Indeed, financial gap exists also for the aforesaid four schemes, between medium term budgetary framework (MTBF) projection and NSSS target for FY19
 - These SSNPs are also inadequate from the coverage point of view

While the targets set forth in the NSSS may appear to be rather ambitious, the reality is that government spending and implementation are lagging far behind the required levels

Budget deficit financing needs an optimum mix

□ Likewise the last six years, budget deficit was well within the planned limit after six months of FY18

➤ Financing was characterised by low net intake from foreign financing sources as against a heavy reliance on domestic financing sources

□ According to MTMPS, total public debt as a share of GDP is expected to increase from 31.5% in FY16 to 35.7% in FY20

➤ Currently about 57% of the public debt is attributable to domestic source and 43% to foreign finance

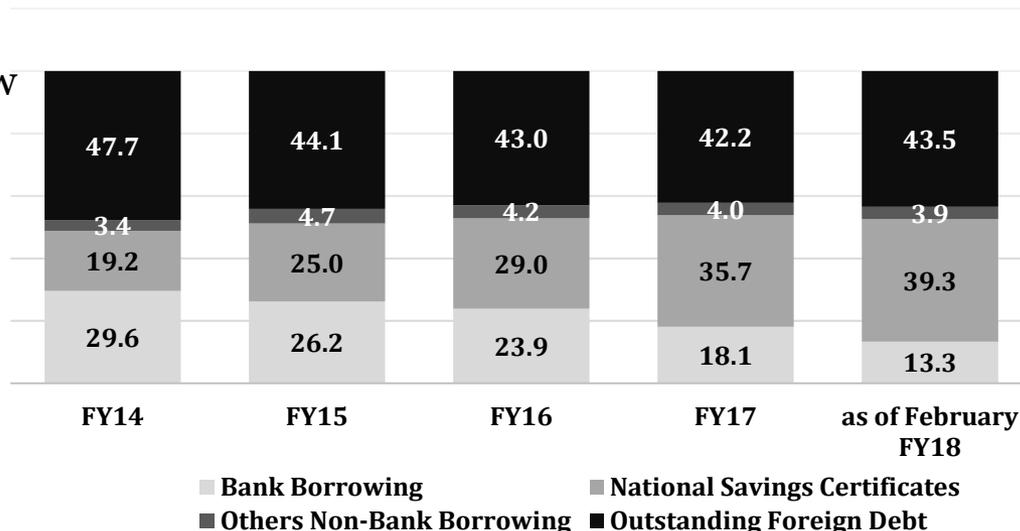
➤ Within the domestic source, debt from non-bank sources is increasing, led by outstanding NSD, while declining from bank sources

▪ Debt against sale of NSD certificate accounted for 69.5% of the total outstanding domestic debt liability of the government from about 36.8% in FY14

➤ Debt from domestic sources comes with a relatively high interest rates leading to the rise of overall interest payment burden of the government over the past years

▪ Total interest payment increased by a staggering 114.9% from Tk. 14,943 crore in FY11 to Tk. 32,114 crore in FY17

Composition of outstanding public debt



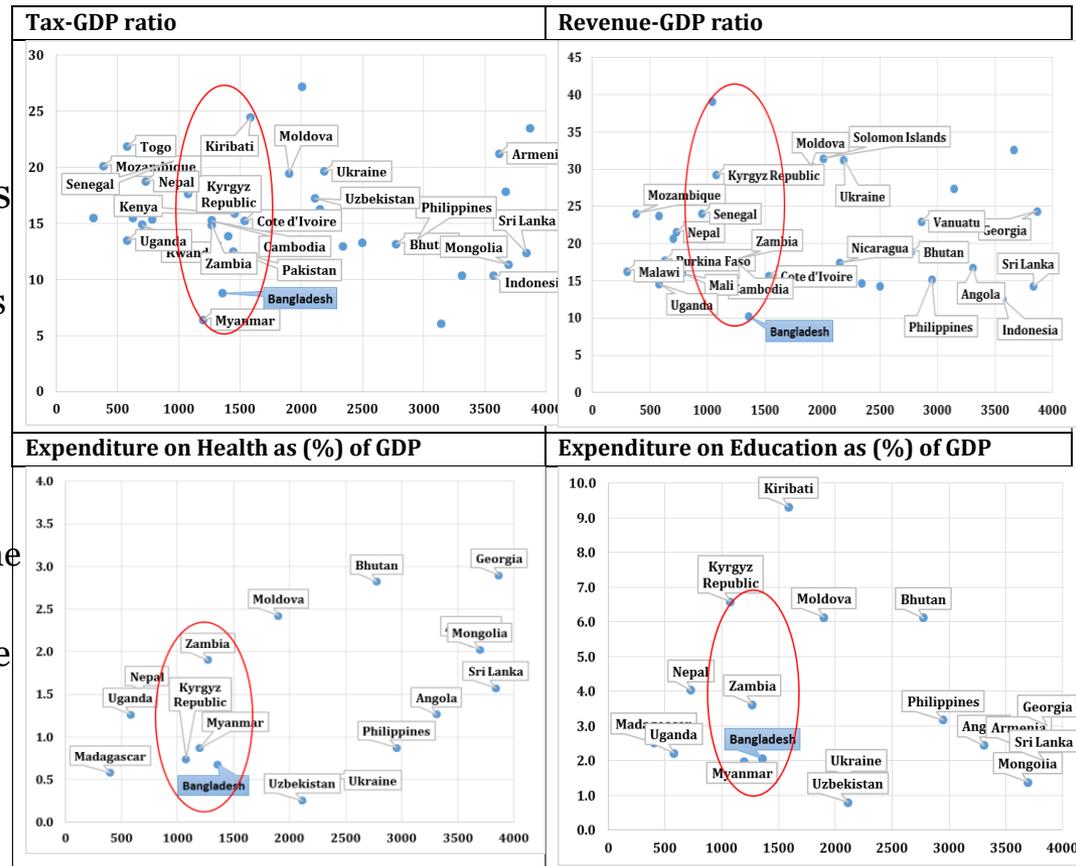
2. Formulating Fiscal and Budgetary Measures for FY19

Fiscal framework for FY19

□ An exercise was conducted by using the World Bank and the IMF data to scatter-plot MICs with per capita GDP up to USD 4,095 and compare Bangladesh' position with LMICs having similar per capita GDP according to different fiscal parameters

- Tax-GDP ratio ranges from 6.5% to 34.2% (**Median: 14.9%**) for countries with per capita GDP between USD 1,000 to 1,500 (Bangladesh- 8.5%)
- The revenue-GDP ratio varies from 10.3% to 39.1% (**Median: 18.1%**)
 - Bangladesh: 10.3%, the lowest in the cohort
- Countries spends 0.9% and 3.8% of the GDP respectively on health, and education.
 - Bangladesh spends only 0.7%, and 2.1% of GDP respectively on the corresponding fiscal parameters

Fiscal parameters as (% of GDP): Bangladesh among the MICs



Fiscal framework for FY19

In the backdrop of the actual outcome of expenditure and income in FY18, once again the fiscal framework of FY19 may find the targets to be vulnerable in the face of reality, undermining the fiscal framework

- ❑ **Revenue** (29.1% against trend growth rate of 16%) projected to grow **faster** (to collect additional Tk. 69,494 crore) than **public expenditure** (26.2% against trend growth rate of 14.7%)
 - Total budget expenditure is set at 18.0% of GDP (16.6% in RBFY18)
 - Revenue income will be 13.0% of GDP (11.6% in RBFY18)
- ❑ **Development expenditure** (16.6%) also programmed to **grow slower** than non-development revenue expenditure (29%)
- ❑ **ADP**: 37.6% of total public expenditure (40% in the RBFY18)
- ❑ **Budget deficit** has been projected at **5.0%** of GDP (same in RBFY18, actual in FY17 was about 3.1% of GDP)
- ❑ Balance in financing the budget deficit is likely to be restored through low foreign financing and increased non-bank borrowing (particularly NSD sales)

Section III: Monetary and banking sector

3. Monetary policy and banking sector

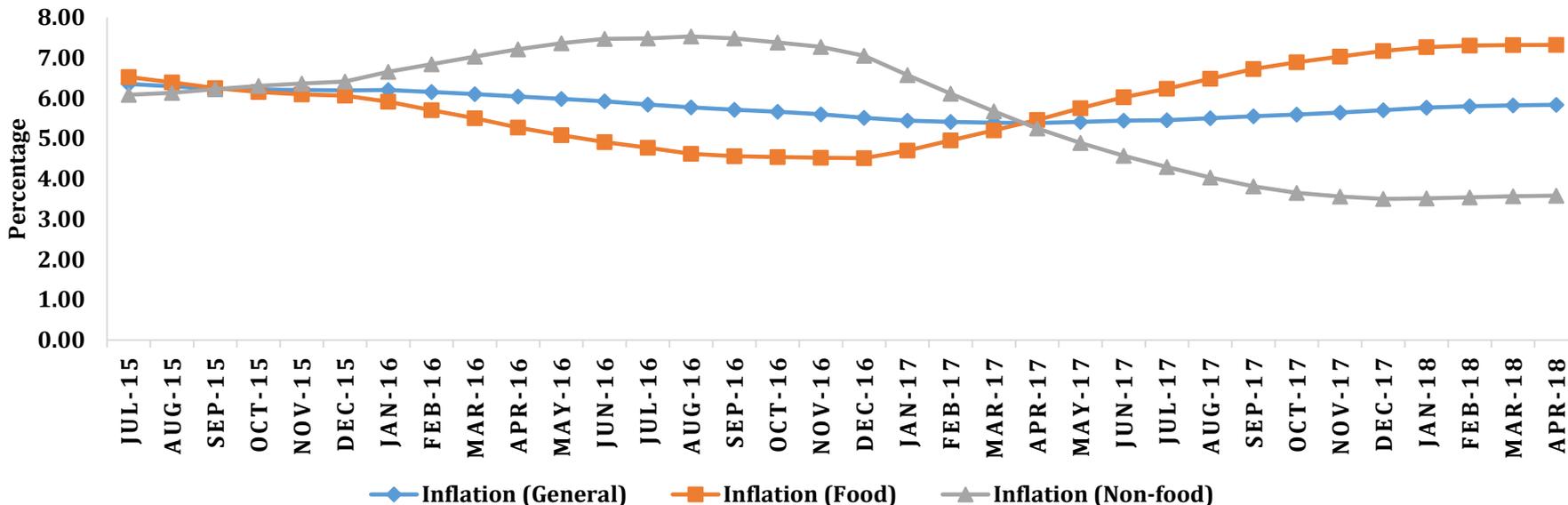
- ❑ Following the downward trend in average inflation rate, since August 2013, the inflation trajectory has started to move upward beginning from May 2017
- ❑ On the other hand, the banking sector has been facing liquidity shortage in recent period
- ❑ In this backdrop, key objectives of the monetary policy ought to be to ensure appropriate and timely measures to arrest growth of inflation and ensure adequate liquidity in the banking sector
- ❑ As may be recalled, Bangladesh Bank (BB) in its Monetary Policy Statement (MPS) for the second half (H2) of FY 2017-18 aimed for maintaining price and macro-financial stability
- ❑ A lot will depend on whether the BB will be able to attain these objectives by pursuing an independent monetary policy

3. Monetary policy and banking sector

Inflation trends

- ❑ Food inflation rose to 7.3% in April 2018 from 5.5% in April 2017 while non-food inflation declined to 3.6% in April 2018, as opposed to 5.3% in April 2017. As a result, general inflation increased to 5.8% in April 2018, compared to 5.4% in April 2017
- ❑ Though lower than the target set out in the Monetary Policy Statement of Bangladesh Bank (BB) for the January-June 2018 period (6%), there is a need for the BB to remain alert to the possibility of inflationary trend gaining momentum while crafting the monetary policy for the July-December, 2018 period

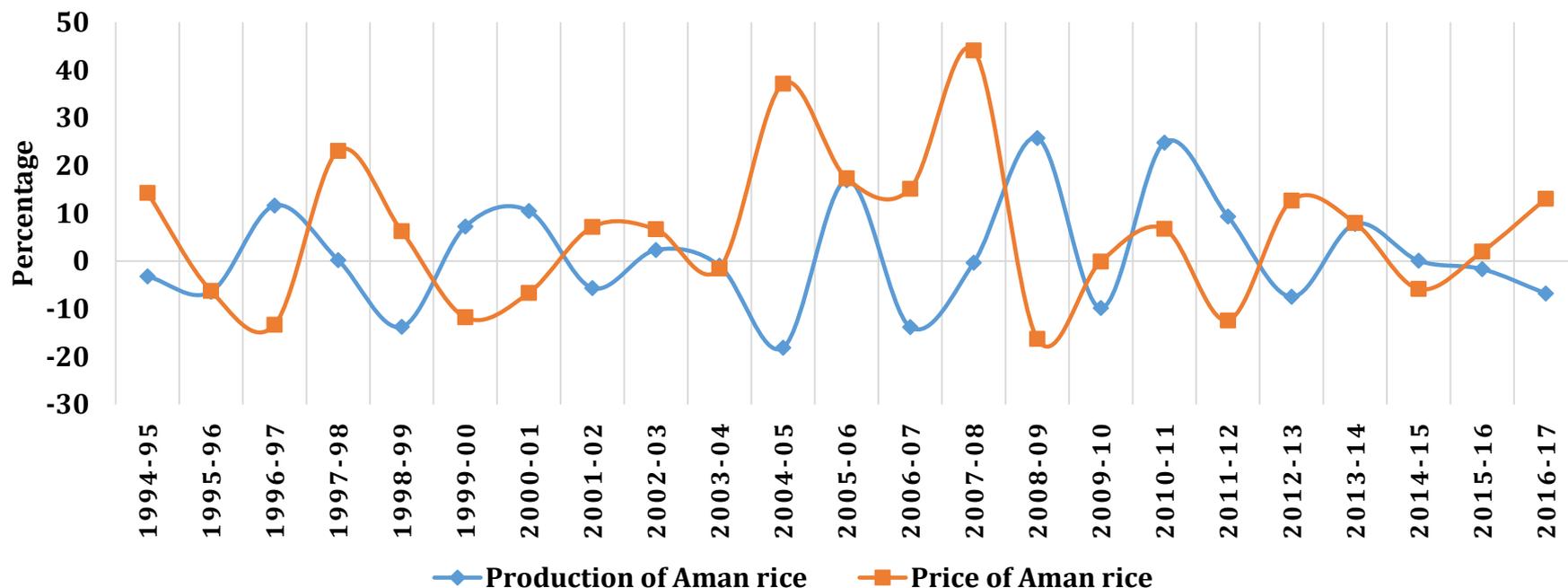
National inflation rate (12-month average) (Base year 2005-06)



3. Monetary policy and banking sector

- ❑ The inverse relationship between food price and food production is quite evident in the Bangladesh case
 - For example, analysis of historical data reveals that the change in the price of Aman rice is inversely related to the change in the level of its production
- ❑ No doubt, the key to controlling food inflation lies in stabilizing food supply

Aman rice production and price (percentage change)

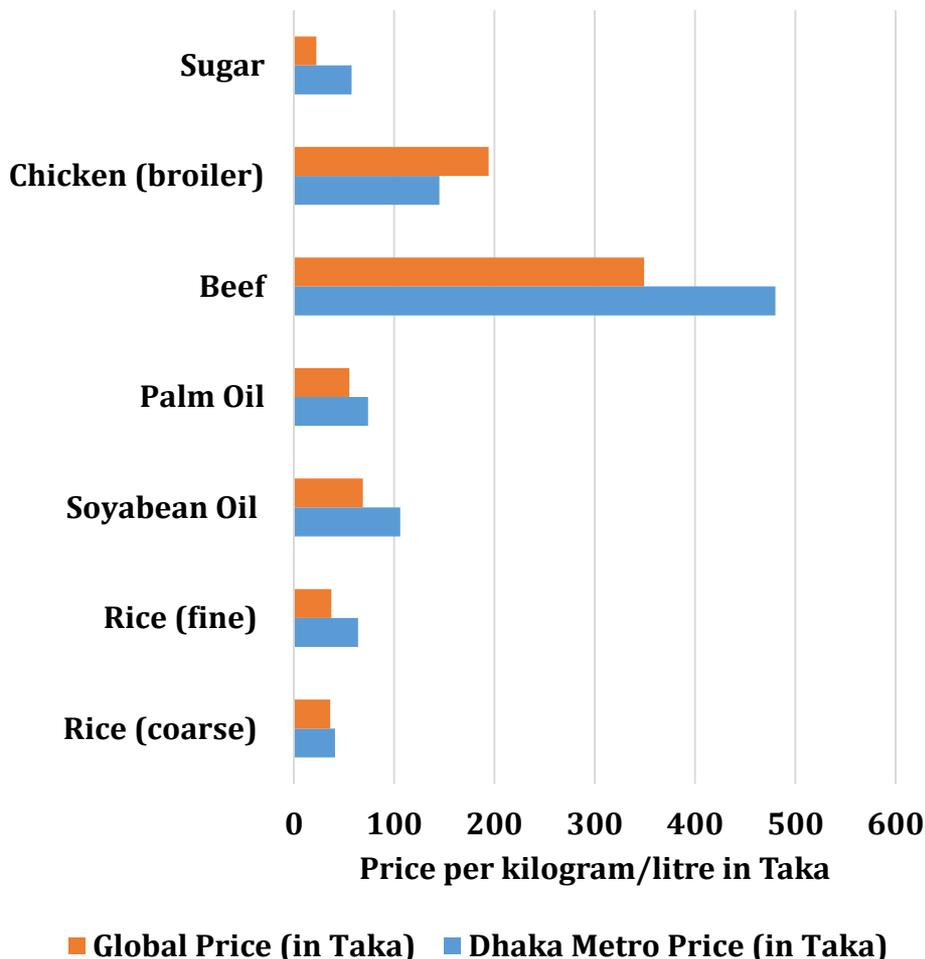


3. Monetary policy and banking sector

❑ A comparison of Bangladesh's price levels with that of global markets indicates that the average prices of essentials in April 2018 was higher compared to international prices

- For example, sugar was about 2.6 times more expensive in Dhaka metro markets in April 2018, compared to the world market
- On the other hand, the price of soya bean oil was 54% higher and the price of palm oil was 34% higher in Dhaka in April 2018, in comparison to the world price
- As is known, petrol and diesel are sold at administered prices on BB. As of 28 May 2018, Bangladesh had the 65th cheapest petrol and the 39th cheapest diesel among 168 countries of the world

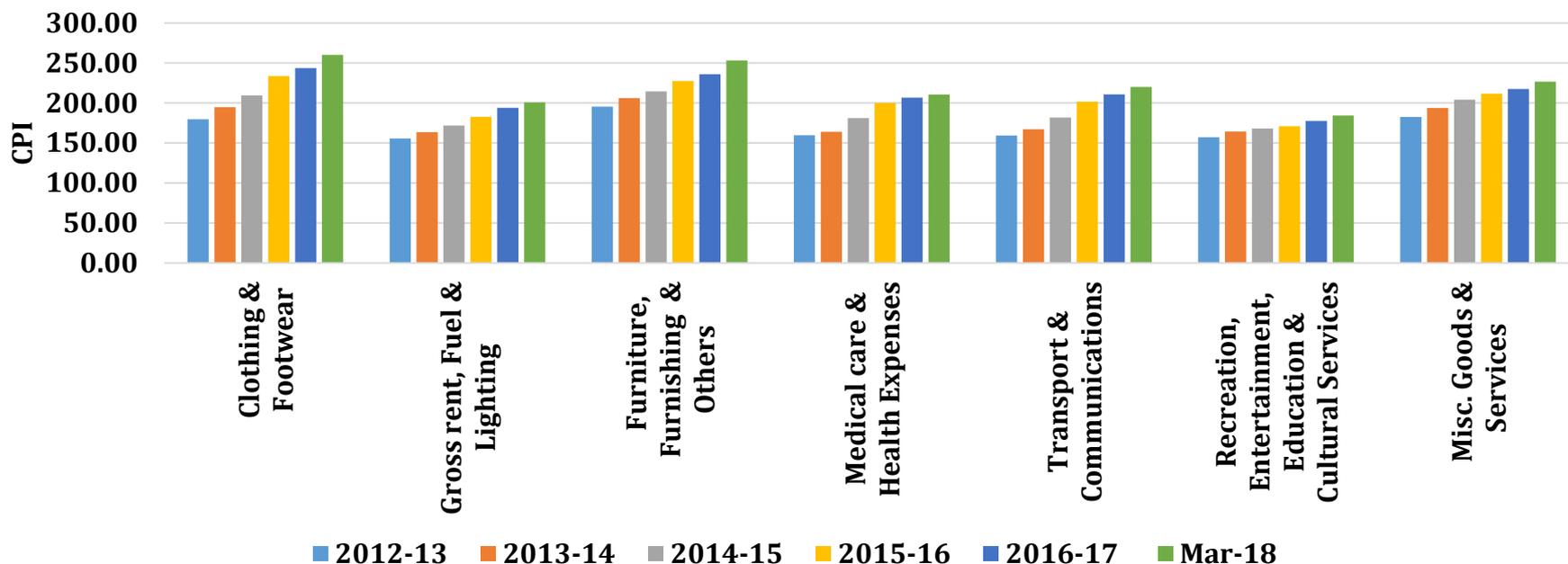
Average prices of essentials in April 2018



3. Monetary policy and banking sector

- ❑ The consumer price index (CPI) for all major non-food items, such as clothing, footwear, house rent, furniture, medical care, transport, and education increased in March 2018 compared to 2016-17
- ❑ This is particularly disquieting since it indicates an overall increase in the cost of living, a trend that has been going on for the past several years

CPI of major non-food items: 2012-2018 (Base year 2005-06)



3. Monetary policy and banking sector

Conduct and misconduct of monetary policy

- ❑ Monetary targets for the second half of FY 2017-18 were set to achieve a GDP growth of 7.4% while maintaining the annual average inflation rate within 6%
- ❑ Overall growth of broad money supply (M2) up to April 2018 was 9.1% compared to the MPS target of 13.3%
 - This implies that further expansion of the money supply is expected in the coming months
 - The growth of the broad money, in recent years, has been influenced by net foreign assets and public sector credit
- ❑ The central bank has to be cautious as regards the growth of M2 since it has the potential to raise inflation

3. Monetary policy and banking sector

- ❑ When key components of the money supply, such as reserve requirements, are altered, they tend to have significant effects on the general price level
- ❑ CPD's own analysis of annual data for the period 1996-2017 also reveal that there is a unidirectional causal relationship running from the supply of broad money to the price level

Results of Granger Causality Test

Null hypothesis	F statistic (p value)	chi square statistic (p value)	Interpretation
M2 growth does not Granger-cause CPI growth	4.06 (0.0599)	4.78 (0.0288)	Unidirectional causality running from M2 growth to CPI growth (M2 ⇒ CPI)
CPI growth does not Granger-cause M2 growth	0.47 (0.5006)	0.56 (0.4554)	
Log of M2 does not Granger-cause log of CPI	8.83 (0.0082)	10.30 (0.0013)	Unidirectional causality running from log of M2 to log of CPI (M2 ⇒ CPI)
Log of CPI does not Granger-cause log of M2	2.71 (0.1171)	3.16 (0.0754)	

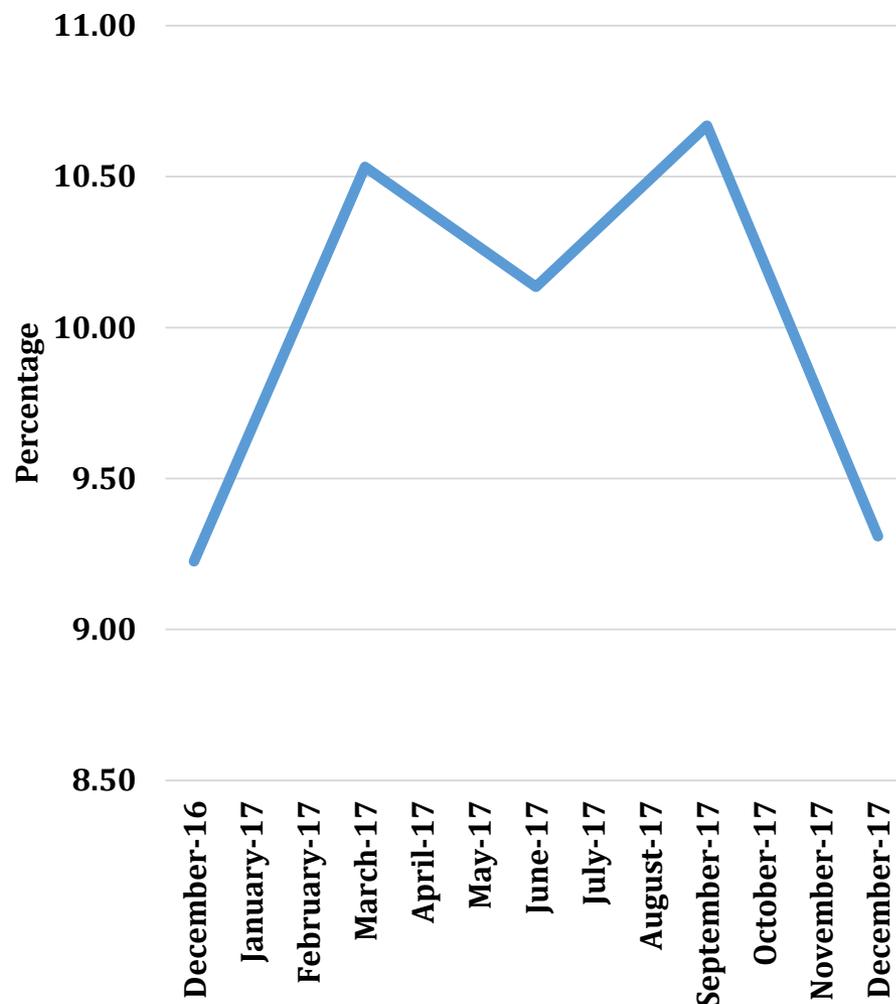
Notes: (i) One period lag chosen; (ii) M2 growth is defined as percentage change in supply of broad money; (iii) CPI growth is defined as percentage change in consumer price index, base year 2005-06; (iv) M2 data from Bangladesh Bank and CPI data from Bangladesh Bureau of Statistics; (v) Granger causality implies predictive causality and not true causality.

3. Monetary policy and banking sector

Non-performing loans

- ❑ Non-performing loans (NPLs) continued to pile up relentlessly, as NPLs hovered around the 10% mark in the calendar year 2017
- ❑ NPLs fell below 9.5% in December 2016, and again in December 2017
 - This is largely due to the practice of commercial banks writing off their loans at the end of the year in order to clean their balance sheets
 - Such off-balance sheet activities are particularly risky, and may have destabilizing effects on the overall banking sector

NPL as percentage of total loans



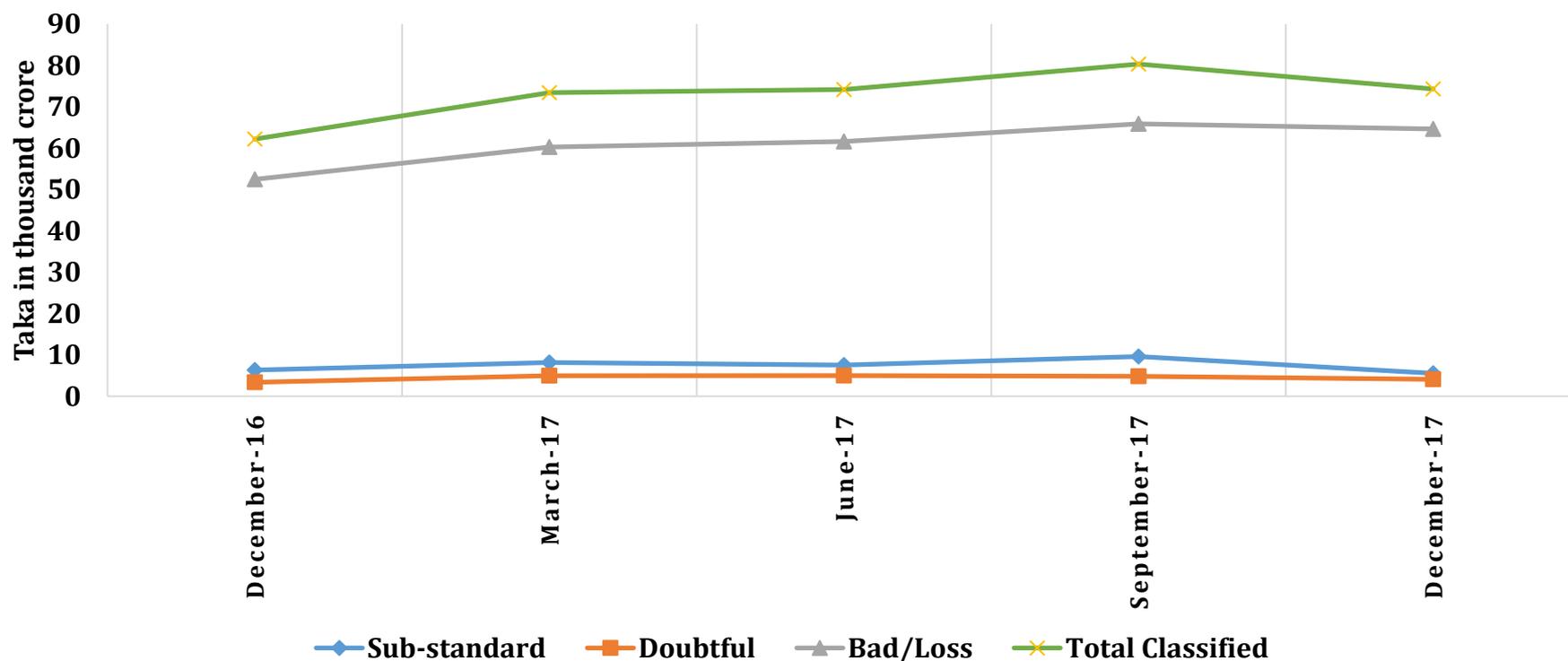
3. Monetary policy and banking sector

- ❑ Financial frauds, lack of proper due diligence during loan sanctions, political influence on loan disbursement, and the failure to undertake strong measures against loan defaulters and wrong-doers have contributed to high NPLs in the banks
- ❑ Additionally, the legal framework for dealing with non-performing loans, which includes the Money Loan Court Act 2003 and the Bankruptcy Act 1997, has become more or less dysfunctional
- ❑ The number of judges dealing with non-performing loan cases is inadequate, and as a consequence, the backlog of cases is a long one

3. Monetary policy and banking sector

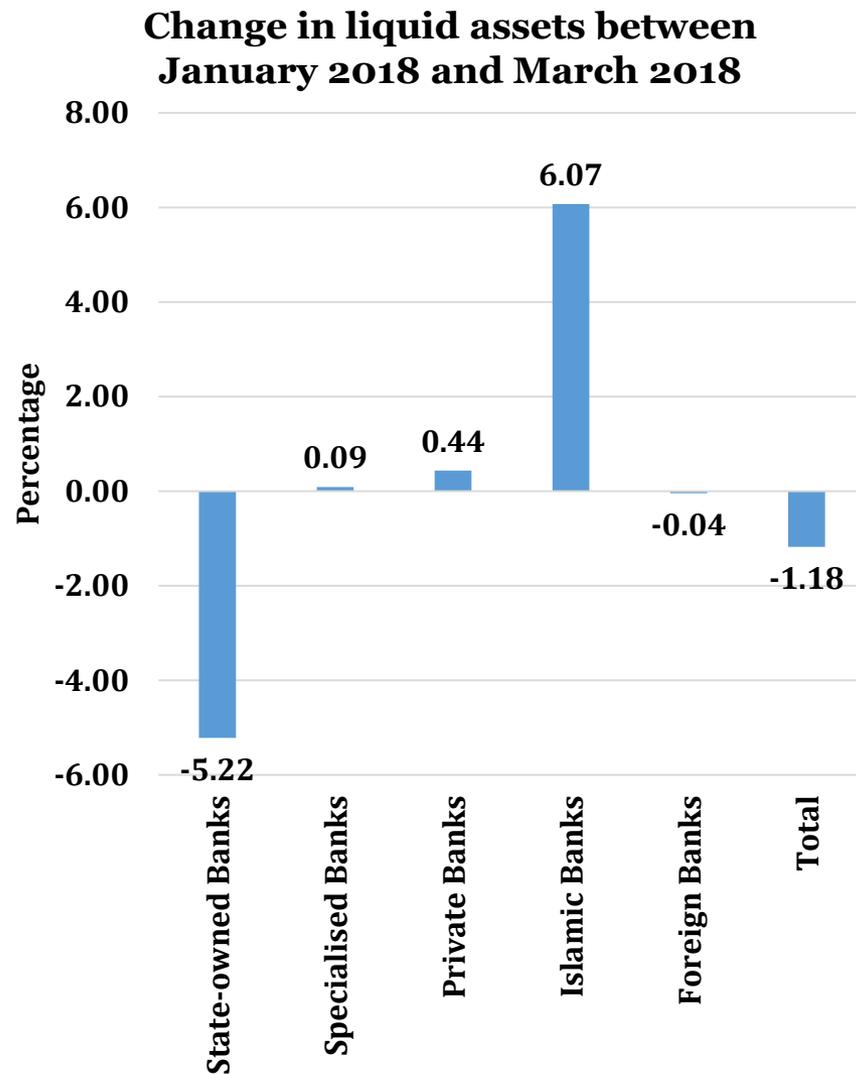
- ❑ Unfortunately, the amount of bad loans is much higher than the other types of NPL
- ❑ As of December 2017, the amount of bad loans was Tk 64,618 crore which was 87% of total classified loans and 8% of total loans

NPL and total loan by types of loan



3. Monetary policy and banking sector

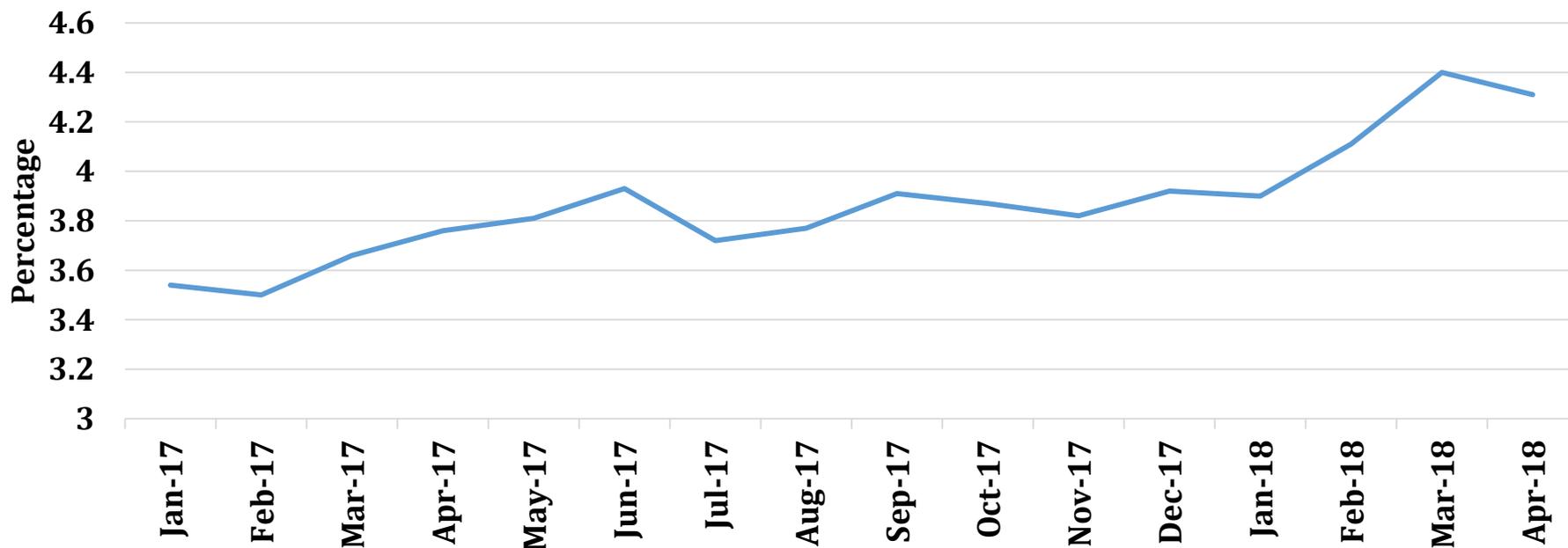
- ❑ The liquidity position of state-owned commercial banks worsened between January and March 2018, as they registered a 5.22% fall in total liquid assets
- ❑ This led to a 1.18% fall in total liquid assets in the overall banking sector from January to March 2018, even though private commercial banks and Islamic commercial banks experienced improvements in the liquidity position during the same period



3. Monetary policy and banking sector

- ❑ The impact of reduced CRR by BB in April 2018 is yet to be observed
- ❑ The wave of liquidity shortage was reflected in the money market
 - Call money rate (overnight average lending rate) was high, 4.31% in April 2018 compared to 3.76% in April 2017
 - Average interbank lending rate was 5% in March 2018

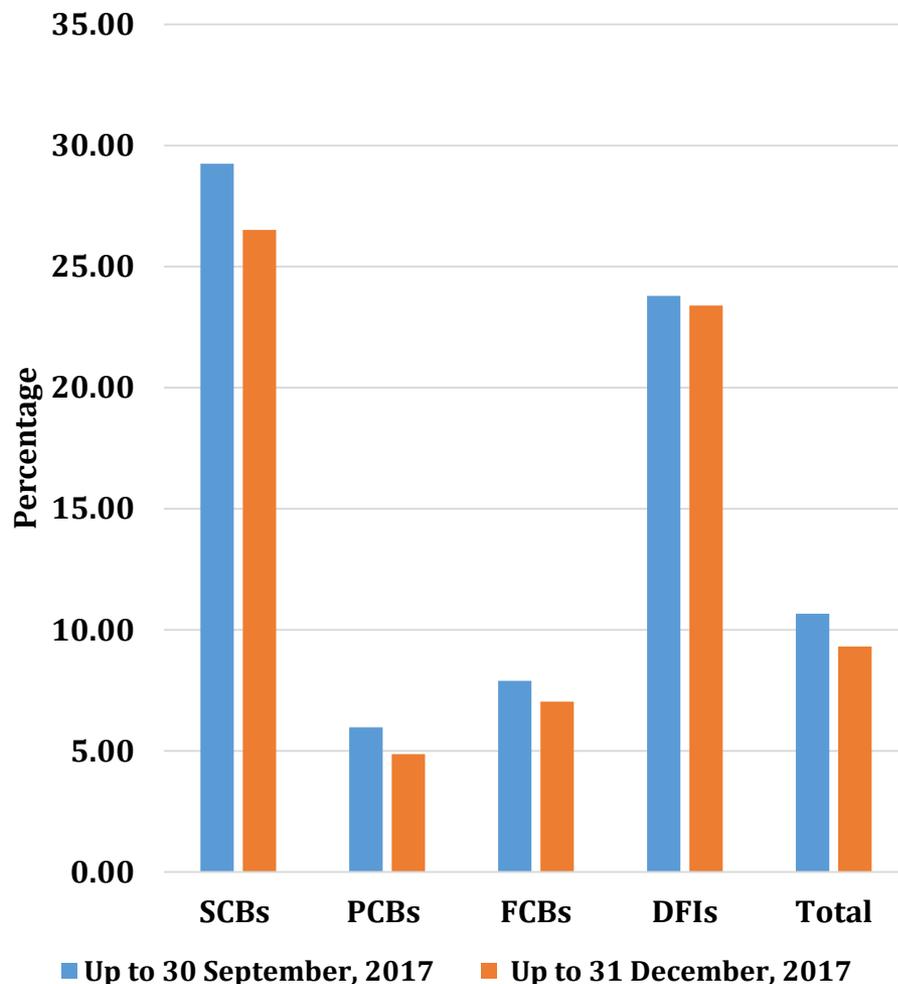
Call money market average lending rate



3. Monetary policy and banking sector

- ❑ At a disaggregated level, the share of NPL in both state-owned commercial banks (SCBs) and development finance institutions (DFIs) is very high
- ❑ This reflects the inefficiency of SCBs and DFIs in loan management. Both SCBs and DFIs had more than 20% NPLs in the second quarter of FY18

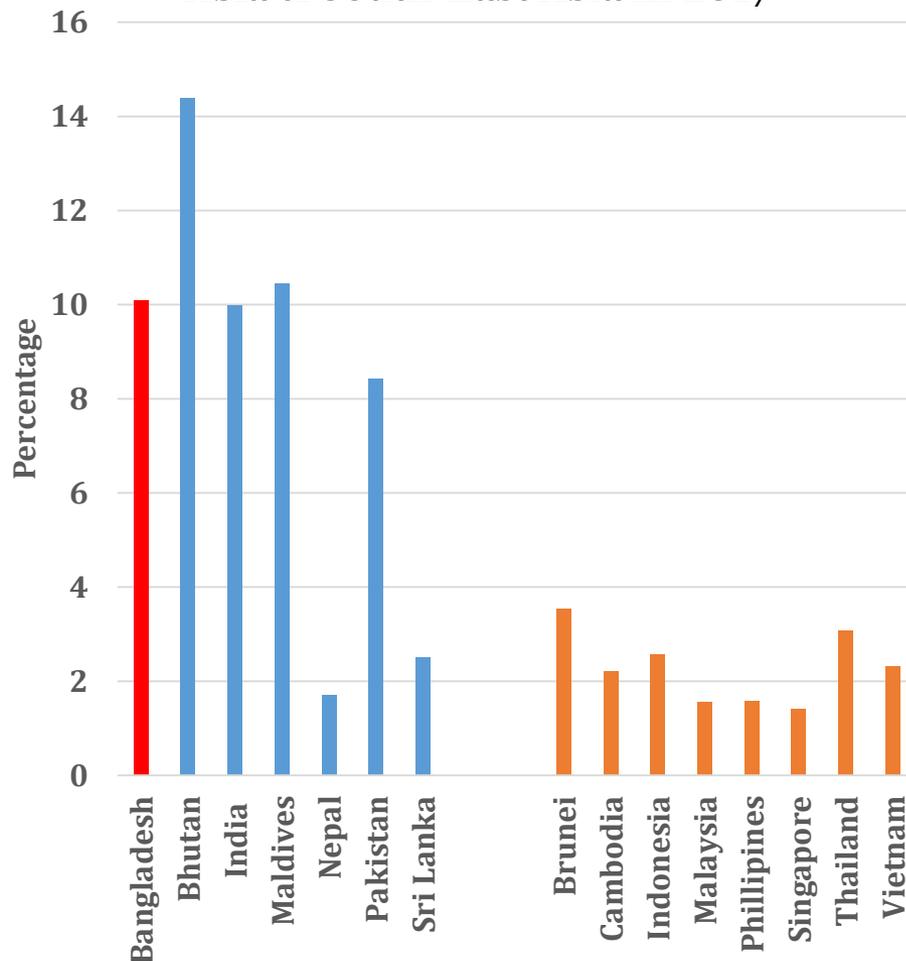
NPLs as percentage of total loans by bank type



3. Monetary policy and banking sector

- ❑ A cross-country comparison of NPLs shows that five South Asian countries, Bangladesh, Bhutan, India, Maldives, and Pakistan, had NPLs exceeding 8% of total loans in 2017
- ❑ On the other hand, eight South-East Asian countries, Brunei, Cambodia, Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam, all had NPLs below 4% of total loans in 2017
- ❑ South Asian countries' banking sectors are caught in a myriad of problems which is reflected through high NPLs. But what is to be noted is that, in contrast to Bangladesh a number of these countries have initiated concrete measures to tackle the situation

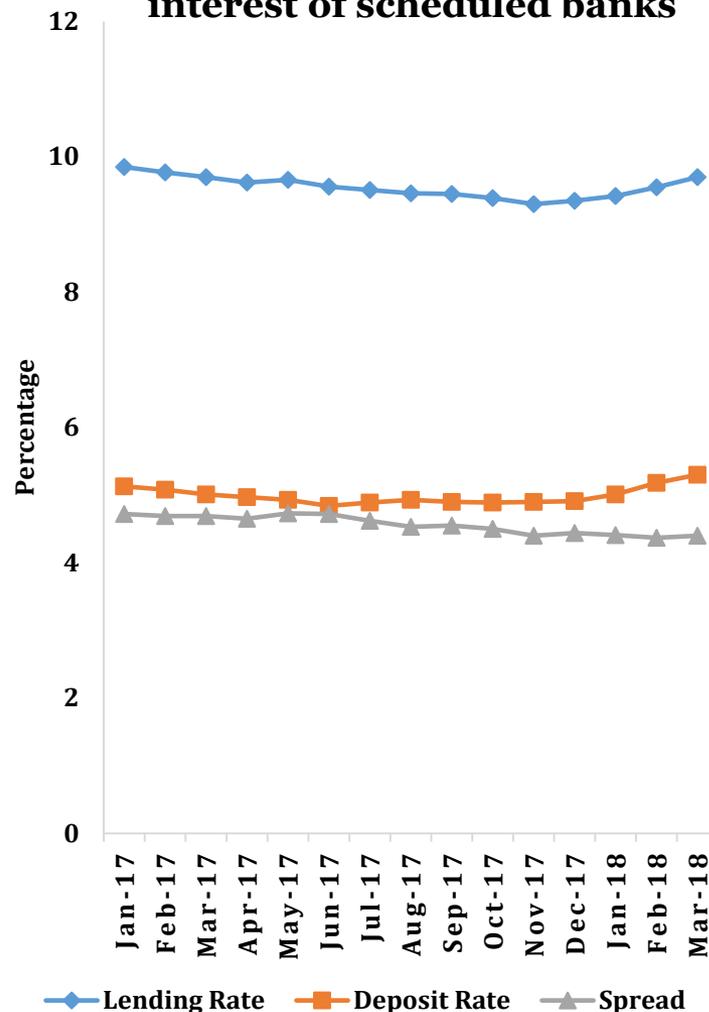
NPL as percentage of total loans in South Asia & South-East Asia in 2017



3. Monetary policy and banking sector

- ❑ In order to rationalize interest rate for productive sectors, the central bank has recently published a circular directing banks to reduce interest rate spread from 5% to 4%
 - BB has also instructed commercial banks not to change lending rate if interest rate is stated as fixed in the credit agreement with the borrower
 - It is expected that this move of the BB will result in reduced lending rates, though in the past no such initiative has been able to bring down interest rate spread to a desired level
- ❑ The desired outcome of recent directive on interest rate spread will not be realised if commercial banks attempt to reduce interest rate on deposits to make up for their profit cut due to lower lending rate
- ❑ However, in order to pull depositors towards the banking system, deposit rates have to be attractive. As it is, savers are now more inclined to invest in National Savings Directorate (NSD) for higher return, a phenomenon which is creating high interest burden for the government
- ❑ Moreover, interest rate is only one of many tools in the arsenal of monetary policy to boost investment. Monetary policy instruments have to be combined with supportive fiscal and institutional policies and the needed infrastructure support

Weighted average rate of interest of scheduled banks



3. Monetary policy and banking sector

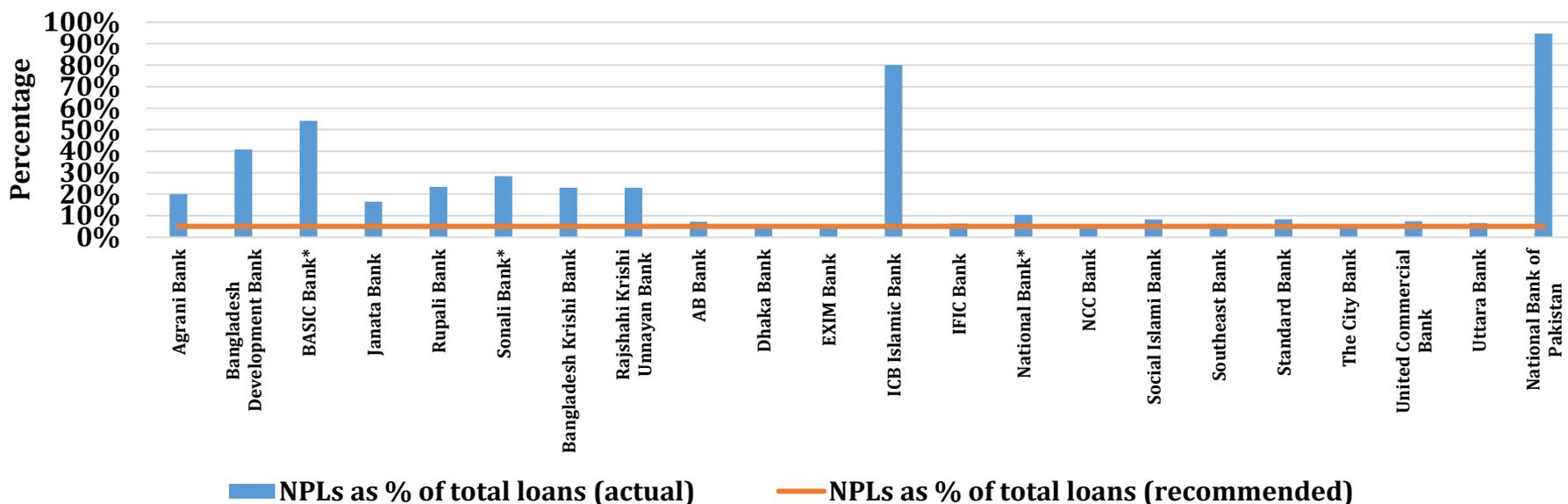
BASEL III preparation of banks

- ❑ BASEL III requirements stipulate that banks should maintain Common Equity Tier 1 (CET1) to Risk Weighted Assets (RWAs) ratio greater than 4.5%, Liquidity Coverage Ratio (LCR) greater than 100%, Net Stable Funding Ratio (NSFR) greater than 100%, and Leverage Ratio greater than 3%
- ❑ Based on the mandatory BASEL III disclosures of December 2017, most banks in Bangladesh were compliant with these four key BASEL III requirements
- ❑ However, there were notable exceptions
 - A number of banks such as BASIC Bank, Bangladesh Krishi Bank, Rajshahi Krishi Unnayan Bank, ICB Islamic Bank, Standard Bank, The Premier Bank, and National Bank of Pakistan are performing poorly in terms of meeting these indicators
 - Additionally, Sonali Bank, Al-Arafah Islamic Bank, Bangladesh Commerce Bank, National Bank, Shimanto Bank, and The Farmers Bank did not disclose their BASEL III compliance status report in December 2017, as required by Bangladesh Bank regulations

3. Monetary policy and banking sector

- ❑ BASEL III disclosures also exposed that 22 banks had NPLs greater than 5% of total loans, whilst 15 other banks did not disclose their NPL to total loan ratios
- ❑ As of 31 December 2017, ICB Islamic Bank had NPL equal to 80% of total loans.
 - It may be recalled that ICB Islamic Bank was created through a central bank order, in the aftermath of the Oriental Bank crisis in 2007. Given the dismal state of the bank at present, doubts have surfaced regarding the effectiveness of the exit strategy employed by Bangladesh Bank in the case of Oriental Bank in 2007

Banks with NPL to total loans ratio greater than 5%



Note: * indicates data for 2016

3. Monetary policy and banking sector

- ❑ It is about time to reconsider policies towards problematic banks
- ❑ In recent years, the government has often become the lender of the first resort and injected large amounts of capital into the troubled banks. However, these banks could not improve their performance despite huge re-capitalisation package offered by the government
- ❑ Ironically enough, there is no moral pressure within the Ministry of Finance (MoF) to make sure that tax payers' money is not wasted in the name of recapitalisation of inefficient banks. Rather, MoF's sympathy has extended to the private sector banks
- ❑ Directed by the MoF, the central bank reduced the minimum cash reserve ratio (CRR) from 6.5% to 5.5% bi-weekly and from 6% to 5% daily in April 2018
- ❑ Moreover, the MoF announced that government agencies would increase their deposits of funds in private commercial banks from 25% to 50%
- ❑ Both these decisions are apprehended to have negative implications
 - Reduced CRR may encourage banks to lend more aggressively while higher share of government funds into the private banks could result in the money going to the poor performing banks
- ❑ In view of such practice of rescuing the troubled banks without any substantial outcome, taxpayers would like to have some assurance that their money is utilized in the most efficient manner

3. Monetary policy and banking sector

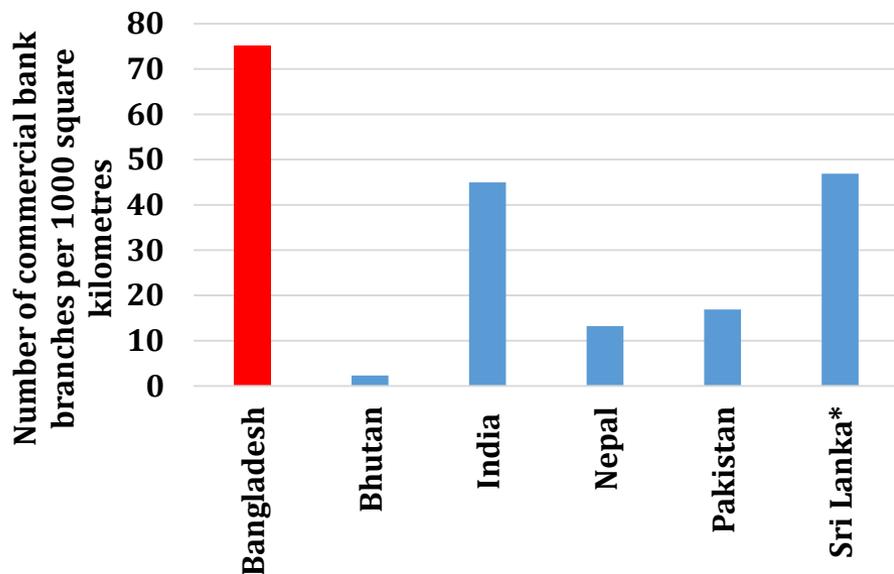
Excessive Number of Banks, Yet Attempts to Permit More

- ❑ According to the Bank Company (Amendment) Act 2013, the central bank will decide to grant licenses to new commercial banks after considering the need for such banks and the overall state of the economy
- ❑ Ironically, this principle is not followed in Bangladesh in case of issuing bank license
- ❑ More than economic justification, political pressure works for the issuance of bank licenses. And over time license for opening a new commercial bank has, in fact, become a tool for misappropriation of public money
- ❑ Cross-country comparison indicates that the total number of banks in Bangladesh is unusually high by global standards
 - For example, Mexico has only 47 commercial banks even though the GDP of Mexico in 2016 was about 7.4 times larger than that of Bangladesh in 2016 and the total surface area of Mexico is about 13.2 times larger than that of Bangladesh
 - Vietnam, which had a GDP similar to that of Bangladesh in 2016, has only 43 commercial banks

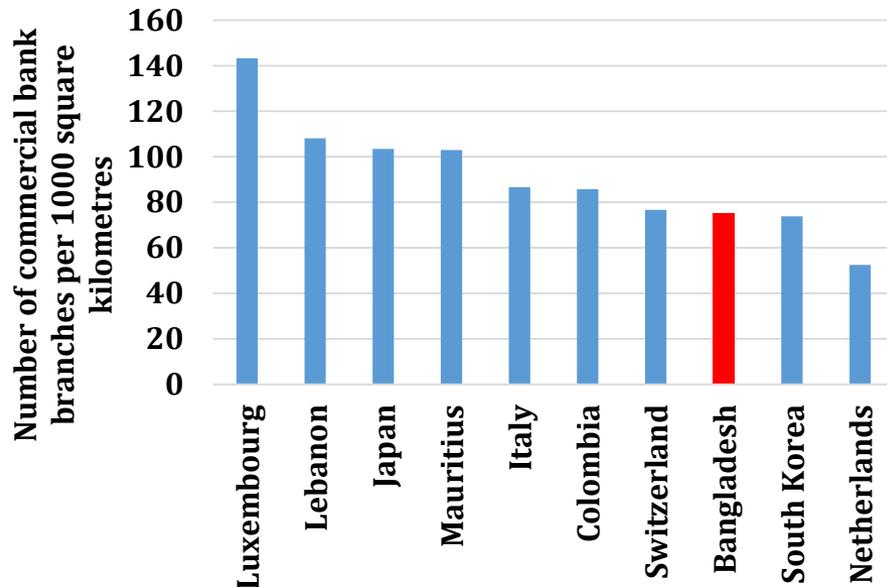
3. Monetary policy and banking sector

- ❑ Bangladesh also has a high geographic density of commercial bank branches
 - For example, in 2016, Bangladesh had 75 branches of commercial banks per 1000 square kilometres of land, which was the highest in the South Asia region
- ❑ Globally, if microstates that have a land area less than 1000 square kilometres are disregarded, Bangladesh has the 8th highest geographic concentration of commercial bank branches

Branches of commercial banks per 1,000 square kilometres in South Asia (2016)



Countries with highest concentration of commercial bank branches (2016)



3. Monetary policy and banking sector

- ❑ Thus the rationale of awarding new licenses to commercial banks on the premise of financial inclusion is not a justified one
- ❑ The ‘unbanked’ population of Bangladesh comprises of two categories of people
 - The first category consists of poor people who live in urban slums or remote rural areas.
 - In order to provide access to financial services to these people, mobile banking could be a superior option compared to conventional banking
 - In either case, these people are usually poor and uneducated, and are often not considered as potential customers by commercial banks
 - The second category of ‘unbanked’ people comprise of the population who voluntarily refrain from banking in order to conceal their financial position
 - Opening new commercial banks is no guarantee that this group of people will be brought within the formal financial system
- ❑ Therefore, without assessment of the requirement, issuance of new licenses for more commercial banks is just another step to benefit a group of people

3. Monetary policy and banking sector

Observations

- ❑ The management of public food stocks requires to be revisited in order to deal adequately with agricultural supply shocks. A cost-benefit analysis may be conducted to evaluate the potential usefulness of buffer-stock schemes in stabilizing food grain prices
- ❑ A permanent Agricultural Price Commission should be set up on an urgent basis to ensure incentive price for the producers while maintaining market stability
- ❑ Appropriate legal and judicial reforms need to be undertaken in order to address the concerns as regards non-performing loans. The number of judges dealing with Money Loan Court Act 2003 and Bankruptcy Act 1997 should be increased to ensure speedy disposal of loan default cases and to reduce backlog. However, it seems that NPL in Bangladesh has become a political economy problem. So, first and foremost, political commitment from policymakers is required in order to resolve the crisis
- ❑ Immediate action must be taken against banks that are performing poorly and are ill-prepared for BASEL III. A new exit policy for troubled banks needs to be formulated, particularly taking into cognisance the ineffectiveness of the Oriental Bank model
- ❑ New commercial banks should not be awarded licenses. Instead, mobile banking should be encouraged to promote financial inclusion

Section IV: Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

4. Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

State of Capital Market

- ❑ Despite various initiatives, capital market is experienced a sluggish growth
- ❑ Market capitalization (as % of GDP) has been declining - both at DSE & CSE
- ❑ Only few IPOs have been offered in last several years: Over subscription rate was 370%
- ❑ DSE is expected to get benefit by taking Chinese Consortium as its strategic partner
- ❑ Chinese Consortium is offering to develop a SME market, assist in product diversification, and jointly operate the V-Next alliance program in Bangladesh.
 - It will assist the DSE in mapping information disclosure and investor service automation framework, developing human resources, and providing technological support with a view to developing the DSE portfolio

4. Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

State of Capital Market

Market Capitalization (% of GDP): DSE & CSE

	Total Market Cap in BDT (bil)	GDP in BDT (in bil)	Market cap as share of GDP (%)
DSE			
30 June, 2015	3247.306	15158	21.4
30 June, 2016	3185.749	17328.6	18.4
29 June, 2017	3801	19758.2	19.2
31 May, 2018	3799.5	22384.98	17.0
CSE			
30 June, 2015	2593.777	15158	17.1
30 June, 2016	2506.113	17328.6	14.5
29 June, 2017	3123.839	19758.2	15.8
31 May, 2018	3120.972	22384.98	13.9

IPOs in DSE

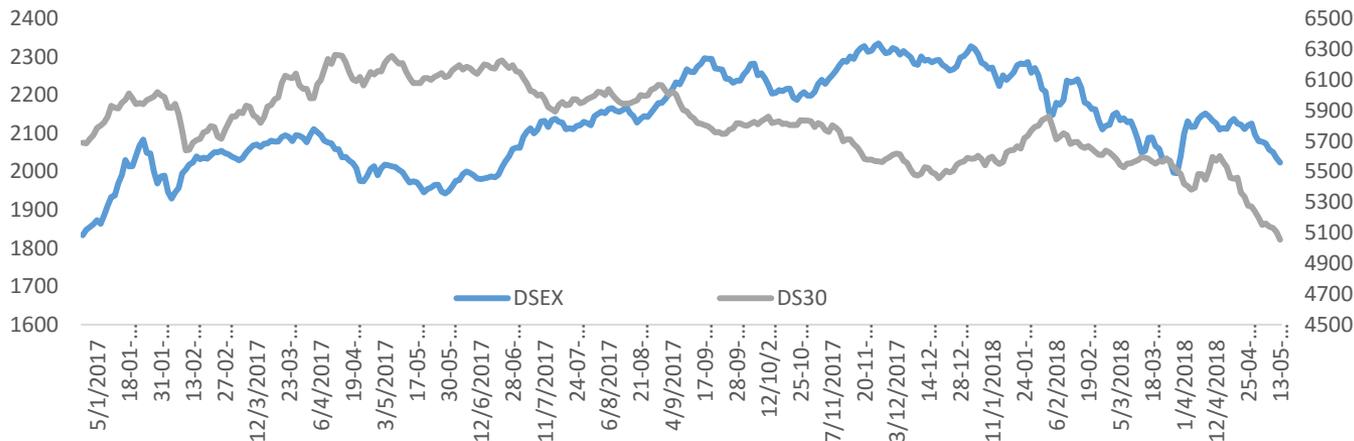
Year	Number of Companies	IPO size in Tk. at offer price (TK)	Post IPO Paid-up Capital (TK)	% of Capital as per Offer Price	% RANGE
2016	7	5843000000	7118517000	121.8298306	51 ~ 705
2017	7	1580000000	5871391950	371.6070854	94 ~ 621
2018	3	650000000	2437500000	375	250 ~ 667

4. Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

Introduction

- ❑ Recent volatility in the capital market demands closer scrutiny: Fluctuations in the capital market did not reflect macroeconomic fundamentals
- ❑ Key indices of the Dhaka Stock Exchange (DSE) have experienced both bullish and bearish trends between January 2017 and mid-May 2018
- ❑ Literature shows that volatility in the capital market may originate from targeting and scale of investment by the institutional investors

Trends in DSEX and DSE30 indices during Jan, 17- Jan, 18 period

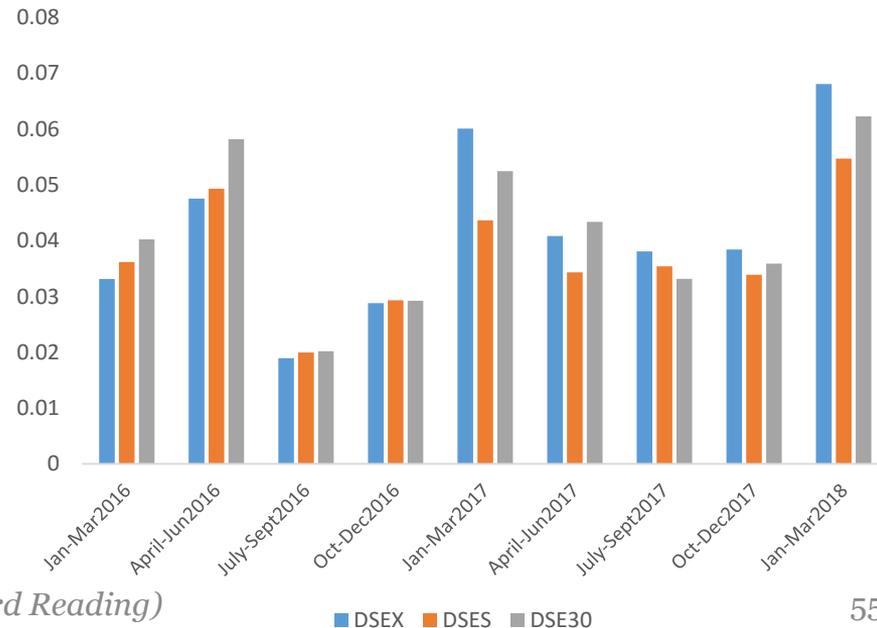
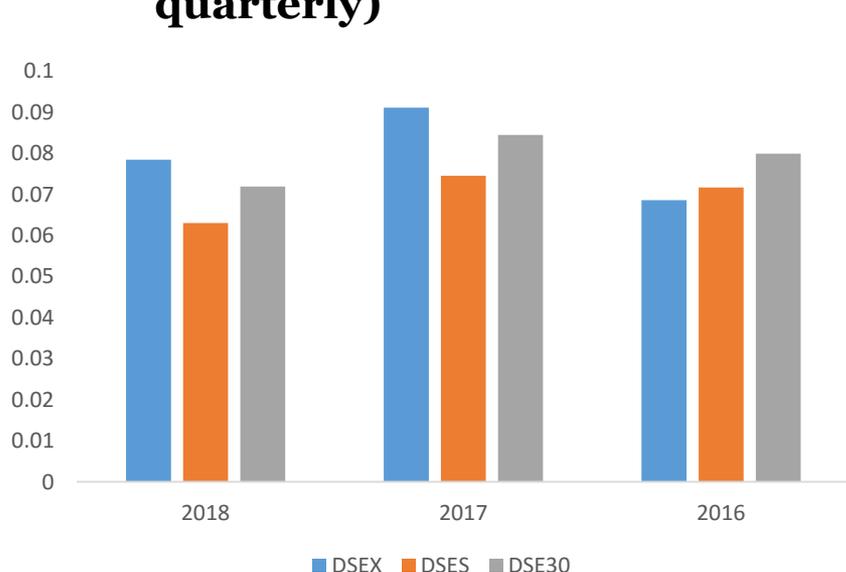


4. Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

Volatility in DSE Stock Prices during 2016-2018 Period

- ❑ Stock market has experienced highest level of volatility in 2017 within last three years
 - Volatility indices: 0.091 for DSEX, 0.075 for DSES and 0.084 for DSE30
 - According to quarterly estimates, the highest level was seen in Jan-Mar,18
- ❑ The volatility is partly attributed to rise in investment mainly by the institutional investors since 2016
 - On the other hand, the banks were compelled to sell a part of their shares in the second half of FY2018 in order to comply with new targets set for credit growth and the ADR under H2 monetary policy

Volatility Index based on standard deviation of daily trade (annual and quarterly)

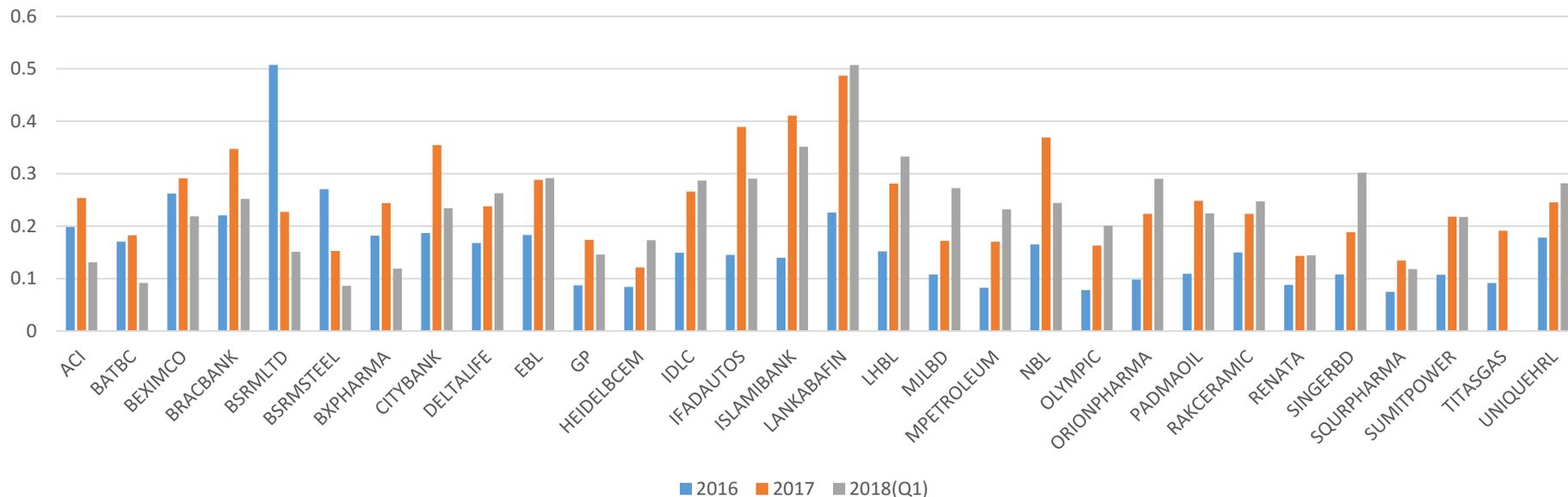


4. Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

Volatility in DSE Stock Prices during 2016-2018 Period

- ❑ The overall volatility (quarterly and annual) is also reflected at the company-level
- ❑ Among the top 30 companies, level of volatility varied across companies for different years
 - Majority of top 30 companies have experienced higher level of volatility in 2017
 - Few companies experienced similar trends in January-March, 18

Volatility Index: DSE30 Companies

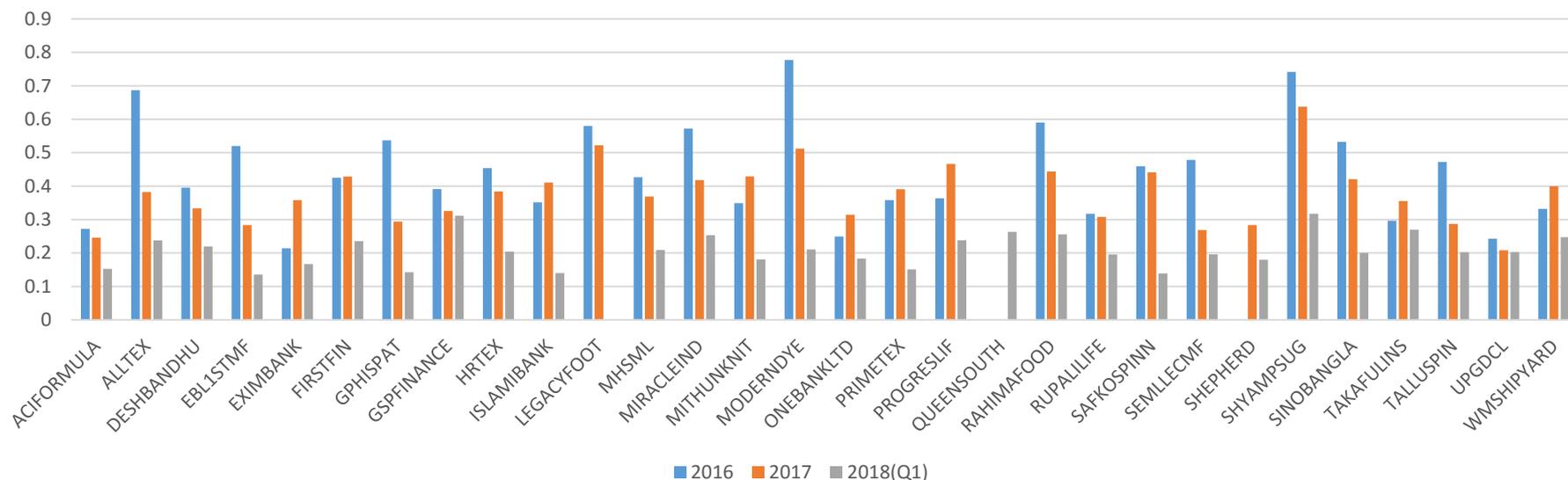


4. Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

Volatility in DSE Stock Prices during 2016-2018 Period

- ❑ The level of volatility in low-traded 30 companies in DSE is higher than that of DSE 30
- ❑ Unlike the DSE 30, the level of volatility of these low-traded companies was higher in 2016 compared to that in 2017 or 2018

Volatility Index: Low Traded 30 companies (Annual)



4. Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

Institutional Investors: Role in Market Volatility

- ❑ CPD carried out an analysis of changes in shareholding by key shareholders to examine their contribution in market volatility
 - Changes in shareholding of a sample set of listed companies during 2016 to April, 2018 period
- ❑ During Jan-June 2017, the shareholding by major shareholders did not experience significant changes
- ❑ Shareholding situation had undergone significant changes during July-Dec, 2017 This could have caused market volatility
 - Shareholding has increased in case of 26 companies and had decreased in case of 25 companies
 - From as low as less than 1% to as high as over 100%
- ❑ These companies include manufacturing, financial, power and energy and services

Changes in shareholding of securities by different shareholders (no. of companies)

	% changes between Jan 17 and Jun 17			% changes between Jun 17 and Dec 17			% changes between Dec 17 and Mar 18			% changes between Mar 18 and Apr 18		
	Sponsor	Inst.	Public									
No. of companies	99	99	99	99	99	99	99	99	99	99	99	99
Shareholding Increased	0	0	0	7	7	12	8	4	13	6	8	11
Shareholding Decreased	0	0	1	7	4	14	9	12	15	8	2	13

4. Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

Institutional Investors: Role in Market Volatility

- ❑ Overall, trading behaviour of sponsor shareholders and institutional investors during the period of market volatility is partly responsible for the market behaviour
- ❑ More importantly, it appears that institutional investors did not perform their expected role in stabilising the market

4. Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

Institutional Investors: Role in Market Volatility

- ❑ A positive correlation is observed in shareholdings by sponsor shareholders and institutions
 - Same in case of sponsor shareholders and public shareholding
- ❑ There is a negative correlation between institutional investors and public shareholding for most of the period.
- ❑ The level of negative correlation rose in tandem with rise in market index (June, 2017 and March, 2018)
 - The inverse relationship indicates that institutional investors despite having a role to support market stability rather adversely influenced behaviour of public shareholders
- ❑ The relationship between institutional and public shareholdings was found to be positive when market was less volatile (in January, 2017)

Correlation between Shareholding by Different Shareholders

Different Shareholding Groups	January, 2017	June, 2017	December, 2017	March, 2018	April, 2018
Sponsors and Institutions	0.321	0.312	0.331	0.312	0.315
Sponsors and Public Shareholding	0.458	0.467	0.460	0.467	0.460
Institutions and Public Shareholding	0.213	-0.141	-0.101	-0.141	-0.103

4. Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

Observations

- ❑ The analysis shows that market players, particularly institutional investors, did not play the expected role during the period of uncertainty in 2017 onward
- ❑ Given the importance of institutional investment in the capital market, the concept of “responsible ownership” is gaining momentum worldwide
 - It is not enough for institutional investors to simply ‘hold/sold’ shares
 - They must also perform a proactive role to ensure good governance practices by the companies
- ❑ Active engagement of institutional investors is a critically important factor to strengthen overall market discipline

4. Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

Observations

- ❑ OECD has developed guidelines for “Responsible Business Conduct for Institutional Investors” putting focus on investors’ due diligence in line with the OECD Guidelines
- ❑ In South Africa, the guidelines for institutional investors state that managing institutions should provide information on institutional clients
- ❑ In Malaysia, the Institutional Investment Code provides guidance on effective exercise of stewardship of responsibilities towards delivery of sustainable long-term value to the institutional investors’ ultimate beneficiaries or clients
- ❑ This type of code of conduct will discourage unpredictable trading practices and provide sound knowledge about good and bad investors in the market

4. Recent Volatility in the Capital Market: To What Extent Institutional Investors Contribute to This?

Observations

- ❑ SEC should consider formulating a separate guideline for institutional investors in the capital market of Bangladesh
- ❑ The guideline will promote the causes of transparency, good governance and ensure safety of investors' investment
- ❑ The guidelines will help institutional investors to take appropriate measures about choice of shares for investment, allocation of investment, investment policy approved by the shareholders every year, regular information sharing about risks, and prohibition for investment that will ensure good governance and regulation.
- ❑ Following six measures could be adopted in this connection:
 - a) disclosure of policies regarding responsibilities;
 - b) monitoring the performance of investee companies and periodic reporting;
 - c) engagement with investee companies;
 - d) implementation of policy on managing conflicts of interest; and
 - e) integrating corporate governance in investment decision-making

Section V: External Sector Balances: Reasons for Concern

5. External Sector Balances: Reasons for Concern

External balances: Score sheet

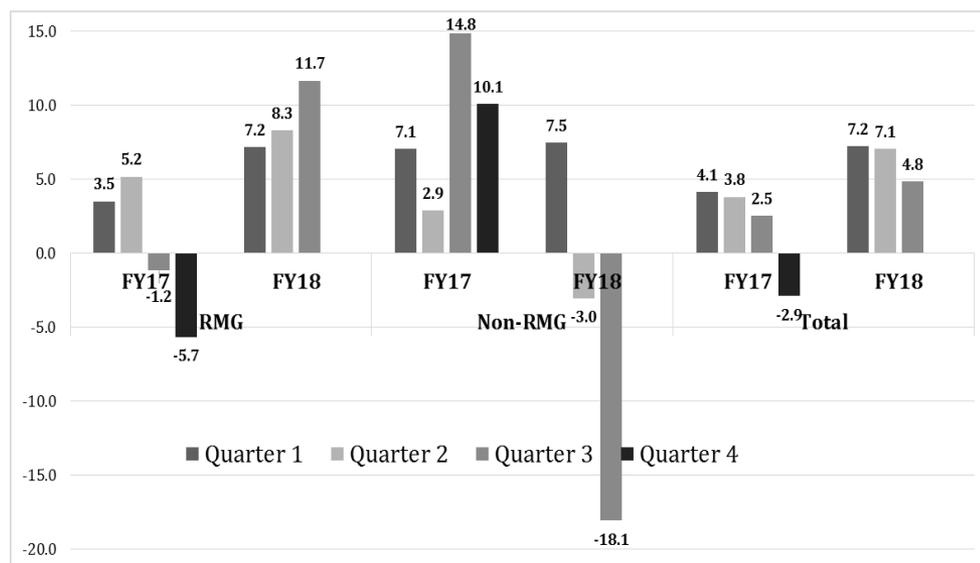
- ❑ Bangladesh's overall **balance of payments**, for the first time since FY11, continued to remain in the negative terrain (USD 1.4 bln) throughout the Q3, FY18
 - Emerging global economic scenario is also not reassuring
 - The rising fuel prices do not augur well
 - US dollar gained against many of the other currencies
- ❑ **Trade balance** to come under considerable pressure – new record high of USD 13.2 bln (Jul-Mar FY18)
 - Almost twice the level of deficit in the corresponding period of FY17
- ❑ Pressure points
 - Rising **imports** (24.5% growth during Jul-Mar FY18;) – particularly rice import and imports related to large scale infrastructure projects
- ❑ Cushions
 - **Exports** (6.4% growth during Jul-Apr FY18) and **remittances** (17.7% growth during Jul-Apr FY18) growth not catching up
 - Record high **foreign aid** disbursement (USD 3.5 bln during Jul-Feb FY18)
- ❑ Resulted in
 - **Depreciation of the BDT** (5% against USD in January)
 - Repletion of **forex reserve** (USD 2.1 bln opted for selling till 30 May 2018)

5. External Sector Balances: Reasons for Concern

Export earnings

- ❑ Export earnings showed resilience (6.4% growth during Jul-Apr FY18; 1.7% in FY17)
 - Strategic annual target for FY18: 8.2% - (last two months required growth: 16.7%)
- ❑ RMG growth 9.4% (Jul-Apr FY18) – increased gradually from Q1 to Q3 in FY18
 - Total export growth registered a reverse trend – due to non-performance from non-RMG products
 - Unlikely that non-RMG growth will recover (high benchmark growth in Q4, FY17)
- ❑ Further market concentration took place
 - both RMG and non-RMG products portrayed better growth in traditional markets compared to non-traditional destinations
 - 77.4% share in Jul-Apr FY18; which was 76.5 in FY15
- ❑ Product concentration has been rising at a fast pace
 - 83.2% of total export in Jul-Apr FY18, as against the share of 81.7% in FY15
- ❑ Non-RMG growth in the non-traditional market: (-) 14.1%

Quarter-to-quarter export growth (%)



5. External Sector Balances: Reasons for Concern

- ❑ EU export market remained a zone of comfort – 11.6% growth during Jul-Apr FY18
 - Knit product growth: 12.3%; Woven growth: 10.7%; Non-RMG growth: 10.6%
 - As Bangladesh is set to graduate from the LDC status in 2024 – will no longer be able to reap the benefits accruing from the DF-QF market access and the relaxed RoO
 - Need to enforce the 27 UN/ILO Conventions for GSP plus status
- ❑ Disquieting developments have been creeping up in the US market – 2.6% growth during Jul-Apr FY18
 - Knit garment growth: 7.8%; Woven growth: 1.5%; Non-RMG growth: (-) 1.0%
 - US market has been experiencing a decelerating growth trend in apparels recent years
 - Highest import duty (14.2%) imposed on apparels and clothing accessories sector in 2017
 - Bangladesh exports faced highest tariff of 15.2% amongst 232 countries/ territories
 - On average, all imports in US faces 1.4% tariff
- ❑ Slide in Bangladesh's apparels price posed a concern
 - Growth of RMG export to major markets was primarily volume-driven
 - Prices of exports have been declining over time – also lower compared to other competitors
- ❑ Raising product diversification and productivity are the only way to remain competitive - A country strategy needs to be crafted

5. External Sector Balances: Reasons for Concern

Import payments

- ❑ Domestic demand prompted increased import payments
 - Phenomenal import growth was observed of 24.5% (Q1-Q3 FY18) – USD 43.6 bln equalled annual import payment for FY17
- ❑ Riding on import of rice – USD 1.6 bln additional payment has been done during Q1-Q3 of FY18
 - Such high import amount may not be required in FY19 - thanks to bumper production of boro rice
 - As of 22 May 2018, about 38.7 lakh MT of rice has been imported, more rice imports are in the pipeline
 - The government should consider reimposing the import duty on rice; whether there is any capital flight by the unscrupulous traders should warrant close scrutiny
- ❑ Import payments for infrastructure-related projects, was underwritten by foreign aid and suppliers' credit – will ease the pressure on the reserves
- ❑ Spending on account of mega-projects will drive imports
 - Some of the other import payments may put pressure on reserves
- ❑ Energy demand will be high in FY2019
 - high import of LNG will raise import payments in the upcoming years
- ❑ Repayment of foreign loans and 'uncovered' import will put further pressure on reserves

5. External Sector Balances: Reasons for Concern

- ❑ Global commodity prices are showing upward trends - petroleum prices have started to rise due to US-Iran tensions, OPEC policy, demand-supply dynamics in the global market and a host of other reasons
 - Increased global commodity prices will likely to put additional pressure on import payments in the coming months
 - Bangladesh's terms of trade deteriorated further in March 2018 compared to March 2017

Changes in terms of trade (in view of RMG price in EU): March 2018 vs March 2017

Reference price	Price ratio: Knit (61)	Price ratio: Woven (62)
Crude oil	1.38	1.41
Rice	1.25	1.28
Fertiliser (index)	1.08	1.10
Cotton (index)	1.15	1.17

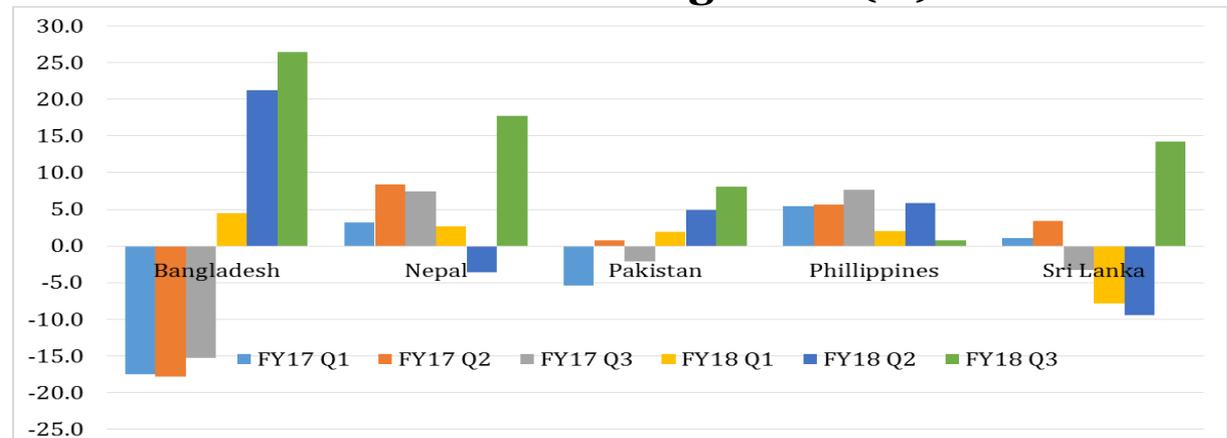
- ❑ L/C payments and openings also are indicative of the pressure on foreign exchanges
 - LC opening stood at USD 56 bln as of March FY18; which was USD 35.7 bln during the matched months of FY17
 - About USD 13 billion worth LC remained open under 'Others' category – there is a need to closely examine and monitor which are these items
 - All this indicate a rising pressure on foreign exchange and reserves

5. External Sector Balances: Reasons for Concern

Migration and Remittances

- ❑ Following back-to back negative growths in FY16 and FY17, remittance inflow was impressive during Jul-Apr FY18: 17.7% growth
 - GCC countries accounted for 56.7% - led by Saudia Arabia (17.3% share) and UAE (15.9% share)
- ❑ The recovery has been achieved:
 - exogenous factors: healthy economic performance in developed countries, rise in oil prices
 - endogenous factors: interventions by the Bangladesh Bank with stringent regulations on mobile banking and allowing devaluation of local currency
- ❑ Indeed, all key sending countries have posted positive growth in remittances in January-March quarter of FY18

Quarter-over-quarter cross-country comparison of remittances growth (%)



- ❑ Did help to narrow down the current account deficit
- ❑ FY18 will still likely to be below the peak level of USD 15.3 bln reached in FY15

5. External Sector Balances: Reasons for Concern

- ❑ In the July-April FY18 period, 7.6 lakh people left Bangladesh for overseas job market; 7.5 lakh was the corresponding number for FY17
 - Between 2013 and 2017, about 23.2 lakh people have joined the migrant labour force
 - 3.43 lakh female workers went, mostly to middle-east countries, during the same period
- ❑ Recently, Saudi government stopped recruitment of foreign workers in 12 categories of jobs - majority of the low-skilled Bangladeshi migrant workers fall into these categories
 - Out-migration to Saudi Arabia has drastically fallen, by 50%, during January-April 2018
 - Indeed, the number of outgoing migrants decreased in all GCC countries in first four months of 2018
 - Total out-migration growth was recorded at about (-) 25.8% during Jan-Apr 2018
 - Current deceleration will likely have a negative impact on remittance flows

5. External Sector Balances: Reasons for Concern

Balance of Payments

- ❑ Trade balance stood at a new high of USD (-) 13.2 bln during Q1-Q3 FY18 – in the face of high import payment
- ❑ The current account balance was USD (-) 7.1 bln – supported by high remittance growth
- ❑ BoP deficit stood at USD 1.4 bln – lowest since FY11
 - Overall balance position was supported by financial and capital account surplus
 - Net MLT loans and net FDI respectively accounted for 61.5% and 22.7% of the financial account
- ❑ Throughout the first three quarters of FY18 foreign exchange reserves hovered around USD 33 bln – currently covering 5.2 months of imports

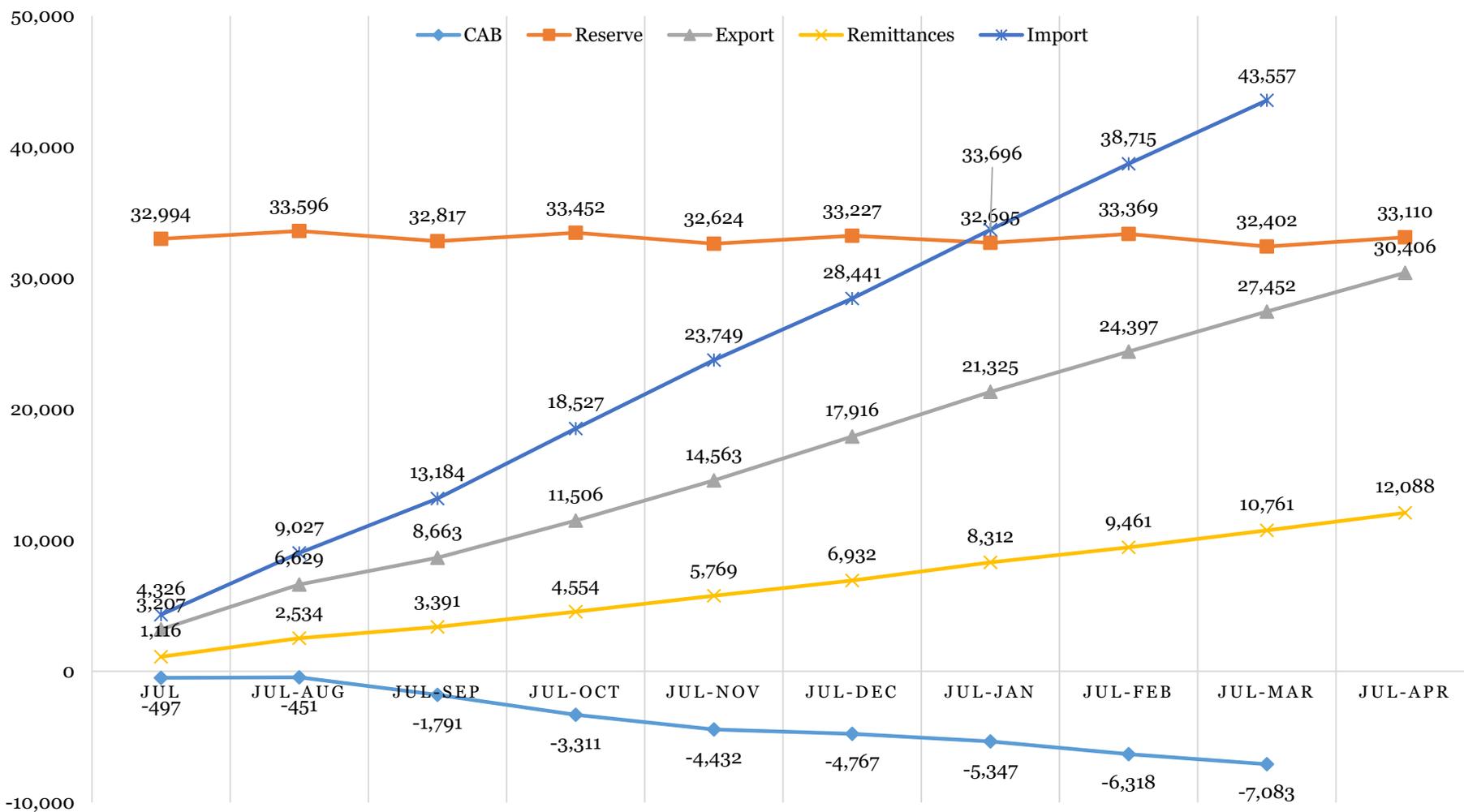
Trends in Bangladesh's balance of payments

Accounts	FY11	FY15	FY16	FY17	FY18
	<i>July -March</i>				
Trade balance	-5,570	-4,673	-4,792	-7,039	-13,202
Export f.o.b.(including EPZ)	16266	22,558	24,353	25,330	27,098
Import f.o.b (including EPZ)	21836	27,231	29,145	32,369	40,300
Current Account Balance	689	2,434	3,355	-1,372	-7,083
Capital account	342	344	364	252	229
Financial account	-1,298	808	761	3,139	6,055
Foreign direct investment (net)	574	1,342	1,097	1,417	1,376
Portfolio investment (net)	-43	360	67	312	320
Errors and omissions	-262	-699	-947	579	-609
Overall Balance	-529	2,887	3,533	2,598	-1,408

- ❑ Indeed, the emerging near-term external sector scenario should be a matter of concern for the policymakers

5. External Sector Balances: Reasons for Concern

Monthly figures for CAB, export, import and remittances and outstanding figure for reserves in FY18



5. External Sector Balances: Reasons for Concern

Observations

- ❑ The emerging near-term external sector scenario should be a matter of concern for the policymakers
- ❑ The likelihood of pressure on reserves will be high in near-term future
- ❑ Policymakers will need to carefully monitor import payments, flow of foreign funds and their implications for exchange rate, future debt servicing and import obligations

Section VI: Concluding Remarks

Positive performance

- ❑ The GDP growth as estimated by BBS continues to be strong, setting new heights compared to other least developed countries
 - Indeed in recent years, high growth has contributed to higher per capita income and lower poverty rate (though the pace of poverty reduction is slowing down)
- ❑ Growth rates of both export earnings and remittance inflow have increased in FY18. If such growth rate continue, they may contribute to restrain the building pressure on BoP to some extent
- ❑ Though increasing, average annual inflation rate remains slightly below the target set by the MPS for the second half of FY18

Concerns

- ❑ Accelerated GDP growth has not been translated into desired employment outcome. Indeed, employment elasticity of growth has declined significantly. Moreover, employment has not led to adequate income for decent living. Thus, benefits of high growth have not reached all citizens of the country equally
- ❑ The fiscal framework continues to be weak with mismatch between target and actual accomplishments
 - Revenue mobilisation for FY18 has lagged behind the target of 7FYP, primarily due to shortfall in income tax, VAT and SD collection. At the current trend of revenue mobilisation, achievement of 7FYP target for revenue mobilisation by FY20 is highly unlikely
 - ADP implementation also could not make any breakthrough in FY18. Delays, cost overrun and institutional weakness are causing low ADP implementation

Concerns

- ❑ The external sector has come under pressure in the face of high import payments, which had resulted in a large current account deficit
 - Higher growth rates of export and remittances could not account for import growth, resulting in negative BoP
- ❑ Inflationary pressure has been building gradually in recent months, mainly due to high food inflation
 - Inflationary pressure may continue in the coming months. This may lead to income erosion of the poor
- ❑ The banking sector and capital market have not shown any prospect of positive changes in the near future
 - While the banking sector is plagued with a large amount of NPL and poor compliance, the capital market has been volatile with very few new investments
- ❑ In the above context, policymakers ought to focus on two broad areas in the coming years:
 - i. Consolidation of macroeconomic stability
 - ii. Reducing inequality (consumption, income and asset) and creating decent jobs.

In the aforementioned context, CPD reiterates on following a restrained macroeconomic management. More specifically, CPD puts forward a few policy recommendations which deserve immediate attention of the policymakers

- ❑ A comprehensive, detailed and realistic revenue collection plan should be designed to fulfil high revenue generation target
 - Such a plan should include broadening tax base, curtailment of tax evasion and tax avoidance, and checking illicit financial flows from the country.
- ❑ A demonstrated mechanism for implementation of fast track project should be devised
 - Examination of the issue of over capitalisation of projects, particularly the big ones, is also necessary to save resources
 - Allocations for the social sectors should not be compromised while emphasising on physical infrastructure
- ❑ Supporting labour-intensive, domestic market-oriented and local resource-based manufacturing and agro-based industry should be given priority by the policymakers for more decent job creation
 - Given the weakness in the external sector, this policy emphasis becomes more pertinent

- ❑ Given the rising inequality in the rural areas and high food inflation, CPD reiterates the need for forming an Agriculture Costs and Prices Commission (ACPC) which will provide guidelines to ensure food security, recommend incentive structure for the produces and provide guidelines for price signals
- ❑ Bangladesh Bank needs to remain vigilant as regards growing pressure on BoP which may result in further dents in foreign exchange reserve along with some depreciation of BDT
 - Maintain stability in the foreign exchange market to avoid any speculation and short-term volatility
- ❑ Announcement of the much-awaited Banking Commission by the Finance Minister is a welcome move
 - This commission should conduct a transparency exercise of the state of the banking sector, the reasons behind weaknesses of the sector and make recommendations to overcome the crisis of the banking sector

- ❑ SEC should formulate a separate guideline for institutional investors in the capital market of Bangladesh
 - A guideline will promote the causes of transparency and ensure safety of investors' investment by taking appropriate measures about choice of shares for investment, allocation of investment, investment policy that is approved by the shareholders every year, regular information sharing about risks, and prohibition for investment that will ensure good governance and regulation
- ❑ Given that there will be less appetite for undertaking any reform measure during the election year, the government should not lose sight of the unfinished reform agenda for various sectors
 - Some of these include setting up of Public Expenditure Review Commission, Local Government (Finance) Commission, Agriculture Costs and Prices Commission, Independent Financial Sector Reform Commission and Independent Statistical Commission

Thank You